



Tax Liability Insurance

Tax Insurance for Tax Certainty

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Agenda

Tax Insurance Overview

Tax Insurance in Mergers & Acquisitions

Tax Insurance outside of M&A

Tax Attributes and Credits & Inflation Reduction Act

Tax Controversy

Q&A

What is tax insurance?

Tax insurance is a solution to **transfer risk** of a known potential tax liability from a company's balance sheet to the insurance markets.

KEY BENEFITS:



Bespoke Solution

Designed to meet the specific coverage needs of the insured party/parties, including interest/penalties, a gross up for income taxes, and capacity for contest costs.



Financial Impact

An economic means to mitigate the financial statement impact of a FIN 48 (ASC 740-10) reserve.



Tax Insurance > Traditional Indemnity

Can be used to replace or backstop an indemnity in transaction agreements for a specific tax risk.

What should tax attorneys / advisors know?

TAX INSURANCE DOES NOT REPLACE TAX ADVICE

- To bind a tax insurance policy, clients will typically need a supporting opinion or memo, tax exposure calculation, and potentially analytical support (e.g., tax basis study or valuation).

TAX INSURANCE IS BROADER THAN YOU THINK IT IS

- Lockton policies are designed by tax professionals and can address complex transactional or transfer pricing risk, but also estate planning, benefits, renewable energy tax credits and many other risks

TAX INSURANCE IS NOT ADVERSARIAL

- Binding tax insurance and processing claims is a collaborative process.
- At Lockton we work with insurance carriers to protect our clients and avoid “traps for the unwary.”

Tax advisors and attorneys play a critical role in helping their clients understand whether to consider obtaining a policy and supporting them throughout the insurance process.

Examples of common insurable risks



MANY TAX EXPOSURES SPECIFICALLY IDENTIFIED DURING DUE DILIGENCE AND EXCLUDED FROM R&W POLICIES

CORPORATE TAX

- Tax-free reorganizations and restructurings
- 355 spin-offs and split-offs
- Deferred compensation 409A
- Withholding taxes
- Internal restructuring and post-acquisition integration transactions

DEDUCTIONS

- Debt/equity treatment
- Ordinary/capital characterization
- Bad debt deductions
- Worthless stock deductions
- Net Operating Losses

QUALIFICATIONS & ELECTIONS

- S-Corp qualifications
- 338(h)(10) and 336(e) elections
- REIT/RIC status and related risks
- Publicly traded partnerships
- Tax treaty qualification
- Leveraged partnerships

TAX CREDITS

- Investment tax credits
- Productions tax credits
- Carbon capture and sequestration
- R&D credits
- Employee retention credits
- Foreign Tax Credits

VALUATION & COMPUTATION

- Transfer pricing
- E&P calculations
- NOL carryforwards
- Leveraged distributions
- 1031 Like-Kind Exchanges

STATE & LOCAL

- Sales/use tax
- Transfer tax
- Domicile
- Property tax reassessment/Prop 13

Market trends

Tax insurance has become more cost efficient, and capacity has significantly expanded to cover larger potential tax exposures.

- Very competitive pricing **(2%-5% of exposure)**
 - 30%-50% decrease in premium costs over the past five years
 - May be available without a formal tax opinion.
 - Often more efficient than purchase price adjustments or transaction alternatives
- Retention is often unnecessary or limited to contest costs only
- Coverage for positions with “more likely than not” advice

An overview of the tax insurance process

LOCKTON

BROKER, INSURED AND TAX ADVISORS

- Engage in an initial conversation to identify your coverage needs.
- Brokers assess information and submits submission to insurers for nonbinding terms.

DAY 1-3

BROKER

Broker provides guidance on initial terms and preferred insurer(s).

DAY 3-4

BROKER AND INSURER(S)

Broker and Insurer(s) negotiate coverage terms and limitations.

DAYS 4-7

BROKER AND INSURER(S)

Our team provides guidance and Broker works with insurance markets to build "tower" if needed.

DAY 7-10

INSURED AND TAX ADVISORS

Provides analysis, memos, opinions, as well as relevant transaction documents to support the tax position.

INSURER

Selects insurer with which to proceed to underwriting process.

INSURED AND TAX ADVISORS

Responds to inquiries and provides additional information as requested during underwriting process.

INSURED

Reviews policy terms and conditions and binds coverage.

INSURED/DEAL TEAM

NOTE: Process typically takes two weeks but can be completed faster if required by deal dynamics.

Tax insurance within M&A

Tax insurance has proliferated as R&W policies have grown in use and taxpayers are faced with discrete tax risks excluded from the R&W policy.



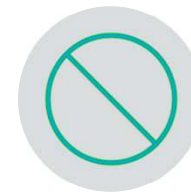
Tax insurance is more efficient than purchase price adjustments or escrows and can be bound by buyer or seller, before or after signing/closing.



Can protect against historic tax exposures, transactions contemporaneous with the deal or post-acquisition structuring.



Often begins with DD report summary; a tax memo or opinion is typical.



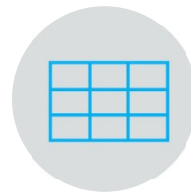
There is no cost to working with Lockton to obtain a non-binding quotes.

Tax insurance outside of M&A

Tax insurance is a broad and evolving solution, which can be designed to address virtually any task risk or benefit that has at least "MLTN" support.



