Insuring tax risks - Practical advice for tax advisors on the use of tax insurances[1]

By Martina Sradj[2]

As an alternative to a binding ruling, tax risks are insurable under two different types of insurance policies, depending on the nature of the underlying risk: Cover may be granted under either a transaction-related W&I-policy or a more generally applicable specific tax risk policy. This article explains basics of insuring tax risks as well as possible use of tax risk insurance as well as the role of the tax advisor.

1. Introduction

The increasing complexity of tax laws naturally gives rise to legal uncertainties, which are accompanied by increasing scrutiny by the tax authorities in tax audits. Legal uncertainties often lead to risks in transactions or (re-)structuring, both in national and especially in cross-border structures. The identification of tax risks is of significant importance if and to the extent that these impede the efficient implementation of transactions or (re-)structuring or, in worst case, completely prevent it. First and foremost, the identification of tax risks should contribute to achieving the best available planning certainty with regard to the liquidity effects of entrepreneurial decisions, including the capital gains to be achieved, the amount of any future financial burdens and, last but not least, possible consequences under criminal tax law with corresponding reputational risks.

However, binding rulings issued by the tax authorities as a proven measure to clarifying tax-related legal uncertainties can only be used to a limited extent, especially if-as in transactions-there is time pressure. In this respect, tax risk insurance has emerged in recent years as an alternative measure for financial protection against tax risks, with which the risk of a tax payment is transferred to an insurer in exchange for a one-time premium payment. Tax risk insurance (or tax liability insurance) is to be distinguished from warranty and indemnity insurance (so-called “W&I” insurance) used in transactions, under which certain tax risks can also be covered.

2. Tax risks and ways to mitigate tax risks

2.1. Definition of tax risks

The term tax risks basically covers all uncertainties that have or can have a negative impact on tax payments[3].

The reasons of these uncertainties are complex: They can consist, for example, in limited knowledge of future economic and tax developments, ambiguity in the determination and extent of the tax burden, uncertainties in the final timing or in possibilities of interpretation and structuring options, e.g. with regard to application or option rights available under the applicable tax laws, grey areas or the granting of tax benefits.

[1] This article is a translation of the author’s original article “Versicherung von Steuerrisiken- Praxishinweise für steuerliche Berater beim Einsatz von Steuerversicherungen“ was published in the German tax advisor magazine „Deutsches Steuerrecht“, issue 11/2022, p. 568 .
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[3] Cf. Weck-Hannemann, in Dichtl/Issing, Vahelns Großes Wurtschaftslexikon, 1987, „Steuerliche Risiken“.

Tax risks can result on the one hand from **factual risks**, e.g. unclear facts or misconduct by persons, and on the other hand from **legal risks**, i.e., uncertainties regarding the application of the law to a matter.

Tax risks can be further divided into

- **Material tax risks**, i.e. tax risks in relation to (i) the factual prerequisites for the application of a tax (factual background or implementation of a structure), (ii) in relation to the amount of a tax or its determination and (iii) its due date (deadline/date).
- **Formal tax risks**, i.e., tax risks that can arise from the (full or partial) compliance with legally stipulated obligations for the taxpayer to cooperate, maintain records or documentations or process flows, e.g., in case of filing of tax returns, maintaining of records or documentations, accounting, as well as in case of non-compliance with formal requirements in the enforcement of tax claims (specifically formal requirements and deadlines).

Tax risks can sometimes entail considerable financial risks, which, in addition to impacting profits and cash flows as a result of (unplanned) tax payments or tax provisions, also trigger interest, surcharges, penalties, fines, litigation costs and consulting costs on a considerable scale. They can also result in reputational risks ("negative press") and, in worst case, criminal law risks.

