Marsh

Tax Insurance

Helping You to Actively Manage Your Tax Risks and Unlock Cash

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. Tax insurance is 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.

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 risk underwriters. There are currently six to seven insurers underwriting Asian tax risks, of which, two of them are based in Singapore.

Technical Specifics

What does it cover?

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

- Tax liability 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, Singapore and Australia 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$20,000 to US$30,000.

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 is fairly mature (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 tax insurance 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.

What costs are payable apart from premium?

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

The insurers will charge underwriting fees of about US$15,000 to US$30,000 (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.

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 of that date will 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 will 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.

EXAMPLES OF RISKS THAT CAN BE INSURED

1. Interpretation of indirect disposal rules (e.g. in Indonesia, India, Vietnam).
2. Availability of treaty benefits.
3. Characterization of trading gains versus capital gains.
4. Tax risks associated with a TK-GK holding structure in Japan.
5. General anti-avoidance rules.
6. Transfer pricing on certain related parties' transactions.
7. Availability of tax losses and capital allowances carried forward.
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.

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. If required, 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 representation letter will be required to be signed by a representative of the insured to incept the policy. The representation letter will include factual statements that are relevant to the insured tax risk.

Case Studies

Nature of Tax Liability Insured	Background	Challenge	Solution
1. Sale of Hong Kong Holding Company ("HK HoldCo") which holds an Indonesian manufacturer ("Target")			
Capital gains tax on the disposal of HK HoldCo if the Indonesian Indirect Disposal Rule is triggered.	The Seller holds Target indirectly through HK HoldCo. The Buyer has taken the position that the Indonesian tax authorities could scrutinize the transaction and impose capital gains tax on the gains derived by the Seller.	The Buyer insisted that the Seller provide a tax indemnity to cover the potential tax risk on the capital gains tax as the tax authorities would go after the Target after the closing of the transaction if the Indonesian Indirect Disposal Rule is triggered. If the indemnity is provided, the Seller will need to hold back a certain amount of the sales proceeds, which will affect the returns for investors.	Marsh assisted the Seller to place a tax policy (more than USD 100m limit) to cover the potential tax exposure (including interest and penalties). Having the tax policy allows the Seller to have a "clean exit" as it will be able to distribute all of the proceeds from the sale to its investors, therefore increasing returns for them.
2. Sale of shares in a Korean Company ("Target") by a Singapore Fund (the "Seller")			
Capital gains tax on the disposal of Target if treaty benefits are denied by the tax authorities.	The Seller was contemplating the sale of shares in the Target and was planning to reduce the Korean capital gains tax by assisting some of the investors to apply for tax exemption under the relevant tax treaties. As a result, the Buyer will withhold capital gains tax using a blended tax rate calculated by the Seller considering that some of the investors will qualify for tax exemption under the relevant tax treaties.	The Buyer has requested the Seller to provide a tax indemnity to cover the potential tax risk in the event that the blended tax rate used to determine the capital gains tax is denied by the Korean tax authorities in a future tax audit. If the indemnity is provided, the Seller will need to hold back a certain amount of sales proceeds, which will affect the returns for investors.	Marsh explored a tax policy with the Seller to replace the indemnity requested by the Buyer.

Nature of Tax Liability Insured	Background	Challenge	Solution
3. Sale of preference shares in a Singaporean Company (the "Target") by a Singaporean Holding Company (the "Seller")			
Tax exposure on the gains derived from the sale if gains are regarded as trading in nature.	The Seller was contemplating the sale of preference shares in the Target. Under Singapore tax law, gains derived from the sale of preference shares will not be subject to tax if the gains are regarded as capital in nature. However, there is no clear guidance on whether a particular income should be regarded as capital or trading in nature. From the Seller's perspective, it has taken the position that the gains from the disposal should be regarded as capital (and hence not subject to tax). However, the Seller understands that there is a risk that the Inland Revenue Authority of Singapore may disagree and subject the gains to tax on the basis that the gains should be trading gains.	Any potential tax liability arising from the sale of the Target would substantially reduce the returns to investors. In addition, the Seller requires certainty that all proceeds from the sale of the Target can be distributed to the investors.	Marsh assisted the Seller to place a tax policy such that the Seller was able to obtain certainty on the tax outcome and distribute all sales proceeds to investors.
4: Transfer of a property between related companies as a result of a corporate group restructuring.			
Tax exposure on the transfer of a property between related parties.	Our client, a corporate real estate group (the "Group") was undergoing a group restructuring in North Asia. As part of the restructuring exercise, the Group is required to transfer one of their properties from one entity to another related entity. Under the relevant tax law, there is a risk that the transfer of the property may result in significant tax liability for the Group unless certain conditions are met.	Given that the potential tax exposure is significant, the Group will require certainty that the transfer will not result in any tax liability. Otherwise, the client will not proceed with the group restructuring and will need to think of alternative plans. The Group attempted to seek confirmation from the tax authority that the restructuring steps should not be subject to tax through an advanced ruling application. However, the tax authority was not willing to provide any confirmation on the tax position and rejected the advanced ruling application.	Marsh assisted the client to place a tax liability insurance such that the client will be able to proceed with the group restructuring with certainty on the tax outcome. With the tax liability insurance in place, the client does not need to be concerned about any tax liability that may crystalize in the future as a result of the group restructuring.

About Marsh

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

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

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

GRACE WU
Greater China Practice Leader
Private Equity and M&A Services
+86 10 6533 4204
grace.n.wu@marsh.com

MANDIRA GUPTA
India Practice Leader
Private Equity and M&A Services
+91 99208 44472
mandira.gupta@marsh.com

JOSEPH YOUNT
Client Executive, Japan
Private Equity and M&A Services
+81 90 6560 1624
joseph.yount@marsh.com

CHARLIE KIM
Assistant Vice President, Korea
Private Equity and M&A Services
+82 10 3231 9426
charlie.kim@marsh.com

SUPARINDAPORN WONGYARA
Thailand Practice Leader
Private Equity and M&A Services
+66 (0)91 770 4013
suparindaporn.wongyara@marsh.com