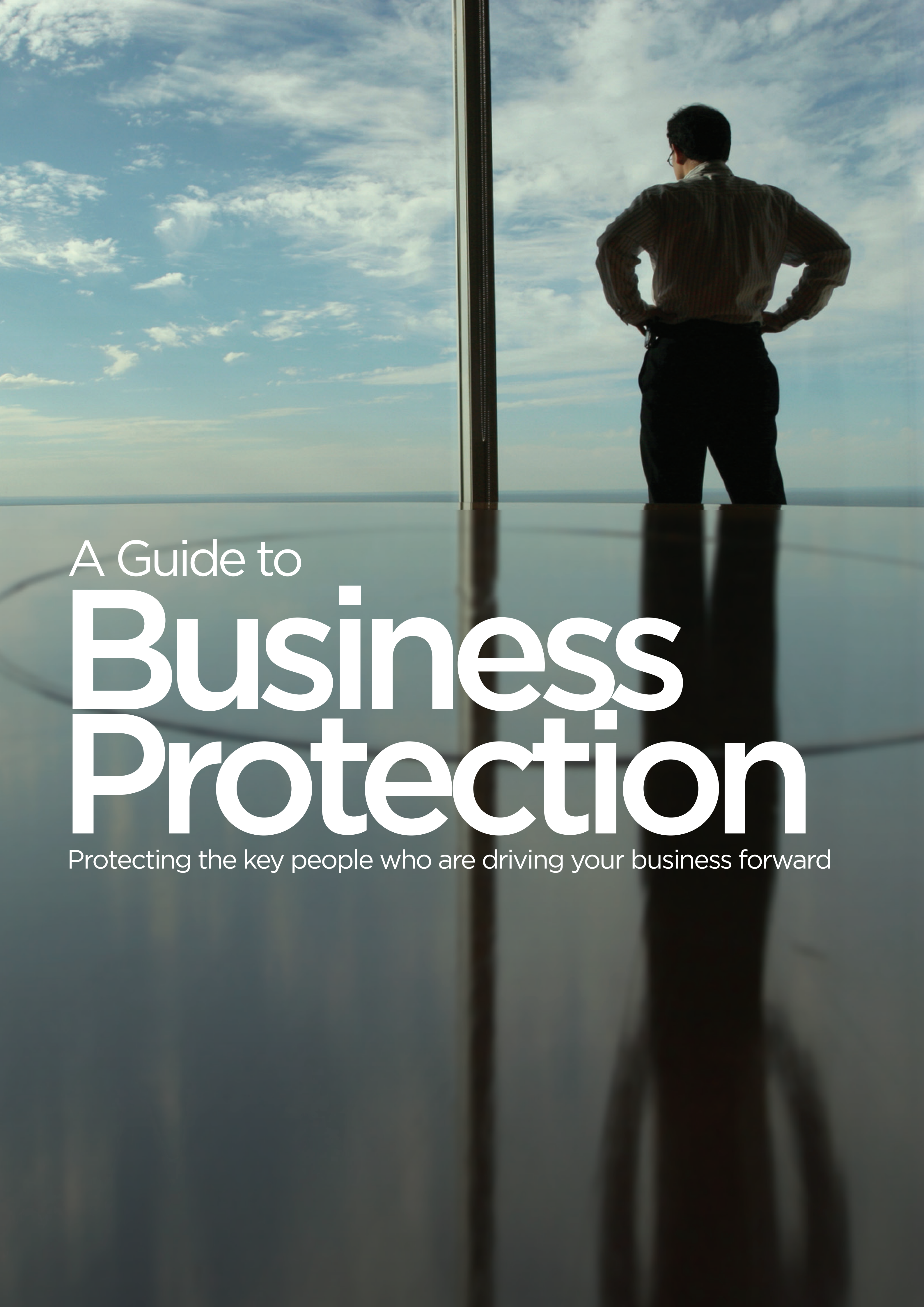

A Guide to Business Protection

Protecting the key people who are driving your business forward

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Welcome to 'A Guide to Business Protection'. Every business has key people who are driving it forward. Many businesses recognise the need to insure their company property, equipment and fixed assets. However, they continually overlook their most important assets, the people who drive the business – a key employee, director or shareholder. In this guide we look at key person, shareholding director and partnership protection.

