Marsh

Marsh Specialty

Private Equity and M&A Practice

Tax liability insurance

A way to mitigate VAT risk

Regardless of whether you have identified a VAT risk in a due diligence report in connection with a contemplated divestment, purchase of an asset or are considering charging for goods or services, it is likely that you have given some thought to the cost of incorrect VAT handling. Including interest and penalties, the cost of such incorrect handling may be material, especially in cases where the asset to be transferred is of high-value and/or the transactions are recurring and therefore increasing the amount at risk over time. Although reputable advisors may take you a long way in mitigating the risk, there are usually some uncertainties remaining. One way to deal with such uncertainties may be to look into tax liability insurance.

This bulletin sets out the basic requirements for insuring a VAT risk and provides examples of risks that may be insurable. The purpose is to help you identify situations where tax liability insurance may be a way to help you or your client mitigate risks, making room to focus on the business or getting the deal through.

Basic requirements

If the monetary exposure of a VAT risk is at least EUR 1.5-2m, and supported by an analysis from a well-reputed advisor characterizing the risk as low or low to medium, tax liability insurance may be a solution. There are 10+ insurers focusing on tax risks alone providing the capacity and appetite needed to help you focus on your business. Tax liability insurance will cover the tax charges as well as interest and penalties (if relevant). Given the growing market for tax liability insurance, the premiums are currently between 1.5-6 percent of the covered limit for VAT risks depending on, inter alia, the size, jurisdiction, and complexity of the risk. Legal fees and insurance premium tax (if any) may be additional costs, but amounts are usually not material in relation to the premium.

Examples of insurable VAT risks

At Marsh, we have insured a multitude of VAT risks in several European jurisdictions, below are a couple of recent examples:

- Risk that certain services provided by a financial institution are considered VAT-able or not.
- Risk that a portion of combination tickets treated as VATable is challenged.
- Risk that an asset transfer (often real estate) is reclassified as a VATable transaction (or the other way around).
- Risk that penalties and interest is levied in case consultants are considered employees for tax purposes (which usually triggers a liability to pay social security contributions, a risk that would also be covered by a tax liability insurance).
- Risk that the VAT-deductible ratio set by the client in case of a business with both deductible and non-deductible VAT (i.e. a "mixed business") is incorrect according to the tax authorities.

Most VAT risks are insured in connection with a transaction, however clients are increasingly looking at insuring such risks on a stand-alone basis as well. This is especially true for the risk highlighted in the last bullet, which may require additional time and resources not always available in the midst of an ongoing M&A transaction. Of course it would also be possible to look at insuring a VAT risk after signing (or even closing), e.g. for the purpose of removing an indemnity tied to the risk but with the option of removing it in case a tax liability insurance can be obtained.

Concluding remarks

Whether you are in the process of acquiring a company where a tax risk related to VAT has been identified, or you are about to implement changes in your VAT setup, we are here to help you manage the risk. Tax liability insurance can usually be put in place within two weeks from the date when the relevant underlying information is received.

We are always happy to have a conversation about how we can help you find a tailored insurance solution, if you are interested please contact your Marsh Specialty representative.

Interested?

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