M&A and PE Portfolio Solutions

Tax Insurance

Tax considerations play a critical role across transactions, ongoing business activity, and long-term planning. However, modern taxpayers are operating in an increasingly complex regulatory environment shaped by evolving laws, regulations, and enforcement practices. Securing proactive certainty around a tax position or resolving a historical tax exposure may not be practical with a shortened timeline or even available in advance from a tax authority.

Against this backdrop, tax insurance has evolved from a tool used in limited transactional settings into a more widely applied form of risk transfer. Today, tax insurance is used across mergers and acquisitions, corporate planning, balance sheet risk management, and numerous investment structures to help allocate tax risk and support clearer outcomes where tax uncertainty remains.

What is tax insurance?

Tax insurance provides financial protection if a tax authority challenges a well-reasoned and supported tax position. A tax insurance policy may be used in connection with an M&A transaction or as part of broader corporate tax risk management. It may apply to income and non-income taxes and may cover US and non-US tax risks at the federal, state, or local level, depending on the circumstances.

Tax insurance is not a standardized product. It is structured to address defined tax risks within a specific transaction or situation. Common forms of tax insurance policies available include:

- **Tax liability insurance** — addresses identified potential tax risks arising in connection with an M&A transaction, or on a company balance sheet outside of a transaction.
- **Tax credit insurance** — addresses potential tax risks related to the qualification, recapture, or transfer of federal, state, or local tax credits.
- **Tax return insurance** — addresses one or more positions taken on a specific tax return filed, or to be filed, by the insured.
- **Hybrid tax insurance** — addresses identified or unknown potential tax exposures in connection with a tax-focused investment such as tax equity financing, or to avoid holdbacks in the winding up or liquidation of a fund structure.

WHY USE TAX INSURANCE?	WHO USES TAX INSURANCE?
Reduces negotiation complexity and accelerates deal timelines.	Traditional buyers of tax insurance include:
Transfers defined tax risk from transaction counterparties to highly rated insurers.	Private equity and strategic corporate buyers in M&A transactions.
Supports exit planning by reducing reliance on post-closing indemnities.	Financial sponsors at the investment and fund level.
Addresses identified or disclosed tax risks not covered by a representation and warranty insurance policy.	Real estate investors and REIT platforms.
Limits the exposure of directors and officers to a company's potential tax risk.	Project developers, sponsors, tax equity investors, and tax credit buyers.
Provides a flexible alternative to an advanced tax ruling, APA, or PLR.	Corporations with significant tax liabilities.
Offsets the impact of financial statement tax reserves.	Corporate tax, finance, and legal leadership.
	Family offices and high-net worth individuals.
	Trustees and fiduciaries.

What does tax insurance cover?

If a covered tax position fails to qualify for its intended tax treatment, the policy is designed to indemnify an insured for losses arising from an unanticipated tax assessment, including taxes owed, related interest, and certain penalties. Coverage may also include costs incurred in responding to the challenge and taxes arising from the receipt of insurance proceeds (a "Gross-Up").

Tax insurance policies may be structured to address one or several tax positions in a single policy.

Representative areas where tax insurance is frequently applied include:

1 Transactional tax treatment

- Tax consequences embedded in transformation
- M&A tax elections, structuring plans, and withholding exposures
- Qualified Small Business Stock (QSBS) eligibility
- Reorganizations, spin-offs, rollovers, and deferral matters
- Internal restructuring and legal entity rationalization

2 Entity status and qualification

- Whether a taxpayer or target qualifies as intended
- REIT, S-Corporation, or partnership status
- US trade or business exposure (including FIRPTA)
- Eligibility to claim tax treaty benefits

3 Tax attributes, credits, and incentives

- Tax benefits underwriting value or yield
- Qualification for federal, state, and local tax credits and incentives for innovation and manufacturing
- Availability of net operating losses, carryforwards, and limitation risk
- Renewable energy tax credit qualification, transferability, and recapture risk
- Tax attribute and benefit generation, preservation, and utilization

4 Capital structure and valuation

- How tax positions affect value, basis, and returns
- Tax treatment of financing arrangements including debt versus equity tax treatment
- Asset and equity valuation for tax purposes
- Basis determinations, gain recognition, and cost recovery

5 Historical and ongoing tax positions

- Tax exposures that survive diligence, planning, and exits
- Tax positions related to prior periods or recurring activities
- Portfolio exits, fund wind-downs, and successor liability
- Tax consequences of generational ownership changes
- Estate tax treatment of closely held businesses

6 Income character and source

- How and when income is taxed — and to whom
- Capital versus ordinary income treatment
- Source, ECI, and cross-border income classification
- Pass-through allocations, income inclusion, and investor-level consequences
- Timing of recognition and deferral assumptions

7 Executive and equity compensation

- Tax treatment that impacts liquidity and compliance
- Deferred compensation compliance (409A, 457)
- Equity compensation and profit-sharing arrangements
- Employment and withholding tax obligations

8 Intercompany and operational taxes

- Tax consequences of business operations
- Transfer pricing, intercompany financing, and guarantee structures
- IP ownership, migration, and licensing structures
- Services, cost-sharing, and operational alignment

Policy features

Coverage: Tailored to the potential tax exposure being insured, and typically excludes misrepresentations by the insured, prospective changes in law (in the US, limited to Code and Regulations), and breach of certain obligations such as taking inconsistent tax positions.

Policy periods: Generally aligned with the applicable statutes of limitations for a tax assessment. For example, a tax insurance policy covering a US federal income tax exposure has a seven-year non-cancellable policy term. May be extended on an annual basis.

Limits of liability: The policy specifies an aggregate limit of liability, typically sized to the worst-case scenario tax exposure or tied to the relevant tax indemnity.

Retention: Self-insured retentions (akin to a deductible) are also on an aggregate basis and, depending on the nature of the tax risk, may be limited to a portion of the insured's costs to defend the challenge.

Cost: Premiums and underwriting fees, paid at once and up-front, are priced based on the coverage structure, strength of supporting analysis, jurisdictions involved, and examination status.

Process and timing

The process of procuring a tax insurance policy is intended to align with transaction timelines and ongoing tax planning activities. The process is initiated with Gallagher's review of the relevant facts and available tax information, a submission to tax insurers for evaluation, and followed by underwriting and issuance of a policy if terms are agreed. The entire process normally takes 10 to 15 business days, but may be expedited in an M&A scenario.

Insurers typically review, on a non-reliance basis, documentation prepared in the ordinary course of business, such as diligence materials, tax opinions, or filed tax returns.

Underwriters expect to perform confirmatory diligence of well-developed factual support and tax analysis, and may seek to conduct an underwriting call or interview financial, legal, or executive personnel. Requirements and timing vary based on the nature of the coverage and early consideration may provide greater flexibility in structuring.

An experienced broker plays a critical role in assessing suitability, coordinating with legal and tax advisors, presenting the risk clearly to insurers, and negotiating coverage that aligns with transaction or planning objectives.

State of the market

In the North American market, Gallagher has access to over twenty-five (25) insurers rated at least "A" by AM Best, S&P and/or Moody's.

In aggregate, the North American tax insurance market currently supports single-risk limits of liability exceeding $100 million, with multi-insurer capacity often approaching $1 billion, depending on the nature of the exposure and market conditions.

Contact us

As a top global broker, Gallagher's Tax team is uniquely positioned to help you navigate your tax insurance needs.

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