MARSH

Tax Insurance

Helping You to Actively Manage Your Tax Risks and Unlock Cash

MARSH & McLENNAN COMPANIES

Tax insurance enables certain specific, identified tax risks to be transferred to the insurance market. This lets you:

Actively manage your tax risks through protecting against financial losses suffered if you cannot defend your tax position from a challenge by tax authorities. By utilizing tax insurance, tax costs can be factored into your financial models accurately with limited assumptions.

Unlock cash by replacing the need to hold cash in escrow. This can be used in situations where a fund has reached the end of its fund life, and a tax policy will allow the fund to distribute all cash to investors during liquidation (as liquidators may request cash to be placed in escrow while pending tax positions to be agreed). This will also increase returns for investors – even if the potential liabilities materialize.

There has been a recent increase in the uptake of tax insurance in Asia, which is also reflected by the steadily growing interest from Asian tax risks underwriters. There are currently six insurers underwriting Asian tax risks, of which, one of them is based in Singapore.

Enjoying Certainty and Mitigating Risk

Across Asia, tax laws are getting more complex and open to interpretation. Hence, there is increasing uncertainty as to whether a particular tax position may be challenged by the tax authorities. While taxpayers may prefer to adopt certain positions and interpretations to their advantage (especially when the tax laws are not clear), the additional tax exposure (including penalties and interest) may be significant.

To manage this, tax insurance can be used to transfer relevant risks to insurers and obviate the need for any remedial actions, providing valuable certainty to the taxpayer.

Tax insurance can cover specific tax positions a taxpayer has taken historically, as part of the company’s ongoing operations, or to cover tax risks associated with a group restructuring.

Tax insurance can also be employed to transfer tax risk arising from or identified in the course of Merger and Acquisitions (M&A) transactions. Such policies are used by sellers to back an indemnity or taken up by buyers when their sellers are unwilling to stand behind the potential liability on specific tax issues. This is an alternative to requiring an escrow mechanism or purchase price adjustments. In addition, tax insurance may avoid the need to obtain any advance ruling from the tax authorities, which may not be feasible due to time constraints in M&A transactions.

Technical Specifics

What does it cover?

The policy provides coverage to the insured against losses arising from the insured tax risks, which includes:

- The amount of the tax authority's assessment or determination, inclusive of interest and penalties.
- Defense costs incurred by the insured in defending a challenge.
- A tax gross-up on the proceeds of the insurance.

Who are the main underwriters?

Tax insurance is underwritten from the UK and Singapore by recognized and highly rated insurers.

What are the main exclusions?

The common general exclusions fall broadly into the following categories:

- Change in law.
- Fraud.
- Material inaccuracy or omissions, misleading statements or misrepresentation in the insured's representations of documents.
- Loss which arises following the insured's non-compliance with the policy's claims provisions or other obligations of the insured.

Is there any required excess or deductible?

Generally, there will not be any excess or deductible in relation to the financial losses suffered.

However, there will be a retention amount to cover defense costs for which the insured will be liable. Depending on the policy, the retention amount usually ranges from US$50,000 to US$100,000.

What is the period of cover?

Generally between five and seven years, depending on the statute of limitations of the relevant jurisdiction's tax laws.

What is the premium?

The premium is a one-off lump sum payment which is payable at the inception of the policy.

While the premium for a policy depends on the specifics of the particular tax risk and the countries involved, in our experience, for markets where tax insurance policies are fairly matured (i.e. Japan, Korea, Hong Kong, India, and Singapore), the premium is generally 3% to 6% of the limit of liability purchased.

For markets where the tax insurance policy is still fairly new (e.g. Indonesia and China), the rates will be determined on a case-by-case basis depending on the specific risks to be insured.

Examples of risks that can be insured

1. CHARACTERIZATION OF TRADING GAINS VERSUS CAPITAL GAINS.
2. AVAILABILITY OF TAX LOSSES AND CAPITAL ALLOWANCES CARRIED FORWARD.
3. AVAILABILITY OF TREATY BENEFITS.
4. INTERPRETATION OF INDIRECT DISPOSAL RULES (e.g. Public Notice 7 in China).
5. GENERAL ANTI-AVOIDANCE RULES.
6. TRANSFER PRICING ON CERTAIN RELATED PARTIES' TRANSACTIONS.
7. STAMP DUTY.
8. DEBT VERSUS EQUITY CHARACTERIZATION.
9. APPLICABILITY OF TRANSFER TAXES (e.g. deemed acquisition tax in Korea).
10. PERMANENT ESTABLISHMENT RISKS.
11. VAT / GST RISKS.
12. WITHHOLDING TAXES.
13. EMPLOYMENT TAXES.

