Marsh

Marsh Specialty

What is real estate tax insurance?

Tax insurance policies in a real estate context are used to give protection against financial losses suffered in the event that the insured tax treatment is successfully challenged by the taxing authorities.

Tax insurance policies can be employed to transfer a tax risk relating to a particular merger and acquisition (M&A) transaction. For example, the policy can be taken out by the seller to back an indemnity or by the buyer if the seller is unwilling to stand behind the liability. This would often avoid the need for an escrow mechanism or price chip.

Tax insurance can also be obtained independently of transactions, and may be used to reduce or eliminate exposure associated with historic tax positions. It is also frequently used in the context of corporate restructurings or liquidations.

Examples of insurable tax risks

The types of tax treatments particular to real estate transactions that have been insured include:

- Transfer Taxes.
- Applicability of Stamp Duty Land Tax (SDLT).
- Trading vs. investment risks.
- Tax residency.
- De-grouping relief following restructurings.
- Substantial shareholder exemptions/participation exemptions.
- Protection of tax losses.
- Other matters which are regarded as low or low/medium risk.

Key inclusions and conditions

The policy will typically cover the following for a period of up to 10 years:

- The tax liability.
- Defence costs.
- Interest.
- Penalties.
- Gross-up where applicable.
- Advance tax payments.

The policy is designed to cover interpretation risks rather than factual risks.

It is therefore not the intention of the policy to insure structures that fail because the parties incorrectly implemented the steps necessary to achieve the desired treatment.

Exclusions can be risk specific but standard exclusions include (1) any material inaccuracy, omissions, misleading statements, or misrepresentation in the insured's representations of documents, (2) loss which arises following the insured's non-compliance with the policy's claims provisions or other obligations of the insured, (3) change in law(s), and (4) fraud.

Pricing

When determining cost and insurability, insurers will consider:

- The strength of the expert opinion/tax adviser's due diligence on the point.
- The likelihood that the treatment will be challenged and the chances of a successful defence thereafter.
- The quantum of the liability.
- How aggressive the tax position taken is.
- The motivation for looking at insurance.
- The jurisdiction of the tax risk.

Premium rates generally range from 1.5% to 5% plus premium taxes and fees.

The process

To enable Marsh Specialty M&A to approach insurers and provide a better sense of price and coverage, we would need:

A brief overview of the tax matter under discussion.

Third-party analysis.

A calculation of the likely tax liability and associated costs (defence costs, applicable interest, and late payment penalties, for example).

A brief summary of the underlying transaction (if this matter has come out of an M&A scenario).

Insurers typically take three to four days to provide their non-binding indications. Once an insurer is selected, the next stage is to proceed to legal review. Insurers will appoint their own legal counsel to give an independent overview of the documents you have supplied. The cost of this review will be determined by the complexity of the tax treatment, the jurisdiction, and the insurers' own previous experience of the specifics.

On average, the external fees range from £15,000 to £30,000. Upon completion of their review, insurers will offer their confirmed terms. The overall length of this process is dependent upon the specifics but will usually take two to three weeks.

Contacts

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About the team

The Marsh Specialty Transactional Risk team in London comprises of over 20 individuals which includes two dedicated tax practitioners, with complementary backgrounds in taxation law and the "big four", and with circa 25 years of experience between them.