Marsh

Tax insurance

A comprehensive and cost-effective risk management solution

Transactional Risk Practice

The IRS and other authorities often challenge specific tax treatments taken by buyers and sellers in merger and acquisition (M&A) transactions. Since the tax implications of these transactions can be considerable, it can be difficult to allocate the resulting risks — and the parties may have differing opinions on the issue. Also, owing in part to the time constraints often involved in M&A transactions, advance tax position rulings and clearances may not be available or practical.

Tax insurance allows the parties in a merger or acquisition to transfer many of their risks to an insurance provider, allocating them away from the transaction itself and obviating the need for special indemnities or purchase price reductions. Marsh’s Transactional Risk Practice has extensive experience in helping clients manage all aspects of the transactional risk and insurance process. Our specialists can help you secure comprehensive and cost-effective insurance coverage for potential tax exposures.

WHY PURCHASE TAX INSURANCE?

Tax insurance, also known as tax indemnity insurance or tax opinion insurance, is most often used:

- To provide protection if a taxing authority challenges a historical tax position taken by a target entity that is either assumed by the buyer or retained by the seller via an indemnity.
- To ensure that a particular tax structure used in a transaction has its intended effect.
- To provide protection when there is no clear guidance on a specific tax issue, and a party is unwilling to accept the tax exposure.

In addition to its use in M&A transactions, tax insurance can be obtained on many tax positions a company has taken historically, or is planning to execute, in case they are reviewed by tax authorities as part of the company's ongoing operations.

A tax insurance policy generally covers the tax liability for seven years, along with any possible fines and penalties, interest, legal contest costs, and tax gross-up. All forms of direct and indirect taxation can be covered, including:

- Corporate income tax.
- Personal income tax.
- Capital gains tax.
- Estate and gift tax.
- Sales and use/value added tax.

HOW MARSH'S TEAM WORKS

The placement of a tax insurance policy can be completed in as little as one to two weeks. Some polices may require more time, depending on the complexity of the exposures to be insured and the availability of relevant information.

Placement of a tax insurance policy begins with a discussion between a member of Marsh's Transactional Risk team and you and your advisors, followed by an independent assessment by potential insurers. Marsh can then negotiate terms with an insurer on your behalf and ensure that the proposed coverage structure is appropriate for your risk.

Marsh can also help you prepare the information needed by an insurer to determine the insurability of your tax position. Generally, this includes:

- A detailed description of your tax position and, if applicable, the proposed transaction structure, including a list of attorneys, accountants, and other outside experts involved.
- A description of the type, value, and timing of tax issues involved for each party to the transaction, including a computation or schedule of the tax benefits/potential loss involved.
- A copy of the final or draft tax opinion or tax memo that sets out the tax issues to be addressed, if available.

PRICING, DURATION, AND AVAILABILITY

Although the premium for a policy depends on the specifics of the particular tax risk, the rate for insurable positions in our experience is typically between 2.5% and 4.5% of the limit of liability purchased. Premium cost can be affected by several factors, including:

- The jurisdiction(s) of the tax risk.
- The insurance limits purchased relative to the magnitude of the risk.
- The amount of risk retained by the insured.
- The degree to which the potential tax loss is "all or nothing."
- The strength of the tax opinion, if issued.
- The breadth of available legal precedent related to the specific tax issue.

Insurers generally offer at least seven years of coverage for tax insurance policies, although extensions may be possible. This means that the insured has seven years from binding coverage within which to make a claim under the policy. For any given insurable risk, there is generally more than $1 billion of available capacity, with the market particularly expected to grow as more insurers enter the sector.

EXAMPLES OF INSURED RISKS

Tax insurance policies have been used to provide coverage for a variety of risks, including:

- REIT status and related risks / FIRPTA.
- Successor liability.
- Tax credits (e.g. Sections 45, 45Q, and 48), including recapture risk, basis risk, and structural risk.
- Net operating losses/potential Section 382 change of control.
- S-corporations/338(h)(10)/336(e) basis step-up elections.
- Capital gains versus ordinary income characterizations.
- Tax-free reorganizations.
- Section 355 spinoffs.
- Cancellation of indebtedness.
- Employee benefits issues, including deferred compensation.
- Debt/equity characterization.
- Partnership structures.
- FASB Interpretation No. 48, including ASC 740-01 / FIN 48 in certain circumstances.