What costs are payable apart from premium?

At the stage of obtaining pricing indications, no costs are charged by Marsh or the insurers.

The insurers will charge underwriting fees of about US$30,000 to US$50,000 (in addition to the premium), which include costs to be incurred by the insurer to seek external tax advisors' advice on the specific tax risks. Depending on the insurer, such underwriting fees may be waived upon purchase of the policy.

The commitment to pay underwriting fees only arises when underwriting commences. If for any reason the underwriting is completed but the policy is not incepted, the insurer's underwriting fees will become payable. If the underwriting has commenced but is aborted midway, the costs incurred as at that date will also be payable, depending on how far the underwriting process has advanced.

What are the fees payable to Marsh?

The premium will already include Marsh's commission and no separate fees will be payable to Marsh.

If, however, we have worked on the policy on your behalf but the policy is not ultimately purchased through Marsh or the policy is otherwise not placed, we will charge a break fee.

Will it cover advance tax payments?

In some jurisdictions (e.g. Japan, Singapore), tax payments have to be made in advance (and cannot be deferred or postponed) to the relevant tax authorities pursuant to the relevant statutory provisions under the law or before an appeal can be pursued in the tax courts. In such scenarios, the policy may also be able to cover such advanced tax payments and make the payment on behalf of the insured at the onset.

In an M&A transaction, if the insured is the target, can the insurance be transferred to the new buyer?

Yes, in an M&A transaction, the insurance may be transferred to the new buyer to cover the tax risk of the target. Hence, obtaining tax insurance to cover certain contentious positions taken may improve the pricing for the sellers as the buyer will not seek any purchase price reductions or any indemnity on the uncertain tax positions taken.

What information is required to obtain a quote / non-binding indication?

To enable Marsh to approach insurers and provide a sense of price and coverage, we would need:

- An overview of the tax risk and context in which it arose.
- A copy of the tax opinion or memo with analysis on the tax issue. The insurer will require your tax advisor to provide a "should" level opinion that suggests a reasonably high level of confidence that the position adopted can be sustained.
- A calculation of the likely tax liability and associated costs (e.g. defense costs, applicable interest and late payment penalties).
- A brief summary of the underlying transaction (if this matter has come out of an M&A scenario).

Our tax insurance team will be able to guide you on the information and documents required.

What is the process and timeline of placing a tax insurance policy?

The placement of a tax insurance policy can be completed in as soon as three to four weeks after Marsh receives complete information and documentation to approach insurers. Some policies may require more time, depending on the complexity of the risk to be insured and the availability of relevant information. An underwriting process will be undertaken by the selected insurer, through which Marsh will advise and guide you.

Process of placing a tax insurance policy

PHASE 1

QUOTATION PHASE

(Week 1)

- Marsh will engage in discussions with you / your advisors to understand the specific tax risks to be insured.
- If required, Marsh will reach out to the insurers to obtain initial feedback.
- Marsh will guide you on the information and documents required by the insurers. Generally, at this stage, the main document required is the “should” level opinion issued by your tax advisor.
- Marsh will prepare a market submission and reach out to insurers for non-binding indications.
- Marsh will provide a detailed non-binding indication report, setting out the primary insurance options, including analysis of price, terms, coverage and execution risk, as well as a recommendation as to how to proceed.

PHASE 2

UNDERWRITING PHASE

(Week 2/3)

- Marsh and the insured will engage the selected insurer to conduct their confirmatory due diligence.
- The insurer will engage their external tax advisors to seek advice on the specific tax risks.
- Some of the information and documents required by the insurer to underwrite the insurance will include:
  - Quantum of financial losses should there be an adverse decision against the position taken.
  - All relevant documents relating to the transactions.
  - Documents to substantiate the tax position taken (e.g. board resolutions, minutes of meetings, etc.).
- The insurer will require about a week to review the documents provided. Thereafter, the insurer will hold an underwriting call with you (together with Marsh) to clarify any material issues arising from their review.
- Following the above, the insurer will provide a draft policy. Marsh will negotiate the terms on your behalf.