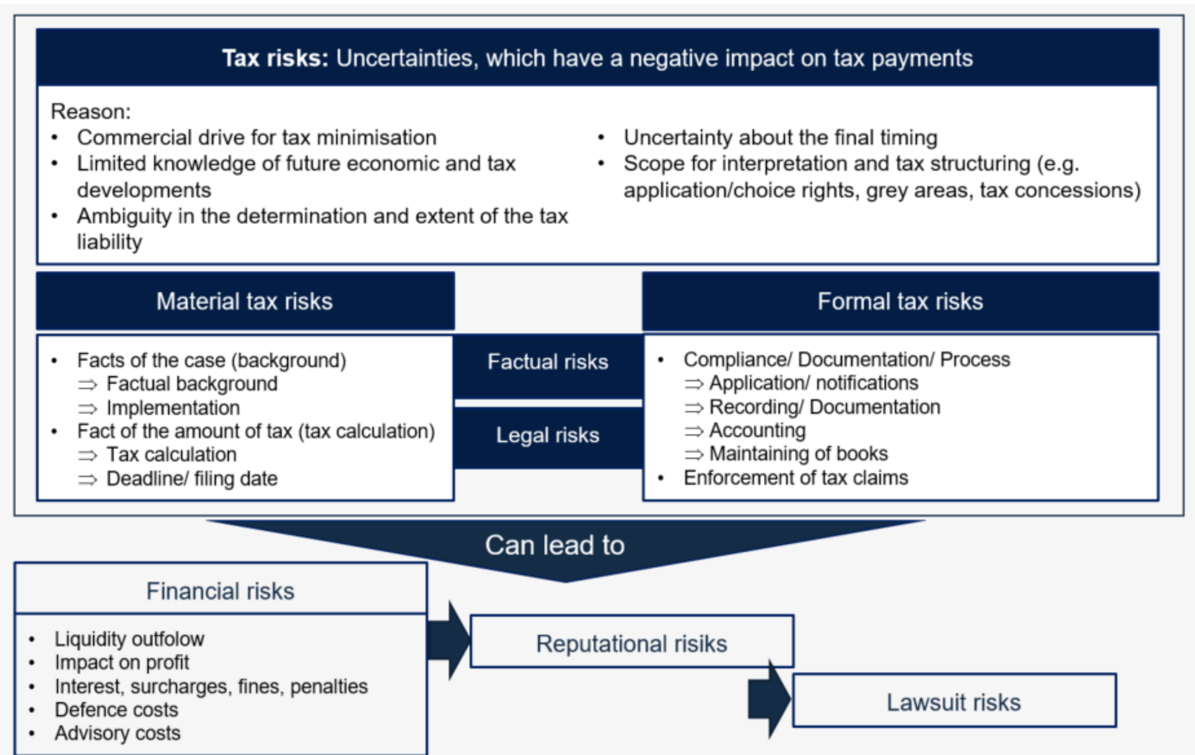

Fig. 1 Types of tax risks

2.2. Assessment of tax risks and factors influencing insurability

In tax due diligence reports, tax risks are usually divided into the risk categories "low", "medium" and "high" according to the traffic light system. Further subdivisions or intermediate levels, e.g. „low to medium", "very low" or "residual risk", can achieve an even more differentiated assessment of the risk.

In principle, the assessment of a tax risk is made up of two components: the probability of occurrence of the risk on the one hand, and the absolute amount of the possible tax loss on the other hand. As far as possible, but depending on available documents, such loss calculation may even be further granulated into possible probabilities of occurrence (e.g., worst case and/or best-case scenarios).

When examining the insurability of (identified) tax risks from an insurer's perspective, there are a number of further relevant aspects, which may even lead to a different risk classification in individual cases, such as, among others

- Background of the risk, e.g., factual risk, documentation risk, implementation of tax requirements,
- Scope and quality of existing documentation,
- Complexity, e.g., of the facts, the planned measures or the contractual framework,
- Legal situation or legal certainty, e.g. (planned) changes in tax law or interpretation of tax law by tax authorities, courts and literature,
- Jurisdictions involved, including with regard to the court system and tax administration practice applicable there, as well as the taxpayer's ability to defend himself,
- Type and scope of tax advice, e.g., quality and scope of analysis, risk assessment and presentation of contentious aspects as well as possible defence positions,
- Potential assumption of an abuse of tax laws with regard to the selected tax position (please note that abusive structures will generally not be insurable),
- Time/ period,
- Type and amount of possible sanctions,
- Status of tax audits, especially extent of (expected) corrections in tax audits,
- Probability of detection.

2.3. Options for mitigating tax risks

Generally, hedging against known or identified tax risks is achieved in three different ways:

1) Agreement of guarantees or indemnities
2) Obtaining a binding ruling with the competent tax authorities
3) Inception of a tax risk insurance policy.

