Business Protection

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One of the major risks facing any business is the loss of a key person in the organisation with all the associated knock-on effects which could have a serious impact on its ability to remain viable and solvent. However there are various forms of protection available and the 3 most common are Shareholder Protection, Key Person Cover and Loan Protection.

Shareholder Protection

This provides a lump sum in the event of the death or critical illness (if this benefit is included) of a company shareholder enabling the remaining shareholders to acquire the deceased's shares and retain control over the business.

The cover can be arranged on a level or escalating basis and can have a specified term where there is a specific requirement to cease the cover at a particular age (for example at 65). Alternatively it can be arranged on a whole of life basis, where the term will run on indefinitely e.g. if there is no intention of selling the shares at 65.

There are 3 main ways to set up these plans:

- **Own Life** - shareholders take out a plan in their own name. Each individual policy (where there are multiple shareholders) is placed in a business trust (a flexible interest in possession trust) from the outset. If one of the shareholders dies the remaining shareholders will then use the funds in the trust to buy the shares from the deceased's legal personal representatives.

  This is the most usual way to arrange cover and gives the greatest future flexibility.

- **Life of Another –** if there are only 2 or 3 shareholders each could take out a plan on the lives of the others. Any benefit is then paid directly to the surviving shareholders and no Trust is needed.

  This is not realistically an option if there are more than 3 shareholders or where ownership may alter in the future.

- **Company Purchase** – the Company takes out a plan on the life of each shareholder and has an agreement to buy the shares on death. This process must be allowable within the articles of association and meet a number of conditions outlined in the Companies Act 2006.

  This should be clarified with the company accountants before proceeding.

In all cases, a cross option agreement should be in place to ensure that the proceeds are used to buy the shares if either party wishes to do so.

NB: *If the company pays the premiums, you should inform your company accountant as it is likely that the premiums will be assessable on each of you as a benefit in kind and therefore liable to income tax and national insurance contributions. However the company should be able to claim a corporate tax deduction for the provision of the benefit and any employer national insurance due.*

If you do decide to pay the premiums personally, then it is important to equalize the premiums to ensure that the commerciality of the arrangement is maintained. If there is disparity in the premiums paid by each shareholder it could be argued that the arrangement isn't commercial thereby jeopardising the inheritance tax effectiveness.

JJFS are able to provide guidance on all aspects of share protection including Trust and Cross Option wordings.

Key Person Cover

This provides a lump sum benefit in the event of the death (or critical illness if this benefit is included at outset) of a key person within the organisation.

The cover can be arranged on a level or escalating basis usually with a specified term (5-10 years on average). It is generally arranged on a 'life of another' basis where the business owns the policy and the key person designated as the 'life assured'. The life assured has no rights of ownership to the policy and there are therefore no tax implications for them.

The amount of cover should be appropriate to cover loss of profits in the event of a key person's death / or diagnosis of a critical illness.

The premiums for this cover are generally paid by the business and the policy proceeds would be paid to them in the event of the life assured's death or earlier critical illness. ***NB*: *You should advise your company accountant about the premiums as they may be eligible for corporation tax relief.***

The proceeds can be used at the discretion of the business to assist in a number of aims (e.g. to pay off company loans or obtain the services of a replacement employee). Normally the policy proceeds are classed as a business trading receipt and taxed accordingly.

It is also possible to commence income protection cover on a key person basis. This can be done in one of two ways (or potentially both):

- **Key Person Basis** - where the replacement income would be for the benefit of the company to potentially fund a replacement employee for the incapacitated key person;
- **Executive Basis** - where the benefit is specifically to provide a replacement for the key individual.

Loan Protection

This helps businesses pay off outstanding business borrowings (e.g. overdraft, commercial loan/mortgage, directors' loan) in the event of the death or critical illness (if included) of the business owner or key person.

Having to repay loans can be a serious problem for a business following the death of a key person, particularly Directors' loan accounts which usually must be repaid on death. The business may therefore struggle to find the funds unless appropriate protection is in place.

Business loan protection works in a similar way to a life assurance policy and is taken out on the life of an individual within the business. When a valid business loan protection claim is made a sum is paid to help repay the outstanding debt.

For more information or to discuss your options please call us on 01789 263257or email justask@jjfsltd.com