Tax & Contingent Risks

Q3 Market Update

Howden's market-leading Tax & Contingent Risks team share the latest market updates. Read on for Q3 key trends in the tax and litigation insurance sector across the UK and Europe, as well as innovative solutions for Pillar 2 and insurance-backed financing.

If you would like more information on a section, do not hesitate to get in touch with our experts below.

Tax Risks

Large Risks

The Tax & Contingent Risk insurance market continues to expand its appetite for large risks, with a notable increase in enquiries from corporate clients as they become familiar with the solutions available. Common situations where insurance has been considered include cross border reorganisations, the structuring of tax efficient disposals, employment incentive schemes, and cash repatriation issues. To provide the best chance of securing sufficient cover for these large risks, early engagement with the Howden team is key - we work with clients to prepare appropriately scoped and detailed analysis of the risk for the insurance markets in advance of the submission stage where most other brokers get involved (which is often too late). This advisory-first approach has established Howden as the clear market leader in the efficient execution of large towers of insurance (with available capacity often in excess of €1B per risk), enabling clients to lock in the expected tax treatment of complex high-quantum risks.

Tax Risks in Live Dispute with the Tax Authorities

Gone are the days where a letter from the tax authorities into an uncertain tax position would prove fatal to its insurability. Today, insurers are willing to look past potential over-reaching from tax authorities and focus on the underlying technical merits of a given tax position. As we come to the end of calendar 2024, appetite for tax risks in dispute remains strong.

A tax risk is classified as in "dispute" once it is on the authorities' radar, and we have experience in insuring tax matters where the authority has only raised initial exploratory questions, right through to active and ongoing tax court proceedings.

Partial cover for defence costs is increasingly achievable – and we have developed some innovative funding solutions using tax policies as collateral in certain jurisdictions. We have also seen insurers become steadily more amenable to deferred premium payment arrangements, where we can ease cash flow concerns and better align payment to specific milestones in the litigation (i.e. paying a portion of premium only should a dispute proceed to an appeal court).

The key to insurability remains a strong tax position in law – and being able to articulate the available defence arguments to insurers gives us the best chance to get terms. Naturally, risks in dispute tend to be more complex with a live and evolving underlying fact pattern, so it is imperative to engage with your Howden broker at the earliest possible opportunity to open up the best chance of securing terms.

Belgium & Luxembourg

We have seen fruitful growth in the number of enquiries and policies placed. Whereas tax policies have historically been placed regarding more 'traditional' risks such as withholding tax and corporate restructurings, we have seen an increased interest for the product in other fields.

In Luxembourg, the awareness regarding tax insurance is steadily growing, especially given the de facto unavailability of tax rulings. We expect this increased awareness to result in an increased number of policies placed in the months to come.

Southern Europe

The demand for tax insurance in Southern Europe is on the rise, especially with regards to Italy. The number of enquiries from Southern Europe has increased almost tenfold compared to last year and we have placed a significant number of tax policies in the region, especially in relation to Italy, regarding a variety of matters including tax credits, VAT and withholding tax, also in contentious matters. As a result, we have seen a drop in premium.

France

While enquiries regarding tax risk coverage in the real estate sector remain a strong and and ongoing trend - particularly concerning risks related to the 3% tax and the reclassification of share transfer tax into real estate transfer tax - we are now seeing clients leverage this product in innovative ways within the French market. For example, tax insurance has been used as part of intra-group reorganisations prior to transaction, serving as an effective alternative to tax ruling. Additionally, we have successfully placed a substantial policy that is used as a guarantee to facilitate a refinancing agreement with a French bank during this quarter.

We are also observing a growing trend in enquiries related to French withholding tax risk as transactions on French assets by non-resident investors and outbound payments from France are now a key focus for the French tax authorities. Notably, Luxembourg holding structures, despite their lower risk profile at the time of establishment, are under greater scrutiny and may be viable candidates for insurance, depending on the specific fact-pattern.