Whether and which type of cover is suitable for the individual case depends in particular on the following criteria:

- Type of tax risk, i.e., whether it is a transaction-related tax risk or a non-transaction-related risk,
- Time relation of the risk, i.e., whether it is a historical tax risk, a current tax risk or a future tax risk,
- Prerequisites of the respective coverage,
- Scope of risk coverage,
- Security,
- Binding effect,
- Impact on profits,
- Disclosure and
- Costs.

2.3.1. Contractual guarantee or indemnity

The hedging of tax risks through contractual guarantees or corresponding purchase price reductions naturally requires a contracting party, which is willing to cooperate, and is therefore the instrument of first choice in most transactions. Provided such agreement is enforceable, it is likely to be a very efficient measure for reducing a tax risk in terms of cost and time. However, in terms of liquidity, the contractual guarantee may be disadvantageous, because it requires money deposited in escrow, which is locked until the expiry of the agreed period and are accordingly not available for distribution to shareholders or investors.

There is also a risk that the negotiation of guarantees for tax risks can jeopardise the implementation of the transaction itself, lead to delays or even can become the deal breaker.

The currently strong seller's market, may prevent a negotiated solution due to the fact that, sellers seek increasingly limiting guarantees and indemnities to the lowest possible level or excluding them with a coverage under a W&I insurance policy. Especially sellers from the investment fund, real estate or private equity sector currently limit their contractual warranties and indemnities to €1 and already provide for the conclusion of a W&I insurance policy (usually signed by the buyer) in the first draft of the contract.

However, it should be noted that the W&I insurance only covers unknown risks, while known tax risks cannot be covered or only to a limited extent (see section 3.1).

2.3.2. Binding Ruling

The most widespread option for hedging tax risks so far is the binding ruling (sec. 89 para. 2 German General Tax Code, Abgabenordnung/ AO)[3]. A binding ruling only applies to future tax risks and requires a formal application. Depending on the issue and the tax authority, several months may pass before a binding ruling is issued. Therefore, a binding ruling is less suitable for time-critical projects. This is in particular relevant, because a request for a binding ruling may also be rejected and still triggers fees, which can currently amount up to EUR 120,721 for an object value of more than EUR 10,000 and a maximum of EUR 30 million (section 89 (4),(5) in conjunction with section 34,39 (2) GKG).

2.3.3. Tax risk insurance

Tax risk insurance offers the advantage that it can cover specific tax risks, irrespective of whether it is a historical, current or even future risk. A tax risk insurance can cover potential tax risks within a short timeframe that no contracting party wants to assume in a transaction, but which can influence the purchase price or delay the transaction and, in particular, lead to material cash out. Outside of transactions, tax risk insurance covers such risks resulting from different interpretations on a legal issue, where no clarification can be obtained through a binding ruling from the tax authorities or for which no precedents or guidelines for the interpretation of laws are available. In principle, no factual risks nor implementation risks nor behavioural risks will be insured.

Tax insurance can cover the amount of tax at risk, but in addition hereto also any interest and penalties (e.g., late payment and default surcharges pursuant to §§ 152, 233 et seq.AO), litigation and defence costs. The policy limit can also cover taxes incurred by the policyholder because the payment made by the insurance company in the event of a claim is considered as taxable income (so-called "gross up").

Policy limit	Agreed between insurer and insured
Policy period	Up to 10 years but in any event should cover statute of limitations
Excess	For low risks, can be less than €50k and set against defence costs only
Premium	Typically 2% - 5% of policy limit for low risk items
Scope of cover	Bespoke definition of Tax Liability (can include interest, penalties and defense costs)
Notification	Policy only covers loss notified to the insurer during the policy period
Conduct	In the event of an audit/assessment the insurer will want to assume conduct
Exclusions	Change of law, fraud of the insured, misrepresentation under reps letter

Policy Limit
Headroom for Gross up
Defence Costs
Interest
Penalties
Tax
Excess / Deductible