Q: What is key person insurance?
A: Key person insurance is designed to compensate a business for the financial loss brought about by the death or critical illness of a key employee, such as a company director or other integral member of staff. It can provide a valuable cash injection to the business to aid a potential loss of turnover and provide funds to replace the key person.

Q: How could my business benefit from key person insurance?
A: You cannot replace the loss of a key person, but you can protect against the financial burden such an event may cause. Without the right cover in place you could also risk losing your business. Key person insurance can be utilised in a number of different ways – for example, to repay any loans taken out by the key person; to help recruit and fund the training costs for replacement staff; to meet the ongoing expenses while the level of sales recover; or to facilitate payments for outside consultants or expert advice that may be required.

Q: What type of key person insurance is available?
A: There are various options to choose from, including life cover only, critical illness cover, or combined life cover and critical illness cover. You can select different levels of cover and terms depending on your specific requirements and there are also policies available that pay out a regular income in the event of sickness.

Q: How is a key person policy taxed?
A: There are a number of issues to be aware of with regard to the taxation aspects of premiums and benefits. Because the premiums may be eligible for tax relief, HM Revenue & Customs (HMRC) require that the amount of benefit covered can be justified.

The premiums paid will be allowed as a business expense for corporation tax purposes provided that: the only relationship between the proposer and the life assured is that of employer and employee (except in the case of shareholding directors); the plan is designed to cover loss of profits only; the term of the insurance is reasonable – a five-year term is normally acceptable but some HMRC inspectors may allow up to ten years; and the employee does not hold a significant shareholding.

If the premium is a permitted allowable expense, then the policy proceeds would normally be subject to taxation. However, there are no hard and fast rules regarding the tax treatment of premiums and benefits, which is the ultimate decision of HMRC.

It is not the case that if the business decides not to apply for tax relief on the premiums, any proceeds will necessarily be tax-free. The taxation decisions rest with HMRC. It is therefore very important that the effects of taxation should be considered when arranging the policy.

Q: How is the level of cover calculated?
A: The cover required is measured by reference to the key person's contribution to the profits of the business. This may be based on the following information: past profits and projections for the future; the effect that the loss of the key person would have on future profitability; the anticipated cost of recruiting and/

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or training a replacement; the expected recovery period, for example, the length of time before a replacement is effective; and the amount of any loan(s) that would be called in on the death of the key person.

Q: Should a key person policy be written in trust?
A: No. Since the object of the policy is to pay a lump sum to the business on the death or incapacity of a key person, it follows that the policy should not be written in trust.

Q: What is shareholder and partnership protection?
A: Shareholder and partnership protection provides an agreement between shareholding directors or partners in a business, supported by life assurance to ensure that there are sufficient funds for the survivor to purchase the shares. It is designed to ensure that the control of the business is retained by the remaining directors or partners but the value of the deceased's interest in the business is passed to their chosen beneficiaries in the most tax-efficient manner possible.

If a shareholding director or partner were to die, the implications for the business could be very serious indeed. Not only would there be a loss of experience and expertise, but consider, too, what might happen to their shares.

The shares could pass to someone who has no knowledge or interest in the business. Or you may discover that you can't afford to buy the shareholding. It's even possible that the person to whom the shares are passed then becomes a majority shareholder and so is in a position to sell the company.

Q: What is a cross-option agreement?
A: By taking out a cross-option agreement you will determine what will happen to the shares in the business if one of the owners were to die or become critically ill. It is important that this agreement is not binding regarding sale of the shares, because this will prevent you from claiming relief from inheritance tax.

The shareholding directors or partners in a business enter into an agreement that does not create a legally binding obligation on either party to buy or sell the shares but rather gives both parties an option to buy or sell. For example, the survivor has the option to buy the shares of the deceased shareholder and the executors of the deceased shareholder have the option to sell those shares.

In either case it is the exercise of the option that creates a binding agreement; there is no binding agreement beforehand. This type of agreement is generally called a 'cross-option' agreement or a 'double option' agreement.

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