

HELPING YOU PROTECT  
THE LONG-TERM FUTURE  
OF YOUR BUSINESS



PROTECTING YOUR  
LIMITED COMPANY

# PROTECTING YOUR LIMITED COMPANY



Successful companies tend to devote a significant amount of their time to planning their business growth and strategy. However, recent research has shown that as few as 10% of companies have actively considered how they would cope with the loss, or long-term serious illness, of one of their key directors or employees\*\*. Not only could this have a major impact on the business itself but could also affect the company's ability to trade.

## For example:

- loss of key contracts
- banks asking for additional security over loans
- cash flow problems
- suppliers requesting early payment for goods and services
- cost of recruitment

## The main areas for the company to consider are:

- Protecting key employees - protecting profits
- Protecting business loans
- Protecting the shareholders and their families

# PROTECTING LIMITED COMPANY KEY EMPLOYEES



## Why is it needed?

The loss of a key employee could adversely affect the company's cash flow and ability to trade. If it is as a result of long-term illness, then there could also be additional contractual employment issues and costs to address.

## What can the company do about this?

The company can insure itself against the loss of the key employee through long-term illness or death.

## How would this help the company?

It would ensure that, in the event of the death or long term illness of a key employee, a lump sum benefit or an agreed income would be payable to the company. This would give the company additional cash flow to support the business recovery and fulfil its obligations.

## How is this arranged?

The company can propose for a life insurance and critical illness or an income protection policy on the life of the key person, with the company owning the policy and also paying the premiums. With advice, the company can agree upon an appropriate sum assured and the most tax-efficient way to arrange the protection plan.

## What are the tax implications?

The tax treatment of this type of key person cover is down to agreement with your local Inspector of Taxes. However, the generally accepted guidelines were laid down in 1944 by the Chancellor of the Exchequer, Sir John Anderson, and are known as the "Anderson Principles". In relation to the issue of tax relief he stated that:

- the relationship should be that of employer and employee
- designed to meet a loss of profits
- be short term in nature – taken as meaning 5 years.

If the above conditions are met, then it is expected that the premiums should attract tax relief (unless the key person is also a major shareholder when relief may be refused under the wholly and exclusively rule) and that the benefits payable would be taxable in the hands of the company.

This will be subject to agreement of your local HMRC Tax Inspector.

### Just the Facts

- Insure against loss of key employees
- Company own their own protection policy
- Ensures cash flow if loss takes place to protect profits
- Get good advice on appropriate sum assured and most tax-efficient solution

# LIMITED COMPANY BUSINESS LOANS



## Why is it needed?

When a company has sought additional finance to support its business activities, the lender may insist that the loan is repaid in the event of the death or long-term illness of one of the key directors/employees or shareholders. In addition, a director could also be a shareholder who has made loans to the company that their estate may request are repaid in the event of death or serious illness.

## What can the company do about this?

The company can insure these key individuals against the liability to ensure it has adequate cash flow to repay the loans.

## How would this help the company?

It would ensure that in the event of the loss of key individuals additional capital could be made available to help the company pay off all or part of the loans.

## How is this arranged?

The company can propose for a life insurance and critical illness policy on the life of the identified director/shareholder, with the company owning the policy and also paying the premiums. With advice, the company can agree upon an appropriate sum assured and the most tax-efficient way to arrange the protection plan.

## What are the tax implications?

It is generally accepted that tax relief for the company would not be available on the premiums payable for a life insurance policy effected for the purposes of loan protection, as this would be for capital purposes and not to meet a loss of profits. The proceeds would normally not be taxable as it is for capital purposes, although this is subject to HRMC approval.

### Just the Facts

- Insure against the repayment of loans on loss of key directors/shareholders.
- Company own their own protection plan.
- Ensures lump sum to help repay loans.
- Get good advice on appropriate sum assured and best solution.

# PROTECTING LIMITED COMPANY SHAREHOLDERS AND THEIR FAMILIES



## Why is it needed?

If a shareholder were to die or contract a serious illness, it is important that there is a robust and open process available to deal with the potential liquidation of their shares. This will ensure that the remaining shareholders can retain control of the company - and also ensures that the family of the shareholder in question is able to release the full value of the shares in an equitable, tax-efficient and timely manner, if required.

## What can the shareholders do about this?

The company should consider drafting a Shareholder Agreement that sets out the process in the event of the death or serious illness of a shareholder, with clear valuation and purchase guidelines. It is best to receive expert legal advice in this area to avoid costly disputes.

This may involve the drafting of "cross option" agreements, which provide legal undertakings for the shareholders. Therefore, the shareholders need to ensure they have adequate funds available to meet these obligations.

To meet these obligations, the shareholders may consider applying for life insurance and critical illness policies to the agreed value of their shares.

## How would this help the shareholders?

This ensures that each shareholder has arranged for the remaining shareholders to have adequate capital available to fulfil their obligations under the Shareholder Agreement. This would result in the family of each shareholder having the peace of mind that the estate would be able to release the capital value of the shareholding in a timely and tax-efficient manner, if required.

## How is this arranged?

Each shareholder can effect a life insurance and critical illness policy on their own lives. Dependant upon the wording in the Shareholder Agreement, this can be done as a life on another basis, own-life policy held under a business trust or company share purchase.

## What are the tax implications?

The shareholders would normally pay the premiums from their post tax income, so no relief would be available. If the premiums were payable by the business, then they would be taxable as if they were part of normal remuneration.

The policy proceeds would normally be free of tax - subject to suitably drafted trust wordings - and the policy proceeds may also fall outside the estate for Inheritance Tax purposes. It is important to receive expert advice in this area to fully understand the implications for inheritance tax and business property relief.

### Just the Facts

- Consider drafting Shareholders Agreement to meet loss of shareholder.
- Shareholders agree to life assurance to value of their shares.
- Enables family to release full share value without other shareholders losing control.
- Get expert advice on tax implications.



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