Fig. 2: Key terms of a tax insurance policy

The process of risk assessment by the insurer up to the inception of the insurance policy (so-called "underwriting") can usually be completed in a period of five to ten days and can thus be implemented quite quickly compared to a binding ruling. The start of the process is flexible in terms of timing and can, in general take place before, during and after transactions or restructurings. However, if it becomes apparent during transactions and restructurings that tax risks will be covered by tax insurance, it is advisable from a practical point of view to involve the broker or the insurance company as early as possible before the contractual agreements have been finally negotiated. For this reason, American and British investors typically appoint the special insurance broker at the same time as their legal and tax advisors in a transaction. An early involvement of broker and insurer helps achieving the best possible insurance cover, which specifically requires that the future policyholder has sufficient possibilities to influence and control the tax procedure of the underlying the tax risk (so called “conduct”) under the contractual documents. Conduct rights are relevant for the policyholder, because under the tax insurance policy he will usually obliged to fulfil specific cooperation and negotiation obligations to ensure the involvement of the insurer in the tax procedures. Nowadays, many lawyers are experienced with W&I insurance policies; nevertheless, they are often not too familiar with the special features of tax insurance policies. Consequently, the specific requirements of tax insurance policies are not (or not sufficiently) reflected in the underlying legal agreements or purchase agreements, which can make it difficult or even impossible to conclude a tax insurance policy after signing of a purchase agreement.

In contrast to a binding ruling, changes in the factual background are possible under a tax insurance policy, provided they do not lead to a different risk assessment. Furthermore, all costs related to the tax risk can be covered against the payment of a single premium, so that in principle neither provisions in the profit and loss statements nor escrow deposits are required. A seller can thus complete the sale considerably faster and distribute proceeds to the investors or shareholders without having to observe the expiry of limitation periods.

The insurance premiums for tax risks currently range between approx. 2% and 5 % of the sum insured, depending on the type of facts and the risk as well as the amount of the deductible. The usual policy limits insured are predominantly in the one or multi-digit million range. For smaller policy limits, insurers will typically charge minimum premiums, which range currently between EUR 100,000 and EUR 150,000. In addition, there is the so-called underwriting fee, which insurers charge as part of the underwriting process, primarily for their third-party costs. The underwriting fee is usually around EUR 20,000 to 50,000.

Tax insurance is generally treated confidentially and will not be disclosed. It is assumed that the facts of the underlying risk have not yet been disclosed to a tax authority and, in particular, that no application for binding ruling has been submitted. Among other things, this can also ensure that facts assessed as risky from a buyer's point of view do not have an effect to the disadvantage of the seller. This is because the risk assessment takes into account in particular the subjective risk awareness, which may be diametrically opposed to that of the other contracting party and obviously depends on the type of investor, his level of experience or his negotiating position. Tax insurance, on the other hand, is not a substitute for a legally required disclosure of facts to a tax authority; rather, tax insurance assumes that all required reporting obligations have been or will be complied with and that all tax returns have been or will be filed on time. A tax insurance does not replace comprehensive tax advice to the policyholder, nor does it cover cases of abusive tax arrangements.

Just as with the binding ruling, a tax insurance policy generally excludes changes in law. However, the change in law is limited only to the law itself, but not its interpretation by the tax authorities or court decisions. Furthermore, knowingly false statements or the submission of false declarations to the insurer in the policy lead to a loss of insurance cover.

Tax insurance policies usually have a term of seven years, which may be extended to a maximum of ten years in individual cases.

	Contractual guarantee	Binding ruling	Tax risk insurance
Type of risk			
Transactional	yes	yes	yes
Non-transactional	*no*	yes	yes
Time-reference of risk	Historic/current/future	*Only future*	Historic/current/future
Prerequisites	Negotatations with contracting party	*Compliance with formal requirements; no implementation until binding ruling has been issued*	Negotiable
Scope of risk coverage	Generally negotiable	*not* negotiable	Negotiable
Tax at risk	covered	covered	covered
Interest and penalties	*not covered*	*not covered*	covered
Defence costs	*not covered*	*not covered*	covered
„Gross up“	*not covered*	*not covered*	covered
Security	Medium to high	*Low (rejection possible)*	High
Binding effect	Limited to agreement	Limited to facts disclosed in the ruling request	Deviations from background possible, as far as not impacting risk assessment
Timing	Within SPA negotiations	*Approx. 3-6 months*	Approx. 5 to 10 days
Disclosure of the risk	No	*yes (tax authority)*	Only in individual cases
Costs	Generally no costs (but impact on purchase price)	*Up to € 120.791 (even in case of rejection)*	*Premium approx. 2%-5% of the risk*

Fig. 3: Overview of possible solutions for hedging against tax risks

3. Insurability of tax risks

3.1. Transaction-related tax risks

Transaction-related tax risks typically occur when an asset is acquired or sold. Such tax risks can generally be divided into unknown and known risks, for which there are different solutions available in terms of risk reduction.

