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STATE AND LOCAL TAX FORUM

Mitigating State Tax Risk Through Insurance: Pros and Cons

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Perspective on the Market

Industry Snapshot

- Expansion Over the Past 5 Years
  - How does state tax risk fit into the broader growth trend?
- Important Metrics
- Why Increasing Interest?
- Implications for Market Participants
- Who are the players?

Basic Principles

- Designed to transfer a known, but uncertain, tax liability from a company's balance sheet.
- Not designed for reportable transactions, tax shelters, unsupportable positions.
- Several main categories:
  - Ahead of an M&A transaction
  - During an M&A transaction following due diligence
  - Outside of a transaction – stand alone
  - Controversy?

Scope of Coverage

- *Taxes* including federal, state, local or foreign taxes
- *Interest*
- *Penalties* that do not relate to fraud, criminal activity or intentional misrepresentation
- *Expenses* of external legal/tax advisors incurred in the event of a contest by the IRS or other taxing authorities
- *Gross-up* of insurance proceeds to account for proceeds being subject to tax

Commonly Insured Positions

Qualification & Exemptions	• REIT, S-Corp, PFIC, UBTI, Treaty Qualification, Employment Tax Withholding, FIRPTA, 338(h)(10) Elections, Indirect Transfer Tax
Deductions	• Debt / Equity classification, Worthless Stock Deduction, NOL Availability / 382 / 384 limitations, ordinary deduction versus capitalization
Credits	• Historic Tax Credit, Foreign Tax Credits, Renewable Energy Tax ITC / PTC, LIHTC, State Tax Credits, R&D Credits, Employee Retention Credits
Reorganizations & Deferral	• Acquisitive / Divisive Reorganizations, Spin-offs / Split-offs / Split-ups, Like-kind Exchange, Deferred Compensation 409A
Transfer Pricing	• Operational, financial
Calculation	• 311(b) Gain, NOL Carryforward, Mandatory Repatriation Inclusion (965), GILTI Inclusions, Subpart F inclusion amount, 83(b) Elections, Qualified Basis, BEAT

What Unique SALT Risks are in the Market?

- Marketplace facilitator risk
- Residency
- Indirect taxability issues, including application of exemptions
- Prop 13
- Transfer tax risk in deal context
- Transfer pricing disputes
- Unclaimed Property
- Bundling

Key Considerations for Tax Executives

Important Considerations

- Implications for audits
- Weighing costs: not securing coverage for tax risk versus coverage
- Buy-in from key stakeholders
- Different considerations for deals versus ongoing audits/controversy/positions?
- Interplay of Tax Insurance and Reserves
  - What impact, if any, does insurance have on existing reserves?
  - How are insurance policies booked on the financial statement?
  - Does seeking insurance trigger a reserve?

Securing Coverage:
Procedural Considerations

Underwriting

Step 1	Initial consultation with broker's tax specialists to discuss the tax risk.
Step 2	The broker will analyze the information and prepare a report for insurers, allowing marketing of the risk to all potential insurers.
Step 3	The broker receives non-binding indicative terms from insurers and provides the client with a comprehensive report, including a recommended insurer.
Step 4	The client selects an insurer and executes an expense agreement.
Step 5	The insurer reviews all the information made available to it as part of the underwriting process.
Step 6	Parties negotiate policy wording.
Step 7	The final binder/policy is issued.

- What do underwriters really consider?
- How important are the opinions from insureds advisors?

Key Policy Terms

Duration – 7 years, but can go out to 10 years in certain circumstances

Limits – As lows as USD ~$5MM up to limits greater than USD $1B

Costs – One time payment of ~3% to 5% of the policy limit

Loss – Loss under the policy can include additional taxes, interest, penalties, contest costs, gross-up

Retention – As low as USD $150,000, and, with “binary risks” (i.e. no loss or total loss), may apply only to contest costs

Tax Jurisdictions – United States, Canada and many other foreign jurisdictions

Standard Exclusions – Inconsistent position, material inaccuracy, settlement without consent, change in law

Contests – Contests are led by the insured and their advisors; The insured has an obligation under the policy to keep insurers informed

Counsel – Deal/opinion counsel are pre-approved in policy; other advisors are subject to the insurers’ reasonable consent

Timing – Underwriting is generally 2 weeks (but has been done in as little as 48 hours)

Policy – Tailored Policy is negotiated to address specific insured risk

Advice – A formal legal opinion is **not** required; however, the better the advice, the better the terms

Concluding Thoughts – Open Discussion

Thank you!