PHASE 3

POLICY NEGOTIATION AND INCEPTION

(Week 3/4)

- Once the policy is fully negotiated, coverage will be put in place at a time of the parties’ choosing.
- A representative letter will be required to be signed by a representative of the insured to incept the policy.

Case Studies

CASE STUDY 1

Sale of a Singapore Holding Company ("SG HoldCo") which indirectly hold investments in a foreign trust through a Singapore SPV ("SG SPV").

NATURE OF TAX LIABILITY INSURED

Tax exposure on the fair value gains or gains from the disposal of the investments in the foreign trust by SG SPV if the investments were regarded as being held on revenue account by the tax authorities.

BACKGROUND

SG HoldCo was an investment holding company that held investments in the foreign trust indirectly through SG SPV. SG SPV had taken the position that the investments were held for long-term investment purposes and any fair value gains or gains from the disposal of the investments should be regarded as capital in nature and hence not subject to tax (as Singapore does not have a capital gains tax regime).

SG HoldCo's shareholder wished to exit the investments through the disposal of shares in SG HoldCo.

CHALLENGE

The buyer wished to seek a purchase price reduction or indemnity from the seller on the position taken by SG SPV.

SOLUTION

The seller decided to take a tax insurance policy and Marsh placed a tax policy (more than US$3 million limit) to cover the potential tax exposure for SG SPV so the buyer would not seek any purchase price reduction or indemnity.

In addition, given that the seller was a private fund that had reached the end of its fund life, having the policy also allowed the seller to have a "clean exit" by allowing them to distribute all the proceeds from the divestment to its investors during liquidation.

CASE STUDY 2

Acquisition of shares in a Singapore SPV ("SG SPV") which indirectly holds interest in Korean real estate.

NATURE OF TAX LIABILITY INSURED

Tax exposure on potential Korean acquisition tax.

BACKGROUND

SG SPV was an investment holding company that indirectly held interest in Korean real estate through a Korean entity. SG SPV was held by a few unrelated shareholders. One of the shareholders wished to exit the investments by transferring shares in SG SPV to another shareholder.

Under Korean tax law, where a taxpayer becomes a controlling shareholder which owns more than 50% of shares or ownership interest in a target company through the acquisition of shares, the controlling shareholder shall be deemed to have acquired the target company's assets (i.e. the Korean real estate) that are subject to an acquisition tax. Hence, there was a risk that the Korean acquisition tax may apply to the transfer of shares in SG SPV.

CHALLENGE

Given that the potential tax exposure was significant, any tax liability arising from the sale of SG SPV would make the deal unattractive. Hence, the shareholders required certainty that the transfer of shares in SG SPV would not be subject to acquisition tax in Korea.

SOLUTION

To obtain certainty on the tax exposure arising from the acquisition, Marsh assisted the shareholders to place a tax policy (more than USD 15 million limit) such that the transaction would be able to proceed with certainty on the tax outcome.

CASE STUDY 3

Sale of shares in a Singapore property holding entity ("SG PropCo") which owned a commercial property in Singapore.

NATURE OF TAX LIABILITY INSURED

Tax exposure on the potential disallowance of interest expenses and related costs incurred on refinancing.

BACKGROUND

The shareholder was contemplating a sale of SG PropCo, the owner of a commercial property in Singapore. SG PropCo had rented out the property and had claimed tax deductions on interest expenses and related costs incurred on loans taken up to refinance existing loans against its rental income.

The tax authorities may have sought to deny tax deductions on the above if the expenses incurred on the loans were not effected for genuine commercial reasons or if the expenses were incurred in respect of non-income-producing assets or activities.

CHALLENGE

Given that the above tax risks were flagged out in the tax due diligence findings and the potential tax exposure was significant, the buyer wished to seek a purchase price reduction or indemnity from the seller on the position taken.

SOLUTION

The seller decided to take a tax insurance policy and Marsh placed a policy (more than US$50 million limit) to cover the potential tax exposure for SG PropCo so that the buyer would not seek any purchase price reduction or indemnity.

For more information on tax insurance policy, please contact our Marsh Private Equity and M&A Practice representatives.

CHEOW AI LING
Asia Practice Leader, Private Equity and M&A Services
+65 6922 8019
ailing.cheow@marsh.com

EUGENE LIM
Head of Tax – Asia, Private Equity and M&A Services
+65 8725 5825
eugene.lim@marsh.com

PH20-1070