Unknown tax risks can generally be covered in a transaction under a so-called warranty and indemnity insurance ("W&I" insurance). However, under a W&I-policy, the following tax risks are generally excluded:

- Secondary tax liabilities (in the case of an asset deal, a tax indemnity in accordance with sec. 75 GTC would be granted)
- Transfer pricing
- loss of tax assets (e.g. expiry of loss carry forwards)
- hidden profit distributions and
- Additional taxes during the Locked Box Period if the contracting parties have agreed on a fixed purchase price that was determined based on annual financial statements from preceding fiscal years.

As a default rule, all risks identified in a tax due diligence, which a buyer or seller may conduct when acquiring or selling assets, are deemed to be known risks, where under the standard of the W&I-policy they are considered disclosed risks. Such known risks are therefore generally not covered in a W&I policy. Rather, the **affirmative cover** of identified tax risks under a W&I-policy largely depends on the negotiating skills and experience of the broker and the support of the advisors, if necessary against payment of an additional insurance premium. The insurer conducts its assessment based on the tax due diligence report, and, as applicable, requests further documents and information.

As to the cover position, it has to be noted that a W&I insurance generally only includes the amount of the guarantee/exemption for the tax risk in question, whereas a specific tax risk insurance can also cover interest, defence costs as well as a gross up (cf. section 2.3). Especially in the case of high-volume tax risks, this can be a relevant aspect with regard to the financial and liquidity situation.

Known risks can generally be covered by contractual warranties in a purchase agreement, by binding rulings or- in case they are not affirmatively coverable under a W&I policy - by a separate tax policy (cf. individual presentation section 2.3).

Typical transactional tax risks frequently insured under a separate tax policy include[4]

- Risks related to tax residency, such as the (inadvertent) creation of a German permanent establishment of non-German real estate companies holding German real estate or conducting harmful commercial activities, which may lead in both cases to a German trade tax exposure
- Capital gains taxation or disclosure of hidden reserves, including tax benefits upon winding up of a German business (sec. 16, 34 German income tax act)
- Risks from the reclassification of income, e.g. conversion of income from immovable assets to commercial income
- Qualification of hybrid financing facilities as equity or debt
- Intra-group payments and repatriation of income

[4] Further examples, cf. Skuratovsky, BB 2021, 2395 (2396 ff.)

- Real estate transfer tax risks (e.g. valuation issues, share deals),
- Secondary tax liabilities pursuant to sec. 75 AO (for asset deals)
- Management participation programmes
- Transfer pricing risks.