As more experienced tax professionals are hired by brokers and carriers, the breadth and sophistication of tax insurance solutions has grown exponentially.



Tax insurance can be bound before or after a transaction is executed and economically offsets the P/L and balance sheet impacts of a tax reserve.



Insurance policies can cover historic risk of executed transactions or anticipated risk from planned transactions.

Tax insurance for attributes and credits

There are well-established markets for insurance to protect the generation and utilization of tax credits and to protect the value of tax attributes.

- Tax insurance has been utilized by tax equity investors and renewable energy producers for decades
 - The Inflation Reduction Act has greatly increased these markets, as new credits and purchasers of transferrable tax credits have entered the market
- Tax attributes can be valuable assets in an M&A transaction, but are often discounted or removed entirely from the deal model by prospective buyers
 - Examples of tax insurance include policies to protect against challenges to S corp status, Section 338 elections, and the quality/quantity of NOLs and R&D credits
 - Tax insurance is a much more efficient alternative, especially in auction situations where bids need to be competitive
- Insurance will typically cover situations when tax attributes are utilized

Tax insurance & renewable energy

- Investment tax credits (ITCs) and production tax credits (PTCs) are essential components of renewable energy project financing.
- Tax insurance provides certainty for insureds involved in renewable energy projects utilizing the ITC or PTC where ambiguity exists as to credit qualification.

COMMONLY INSURED ITC/PTC RISKS

TAX CREDIT AMOUNT

Qualified basis: Covers the fair market value for calculating the credits (including developer markups)

TAX CREDIT QUALIFICATION

Begun constructions: Commencement of physical work of a significant nature

INVESTMENT STRUCTURE

Structure/allocations: Protects the allocation of credits and attributes between the parties, including under the partnership anti-abuse rules

Continuous efforts: Satisfaction of continuous efforts if COD extends beyond the safe harbor period

RECAPTURE OF TAX CREDITS:

Recapture: Credits lost from a future recapture event

Repowering: Confirms qualification under 80/20 rule or projects that originally qualified for Section 1603 cash grants

BENEFITS OF USING TAX INSURANCE

- A financial backstop, supplement or replacement for an indemnity from a developer or sponsor
- Attracts additional interest for a project from tax equity investors that are seeking certainty with respect to tax credits
- Increased liquidity without establishing reserves/holdbacks
- Achieves visibility on returns/cash flows
- Coverage is comprehensive in nature and includes tax, interest, penalties, defense costs and gross-up

Inflation Reduction Act

Opportunities, Risks, & Potential Tax Insurance Solutions

The new legislation delivers an extension and expansion of the ITC and PTC, while also establishing new incentives to support the clean energy industry.

ITC/PTC EXPANSION

- Higher/bonus tax credit amounts: Tax insurance can backstop the qualification of a project for an increased tax credit, including:
 - Prevailing wage and apprentice standards
 - Domestic content
 - Energy community
- Transferability: Tax insurance may provide a solution for an indemnity that would otherwise be required between a transferor and transferee
 - Qualification for nuclear projects
 - Stand-alone energy storage

NEW TAX CREDITS

- Clean hydrogen production tax credit (CHPTC)
- Clean hydrogen investment Tax credit (CHITC)
- Clean electricity investment Tax credit (CEITC)
- Clean electricity production Tax credit (CEPTC)
- Advanced energy production credit
- Expansion of 45Q credits

Tax insurance before and during controversy

Tax insurance is available for many exposures despite notice of audit and even commencement of litigation.

- Insurance carriers have increasingly provided competitive quotes for tax risks that are the subject of audit and/or litigation
 - The policy may require some amount of retention (i.e., deductible) to ensure that the policy triggers above the anticipated settlement value of the risk
- Rates for tax insurance policies for exposures under audit or the subject of litigation may be higher than for other tax risks, but are still very efficient when compared to tax reserves
- Tax insurance can be sought for transfer pricing, including where advanced pricing agreements (APAs) are being sought

Team & expertise



Daniel Berger

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Dan most recently led tax insurance underwriting for AIG in North America and has more than 12 years of tax experience. He previously worked as a Tax Director at Brookfield Asset Management and as an Associate at Moelis & Company, both in New York. Dan began his tax career as an attorney at Proskauer Rose, where he advised on various transactional tax matters.



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Doug Brody is the Senior Vice President of Business Development, M&A Tax at Lockton. Previously, Doug was a Managing Director of Tax Business Development at Aon, and prior to that was a partner in EY's Transaction Tax Practice. In his current role, Doug works with taxpayers and their advisors to design tax insurance solutions for corporate, pass-through, individual and estate tax matters.



Audrey Bailey

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Prior to joining Lockton's tax insurance team, Audrey was a Senior Manager in EY's Transaction Tax practice. She worked on a variety of corporate or private-equity transactions for which she performed tax due diligence, advised on tax structure, drafted tax opinions or memoranda, or modeled tax cost calculations.



John Rayis

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John was previously a tax partner at the global law firm of Skadden, Arps, Slate, Meagher & Flom LLP, where he served as tax partner for companies in a variety of complex corporate and partnership tax law matters, with a particular focus on REITs, as well as external tax counsel for several large private equity funds.

John is a Senior Strategic Advisor for Lockton and will advise clients on tax insurance and other transaction-related insurance.

Independence changes everything.



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