Regarding pricing, we are witnessing a consistent decline in premium rates for low tax risks backed by robust technical defence positions, especially in the real estate sector.

Netherlands

Numerous tax policies were placed in the Netherlands during Q3, both in the context of M&A and beyond. A recurring risk has been real estate transfer tax (RETT). At 10.4%, the Dutch RETT rate is among the highest in Europe, prompting investors to seek insurance against the risk of one of the RETT exemptions not being applicable. Furthermore, we've seen continued interest in forward-looking dividend tax policies, often supplemented by coverage against the conditional dividend withholding tax applicable as of 1 January 2024.

Poland

Due to the recent uptick in M&A activity, Q3 in Poland has been marked by increased interest in tax risk insurance related to M&A. One specific risk to highlight is the reclassification of B2B contractors as employees, a topic on which we have recently received numerous enquiries. While B2B contracts are widely used across various industries, challenges from the tax and social security authorities continue to create uncertainty, making tax insurance an effective de-risking tool.

Iberia

This quarter is one of the busiest in Iberia due to the halt for summer break in the month of August; a month when the teams at most local advisors, funds, and corporates traditionally take their leave. Risks around non-resident capital gains tax continue to be in high demand for insurance in Spain, often leading to large policy limits and the need to approach insurers to build programs of insurance. There has also been an uptick this quarter on withholding tax enquiries, which had been silent for some months, and risks under dispute.

Portuguese taxpayers are concerned about the novel aggravated municipal property tax for investment structures where the UBO is in a blacklisted jurisdiction and finding terms for this risk continues to prove difficult.

Indirect tax-related enquiries, both in Spain and Portugal, have been less frequent this quarter, but we would predict this to change into the next quarter as real estate transactions pick up. Lastly, there have been some personnel shifts at some competing broking teams, leading to a a significant growth in the number of enquiries received. The number of potential insurers has also grown, not only in terms of number of markets, but also in terms of Spanish-trained or Portuguese-trained tax lawyers joining local underwriting teams in Iberia.

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Contingent Risks

The contingent risk market has been facing headwinds from significant anticipated losses in the US market. Whilst appetite and capacity have been impacted in the UK and Europe, with increased price sensitivity, the market remains open. However, the importance of working with true subject matter experts with deep experience is always heightened in these circumstances. We have been able to obtain executable terms in the following categories in Q3:

1. Removing exposure to post M&A litigation: covering the risk of shareholders challenging the price paid in a public to private transaction.
2. Enabling distressed M&A: insurance against the risk of sale of assets by distressed company being unwound, as a result of success in pending challenge to certain pre-sale corporate actions.
3. Releasing cash from escrow: replacing a post-M&A escrow against pending and potential litigation with insurance, pursuant to SPA provisions allowing the escrow to be released if insurance were obtained.
4. Releasing cash to creditors: replacing a reserve held by a Security Trustee against litigation risk with insurance, allowing the release of cash to creditors.
5. Enhancing sale of arbitration award: insurance against the risk of annulment to an arbitration award, enabling the sale of the award while annulment proceedings were still pending and maximising up-front cash realised from sale.
6. Facilitating financing of legal assets: insurance fixing the value of law firm contingent fees to enable financing of receivables on better terms.

Alex Southby
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New Products

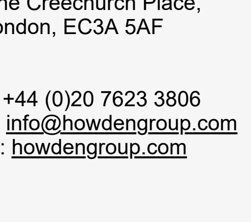
Pillar 2

Over the last quarter we have seen increased interest in the use of tax insurance to obtain certainty around their Pillar 2 position. While cover is not available for all positions, in particular where the rules are yet to be finalised, it can be obtained to cover specific issues that arise from difference between the rules in separate jurisdictions and particular factual circumstances.

Financing

We have seen an increase in the number of clients who are looking to use an insurance policy to cover uncertainty that is causing issues in either financing or raising new capital.

A number of lenders are becoming more familiar with the use of insurance and can offer improved pricing.



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