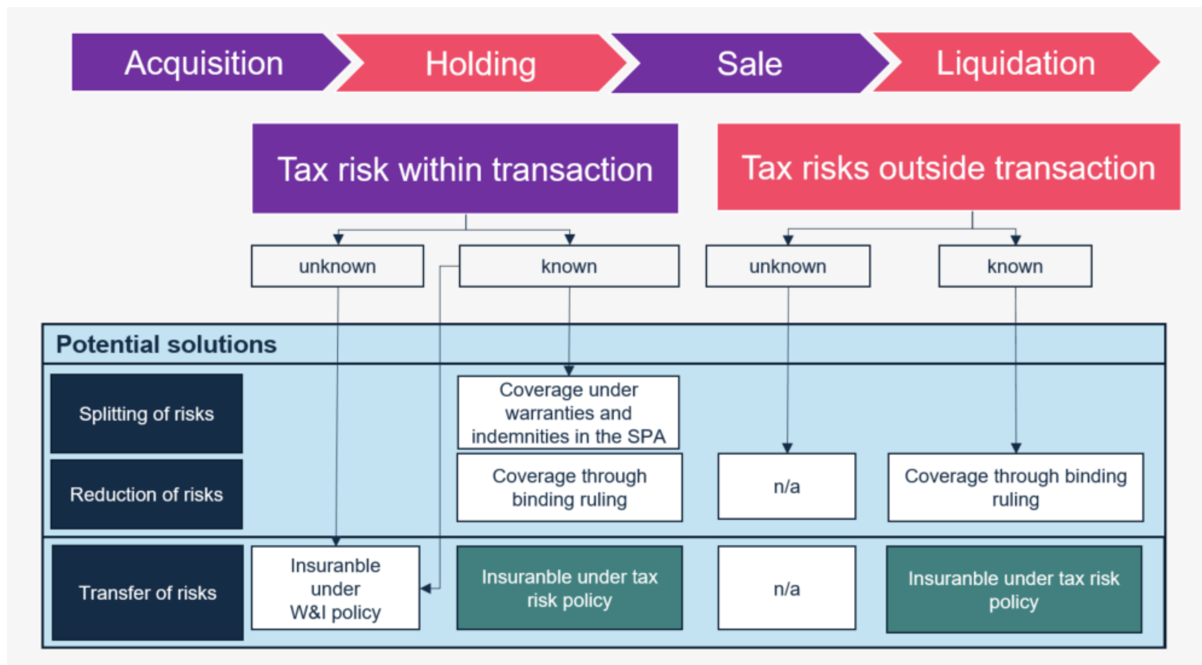

Fig. 4: Tax risks in the investment cycle and possible solutions

3.2. Non-transactional tax risks

Non-transactional tax risks typically arise during the holding phase of an asset or in connection with the liquidation of an investment. In the absence of a contractual party, the only options to cover known risks in such cases are either through a binding ruling or through tax insurance. Such risks usually include tax risks in connection with restructurings or reorganisations, which in particular concern uncertainties with regard to the German Reorganisation Tax Act (Umwandlungssteuergesetz), income taxes/ withholding taxes, real estate transfer tax, or VAT[5]. In addition, risks in connection with tax audits may also be coverable under a tax insurance policy.

4. Process and costs involved with a tax insurance

4.1. Parties involved in the insurance process

The relevant parties in the insurance process are the client (policyholder), the broker and the insurer or the underwriter, which assesses the risks on behalf of an insurer.

The client (buyer or seller) may be the policyholder or may act on behalf of another policyholder, such as the target company (or target companies). In most cases, the policyholders are companies, and only in exceptional cases individuals. In transactions where target companies have not yet been legally established or the shares in target companies have not yet been transferred at the time of signing of the policy and/or purchase agreement, the policy will generally include the buyers as

[5] For further examples, cf. Skuratovsky, BB 2021, 2395 (2396 ff.)

policyholders as well as the target companies (after the transfer in title) to benefit from the insurance cover.

As a default rule, clients need a tax advisor who ideally advises on the transaction or the underlying tax issue and assists in negotiating the tax policy.

The current market environment is characterised by an increasing demand for special insurance, especially tax insurance, which also increases the interest of insurers in tax risks. Accordingly, insurers have either built up own tax expertise or outsourced it to specialised external risk assessors - called Managing General Agents("MGA") or Managing General Underwriters ("MGU"). MGAs are licensed companies, which sign tax policies on behalf of A/A+ rated insurance syndicates or Lloyds syndicates (risk capital providers). The main differentiators in the insurance market are the so-called risk appetite, the maximum policy limits ranging between EUR 20 m. to approx. EUR 600 m and the available tax expertise, especially in insuring German tax risks, which can be particularly significant in time-critical processes.

Currently, there are about 10 to 15 specialist insurers on the market, the majority of which come from the British or American headquartered insurance groups. To the benefit of policyholders, the increasing competition in the insurance market results in a decreasing premiums.

4.2. Role of the broker

Brokers operating in Germany are usually insurance brokers according to sec. 59 VVG and generally act as brokers of insurance contracts for their clients on a professional basis. They act exclusively in the interest of their clients without being commissioned by an insurer or an insurance agent. Their activity requires a licence according to sec. 34d para. 1 GewO and they are generally subject to the professional supervision of the competent local chamber of industry and commerce.