Case Studies

REIT Qualification

A private equity firm with $2 billion in commercial real estate assets in several real estate investment trusts entered into an agreement to sell the REITs rather than the underlying assets. The buyer required a significant escrow account in the event the IRS challenged the qualification of an entity as a tax-compliant REIT. The seller objected, leaving the parties at a standstill. The potential exposure was $100 million in back taxes, interest, and penalties.

Marsh structured and placed a tax insurance policy that protected the buyer against a breach of seller's representations on REIT qualification, and ensured that certain transactions would not be considered prohibited transactions. The final policy was for $160 million in insured limits and covered taxes, interest, penalties, and a gross-up (if the receipt of the claim payment were treated as taxable). The policy covered a seven-year period.

Solar Investment Tax Credit

An investment fund invested in a project company that operated solar farms. A bank acted as a tax equity investor and was allocated the majority of the investment tax credits (ITCs) associated with the transaction. The project company was required to indemnify the tax equity investor in the event that the ITCs were not allocated to the bank or were otherwise not available to be used by the bank. The fund and the project company sought a tax insurance policy to cover the projected ITCs and other tax benefits that would be received by the bank (i.e., not subject to a recapture event). The potential exposure was $64 million of back taxes, interest, and penalties.

Marsh structured and placed a tax insurance policy that named the bank as the insured in the event the indemnity was invoked because of a loss of the ITCs. The policy provided coverage so that if the investment vehicle was not respected as a "pass-through," the value of the ITCs would not be unavailable to the intended parties, the tax basis would be respected, and there would be no loss due to recapture. The final policy was for $105 million in insured limits and covered taxes, interest, penalties, and a gross-up. The policy covered a seven-year period.

S-Corp Election

A private equity fund acquired a private company that had elected to be treated as an S-corporation. During due diligence, the S election could not be located and there was concern that the S-Corp status may have been lost several years earlier. A leading law firm advised the seller that its S-Corp status should not be successfully challenged by the IRS. The potential exposure was $95 million of back taxes, interest, and penalties. The seller would not provide indemnity for this risk.

Marsh structured and placed a tax insurance policy that named the buying entity as the insured and protected the buyer in the event that the target company lost its historical S-Corp status and was taxed as a C-corporation, meaning it would owe back taxes, interest, and penalties. The policy also covered the step-up in basis under Section 338(h)(10) of the US Internal Revenue Code to ensure the assets could be amortized currently with the stepped up basis as no pre-acquisition restructuring under Rev. Rul. 2008-18 took place. The final policy was for $158 million in insured limits and covered taxes, interest, penalties, and a gross-up. The policy covered a seven-year period.

Why Marsh?

Marsh's North American Transactional Risk Practice placed nearly $38 billion in transactional insurance limits in 2021 for almost 1,000 deals. Marsh's tax insurance team has more than 30 years of experience in investment banking, real deal team execution, and structured solution experience. Comprised of specialists with backgrounds in taxation, corporate law, investment banking, and accounting policy, our team understands the critical risks you can face during and after a transaction. We offer high-level access to all leading transactional risk insurance markets, so we can deliver the most comprehensive and cost-effective solutions to meet your needs.

For more information about Marsh’s tax insurance solutions, visit marsh.com, or contact your local Marsh representative.

Craig Schioppo
Managing Director
+1 212 345 6492
craig.schioppo@marsh.com

Antony Joyce
Senior Vice President
Tax Insurance Specialist
+1 212 345 0780
antony.joyce@marsh.com

Mark McTigue
Managing Director
Tax Insurance Specialist
+1 212 345 5635
mark.mctigue@marsh.com

Alisha Soares
Senior Vice President
Tax Insurance Specialist
+1 212 345 3121
alisha.soares@marsh.com

Patrick J. Browne Jr.
Senior Vice President
Tax Insurance Specialist
+1 202 256 9096
patrick.browne@marsh.com

Marsh

About Marsh

Marsh is the world’s leading insurance broker and risk advisor. With around 45,000 colleagues operating in 130 countries, Marsh serves commercial and individual clients with data-driven risk solutions and advisory services. Marsh is a business of Marsh McLennan (NYSE: MMC), the world’s leading professional services firm in the areas of risk, strategy and people. With annual revenue nearly $20 billion, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses: Marsh, Guy Carpenter, Mercer and Oliver Wyman. For more information, visit marsh.com, follow us on LinkedIn and Twitter or subscribe to BRINK.

1166 Avenue of the Americas, New York 10036