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India Inc takes cover to avoid Vodafone-like fate

Reghu Balakrishnan / Mumbai June 7, 2011, 0:35 IST

UK-headquartered Vodafone's cross-connection with Indian tax authorities has prompted many in India Inc to take insurance cover for liabilities arising out of mergers and acquisitions (M&As).

Praveen Vashishta, chairman and managing director of Howden India, one of the main players selling such insurance products, said there had been a visible increase in demand for tax opinion liability products. There were four-five enquiries three years ago. Last year, the number went up to at least 15.

Aon-Global and Marsh India are the other two main players in the segment. Besides tax liability, such products cover doubtful tax provisions in the target company's balance sheet which can be an obstacle during the transaction. Murray Wood, regional managing director, Aon Asia, said, "The use of transaction insurance products and tax liability insurance has increased significantly over the past 18 months."

Tax liability insurance is a key negotiation tool used by companies and advisers when a potential tax exposure has been identified and neither party is willing to bear the risk.

Vodafone has been battling a Rs 11,000-crore tax demand after acquiring Hutchison's India operations in 2007 in a $11-billion deal. Vashistha said earlier, warranty & indemnity insurance, as a whole, covered tax liability too. But, now, availability of a standalone tax opinion liability product has increased its popularity.

Howden India typically insures deals ranging from $50-400 million. The tax liability is calculated at 10-15 per cent of the deal size. The insurance premium is two-four per cent of the sum insured. In India, where tax authorities can reopen cases up to seven years after the transaction, the cover can come in handy. Aon Global, which has seen a 40 per cent increase in use of transaction covers, provides single-premium policies. The cover can be used for up to six years or during the applicable statutory limitation period. The policy covers the cost of the actual tax liability materialising, plus interest and defence costs.

Nishchal Joshipura, head of M&A Practice at Nishith Desai Associates, said, "The ability of tax authorities to reopen assessment of a transaction for up to seven years has resulted in prolonged uncertainty on taxability of cross-border transactions. On account of such uncertainty, the acquirers and sellers have started looking at innovative tax liability insurance products."

Global confectionery major Kraft's purchase of Cadbury in a $19.6-billion deal in 2010, after which Cadbury's India business also came under Kraft, has also come under the income tax department's scanner.

"Following the economic crisis, there has been a knock-on effect on the level of activity and stringency of authorities. This has resulted in a drop in the risk appetite of transacting parties. Where previously a potential tax exposure was borne by either the buyer or the seller, now there is a greater demand for certainty and protection offered by tax insurance," said Wood, adding that though the rise in demand was due to an increase in deal flow, both institutional investors and advisers were more familiar with the strategic use of these products.