For the placement of tax policies, some brokers have employed own tax experts. Their tax expertise is required to advise clients on the insurability of a tax risk from the first enquiry to the technical review of the policy and negotiating support during underwriting. However, it has to be emphasised that the broker does not provide tax or legal advice; rather, client's tax advisor will exclusively render all relevant tax advice. However, depending on his level of experience, the broker can perform plausibility checks of the tax advice or even carry out a professional second review based on which he may give recommendations regarding the insurability of the tax risk or measures to improve the client's negotiating position vis-à-vis the insurance company. The broker structures insurance solutions and can provide significant support in negotiations. He is responsible for coordinating the insurer's queries with the client (or subsequent policyholder) and all related communication. Where a the client takes out both a W&I policy and a tax policy for a transaction through one broker, this will help synergizing that the two policies are coordinated in terms of content and wording as well as cover for the required insurance cover. Policyholder and the insurer will finally sign the policy. The role of the broker is limited to the mediation of the policy, but he does neither act as an agent nor tax advisor to the policyholder.

Ideally, the broker accompanies the policyholder throughout the entire term of the tax policy, i.e. provides support in particular in the event of a claim and in the settlement of the claim.

4.3. Process and costs

For any enquiry of a tax risk insurance, a broker generally requires a tax memo or tax due diligence report prepared by an external tax or legal advisor, in which the tax risk is analysed and assessed.

The broker reviews these documents and may provide his initial assessment of the insurability of the risk on this basis.

The broker then sends out submissions to obtain (non-binding) offers from suitable insurers, evaluates the offers in a comparative overview of the insurance conditions and makes a recommendation. The broker should ensure that all relevant information for the offer is available and, in particular, that the understanding of the risk, the assumptions made and the conditions offered by the insurers are adequate. Addressing different insurer increases price competition to the policyholder's benefit. However, it is relevant for a policyholder that the offers include all cost components, specifically the applicable insurance premium tax as well as any irrecoverable VAT on underwriting fees that the insurer may charge.

Costs will be triggered once the client selects an insurer and concludes an expense agreement with him for the so-called underwriting process. The insurer charges an underwriting fee to cover his costs for consulting external advisors in the context of the risk assessment.

For most insurers, the underwriting process runs in parallel with the drafting of the insurance policy. In this context, the insurer usually requests further documents and information from the client or the client's tax advisors. The timely response to such requests contributes significantly to meeting the time requirements. Through the queries, the insurers verifies certain assumptions or individual aspects that were the basis of the offer. The broker supports the client in the negotiations, in particular the wording of the policy and the scope of the insurance cover.

The process finally ends with the signing of the policy and its inception. At this point of time, the insurance premium will become payable and any additional documents and information provided agreed in the policy has to be provided within the agreed timelines (e.g., signed versions of the purchase agreement, documents from the data room). Appropriate support from the broker will help complying with such deadlines agreed in the policy to mitigate the risk that the insurer may be entitles in case of non-compliance to withdraw from the policy.

If a claim occurs during the term of the policy, the broker or insurer should be informed in accordance with the agreements in the policy[6].Tax policies usually provide for comprehensive conduct rights, which the policyholder must comply with in order to maintain insurance cover. Typically, conduct rights include the providing tax assessments notes to the insurer within fixed deadlines, the involvement of the insurer in objection or lawsuit proceedings as well as other rules of conduct. The scope of such conduct requirements may also be reduced in individual cases, depending on the amount of the agreed deductible (retention) or the conduct rights of the respective taxpayer agreed in the underlying contractual or purchase agreements.

5. The role of the tax advisor within the process of insuring tax risks

5.1. Importance of the tax advisor

The tax advisor can significantly contribute to the insurability of tax risks, as his assessments and analyses of tax risks are submitted to the insurer and form the basis of the insurer's risk assessment.

In this respect, it is recommendable if the tax advisor has already clarified upon his engagement with his client whether, for example, the client contemplates insuring risks in a transaction, be it under a W&I insurance or a separate tax insurance. Risks may also arise in the course of tax planning or tax structuring, where mitigation through tax insurance may also be considered. In such cases, he tax

[6] Cf. Bhoma, Tax liability insurance: dealing with tax risks in M&A and other commercial transactions, Thomason Reuters 2021, uk.practicallw.tr.com/6-543-2265.

advisor may even proactively seek a discussion with a broker in advance to obtain an initial assessment as to whether the identified risk is insurable and, if so, which aspects should be addressed in the tax advice. If necessary, such initial discussions can be made on an anonymous basis. On this basis, the tax advisor will be in a position to proceed with his client's matters efficiently in a time-and cost-saving manner.

