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Can Tax Liability Valuation Risks be Insured?

A certain tax treatment may be dependent on a particular valuation of a company or underlying assets. In these cases there is usually no uncertainty relating to the interpretation of the tax law; the risk relates to an incorrect valuation, which may result in additional tax charges. The purpose of this tax bulletin is to discuss the insurability of valuation risks, with specific reference to the new rules relating to the disposal of commercial UK real estate by non-residents.

Changes in UK real estate taxation

Since 6 April 2019, all gains from UK real estate realised on disposal by non-residents, whether by way of direct or "indirect" disposal, will be subject to UK capital gains tax or corporation tax. Prior to 6 April 2019, capital gains realised by a non-resident on disposal of commercial real estate in the UK (held for investment purposes), was not taxed. (Note that where such real estate was held as "trading stock" in the past, it was taxed.)

Since 6 April 2019, a single UK tax regime will apply to sales of both residential and commercial UK real estate by non-residents, comprising:

1. A new UK tax charge for gains on "direct" sales of UK real estate.
2. A new UK tax charge for gains on "indirect disposals" of UK "property rich" interests. This will bring within the scope of UK tax disposals by non-residents of certain companies, partnerships and unit trusts holding UK real estate.

For the purpose of "indirect disposals", the charge will only apply to disposals of interests in "property rich" entities, i.e. entities where at least 75% of the value of the interest sold is derived from UK land. Certain exemptions may exist (notably in relation to "trading"), but it is not the purpose of this bulletin to discuss these in detail.

The new tax charge(s) will in each case only apply to gains arising since 6 April 2019 (i.e. property held at that date will be rebased to its current market value). Therefore, growth in value prior to 6 April 2019 will remain untaxed provided the real estate has been held on investment account.

Valuation risks

In the above scenario, valuations may affect the tax liability, broadly, under two scenarios:

1. The value of the UK based real estate on 6 April 2019, which will form the base cost for any capital gains tax calculation going forward where the is a "direct disposal" of real estate.
2. The value of shares (or other interest sold), which relate to UK real estate, in the case of "indirect disposals".

Should a valuation be incorrect, this could result in an increased tax liability.

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Insurability of valuation risks

Non-resident real estate owners may be pleased to know that it is increasingly possible to insure the valuation risk, i.e. the correctness of a certain valuation, in a tax context. Depending on the facts in each case, it should be possible to insure non-resident real estate owners against risks of additional tax charges due to incorrect valuations.

Before considering insuring such risks, insurers would likely wish to see a third party valuation performed in relation to the relevant property, alternatively another form of verification of the value. This information will be evaluated by the insurer's own advisors.

Premium pricing may depend on a number of factors (including excess levels), but is likely to be in the range of 3% to 8%.

Conclusion

Although this bulletin focused on the insurance of valuation risks relating to the new UK real estate taxation rules, valuation risks in other instances and other jurisdictions are also potentially insurable and are being insured. Valuations are often subject to challenge by tax authorities if a different valuation could result in additional taxes payable. Insuring these risks could go a long way in providing certainty to a taxpayer and help manage tax risks.

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