During the underwriting process, the tax advisor can significantly contribute to an efficient process, if he responds promptly to questions from the insurers, provides complete and accurate information and supports with further explanations, if necessary. It should be kept in mind that the insurer can only refer to information and documents provided to him. The insurer typically does not have all details that seem self-evident to the tax advisor from his knowledge of the client's background or the transaction or from other sources. It is key that any deliverables prepared by the tax advisor may provide the insurer as a knowledgeable third party an overview of the facts and their tax assessment within reasonable time.

5.2. Key points to consider in tax due diligence reports and tax opinions

To improve the potential (co-)insurance of tax risks in a transaction, the following aspects should ideally be included or considered when drafting a tax due diligence or a tax opinion:

- Description of the **scope of work** agreed with the client ("Scope of Work"), if applicable annex of the engagement letter (excerpts are sufficient)
- Presentation of the tax review should be in tabular form, ideally including a summary of the material risks ("red flag") as well as a more detailed description and analysis of all aspects under review and the assessment of the risks identified in this context. In case of larger transactions, any overviews containing relevant information on financing, histories of companies or changes in shareholders, status of assessments and tax audits, status of loss carried forwards, etc. can also contribute to an increased level of information.
- Description of the underlying transaction and, if applicable, its financing(facts):
    - **Structure charts** the initial structure, transaction structure and target structure are helpful, or any structure charts visualising the financing or liquidity flows.
    - Accurate and complete **description of the asset under review** (e.g., type of asset(s), name, legal form and registered office of companies),
    - the indication of the **period under review** (fiscal years),
    - **Status and level of completeness of the reviewed documents** or the information provided in the data room should be included.

The background is that an insurer will exactly reflect this information from the tax advisor's reports by the insurance in a policy. If, for example, the period under review was limited to the last tax returns received, but does not include a review of a trial balance or other documents available for the current fiscal year, the policy will exclude potential risks for current fiscal year at the time of acquisition or sale from insurance cover. The same applies to incomplete data and information and companies or assets out of the scope.

If for purposes of the tax review any (materiality) threshold for risks has been applied, insurers will generally transfer it to the policy as De Minimis[7]. Often tax due diligence reports set a materiality threshold, but despite of this, assess and report specific risk, which are significantly lower. In such

[7] W&I policies typically will cover unknown risks exceeding the De Minimis value, irrespective of a potentially agreed retention.

cases, it would be more favourable to reduce the materiality thresholds to the lowest identified risk or even set no threshold to achieve the most comprehensive insurance cover possible.

The identified risks should be described briefly and concisely, assessed qualitatively (e.g., low, medium, high) and - as far as possible- assessed or estimated quantitatively[8].

Within the risk assessment, all intermediate levels may be applied, such as residual risk, remote risk, very low risk or low to medium risk. The more granular the risk assessment is, the better it will be from an insurance perspective, hence impacting insurability and premiums.

To obtain insurance cover under a specific tax risk policy, it is mandatory to provide at least an estimated and comprehensible calculation of the potential tax risk. Non-quantifiable risks may be coverable under a W&I policy in individual cases, but not under a tax risk policy.

Finally, in his tax analysis for identified risks the tax advisor should include his own assessment of the tax risk. Specifically in case of disputed or unclear matters he should provide arguments in favour of or against the risk assessment and outline potential lines of defence. Of course such analysis has to be in line with the respective scope of the work deliverable. It is acknowledged that such technical matters would be less detailed in a tax due diligence report, whereas a tax opinion elaborates controversial aspects of tax issues in further detail with reference to relevant laws and their interpretation by the tax authorities, relevant case law and literature.

6. Summary and outlook

Depending on the type of tax risk, insurance cover can be provided under a W&I policy or under a specific tax risk insurance policy. However, the two types of insurance policies differ in terms of their possible uses, the objective, the scope of insurance and the amount of premium.

Specific tax risk insurance for known tax risks is a flexible and quite universally applicable tool covering transactional risks as well as specifically tax risks without transactional nexus, such as reorganisations and restructurings. In particular, specific tax risk insurance is useful for tax risk management for hedging against losses from tax risks or as an alternative to a binding ruling.

[8] Cf. Sec. 2.2 above.