

HELPING YOU PROTECT  
THE LONG-TERM FUTURE  
OF YOUR BUSINESS



PROTECTING YOUR  
PARTNERSHIP

# PROTECTING YOUR PARTNERSHIP



Partnerships are defined in Section 1 of the Partnership Act 1890 as “the relationship which exists between persons carrying on a business in common with a view to profit”.

In England and Wales, the partners are jointly and severally liable to the full extent of the partnership liabilities. A partnership does not have a separate legal identity from the partners that comprise it, unless it is established in Scotland or is set up on a Limited Liability basis (LLP).

Whilst there is no legal requirement to have a written Partnership Deed - as the Partnership Act will apply in its absence - it is certainly advisable for all partnerships to seek specialist legal advice to draft an agreement that meets the partnership’s requirements. In particular, the agreement should address issues around the loss of a partner through death or serious ill health, especially where these events could have a major impact on the partnership’s ability to continue 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 partnership loans
- Protecting the partners and their families

# PROTECTING PARTNERSHIP KEY EMPLOYEES



## Why is it needed?

The loss of a partner or key employee could adversely affect the partnership's cash flow and ability to trade. If it is as a result of long-term illness, then there could also be additional issues around the partner still being entitled to a proportion of the partnership profits.

## What can the partnership do about this?

Dependent upon the structure of the partnership, it may be able to insure against the loss of the partner or key employee through long-term illness or death.

## How would this help the partnership?

It would ensure that, in the event of a claim, that a lump sum benefit or income would be payable to the partnership to give it additional cash flow to support the business recovery.

## How is this arranged?

In England and Wales, a partnership is not a legal entity and so is unable to effect a life policy in the name of the business. Therefore, they will need to take out the policy on the life of the partner or key employee and with the individual partners as owners or beneficiaries.

It is worth noting that Scottish partnerships and English LLPs are legal entities and so can take out a life policy in the name of the business on the partner or key employee.

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 and that the benefits would be taxable.

Where cover is effected on a partner, who is key to the business, rather than an employee, relief on premiums may be refused due to the lack of an employer/employee relationship.

### Just the Facts

- Insure against loss of partner or key employee
- Ensures payment met in event of a claim to support business recovery.
- Get expert advice on appropriate sum assured and tax relief.

# PROTECTING PARTNERSHIP LOANS



## Why is it needed?

When a partnership 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 partners. In addition, the partner could also have made personal loans to the partnership which their estate may request are repaid in the event of death or serious illness.

## What can the partnership do about this?

The partners can effect individual life policies, written in trust for the benefit of the other partners for the potential liability, to ensure that they have adequate cash available to repay the loans.

## How would this help the partnership?

It would ensure that, in the event of a claim, that a lump sum benefit would be payable to the partners to provide them with the additional cash to repay the loans.

## How is this arranged?

The partners can propose for a life insurance and critical illness policy on their own life with the benefits written in trust for the other partners. With advice, the partners can agree upon an appropriate sum assured and the most tax-efficient way to arrange the protection plan.

## What are the tax implications?

Where the business is a partnership, the premiums are not an allowable expense against the trading profits.

### Just the Facts

- Insure against loss of partner.
- Partners effect own life policies.
- Ensures lump sum to help repay loans.
- Get expert advice on appropriate sum assured and best solution.

# PROTECTING THE PARTNERSHIP AND THEIR FAMILIES



## Why is it needed?

If a partner were to die or contract a serious illness, it is important that there is a robust and open process available to deal with their share of the partnership. One option would be for a member of the family to replace them in the partnership, although their value and contribution to the partnership may be questionable. An alternative is for the family to seek to sell their share in the partnership. This will ensure that the remaining partners can retain control of the business and that the family of the partner in question is able to release the full value of the partnership in an equitable, tax-efficient and timely manner.

## What can the partners do about this?

The partners should consider drafting a Partnership Agreement that sets out the process in the event of the death or serious illness of a partner, 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” or automatic accrual agreement, which provide legal undertakings for the partners and, therefore, the remaining partners need to ensure they have adequate funds available to meet these obligations.

To meet these obligations, the partners are able to apply for their own life insurance and critical illness policies to the agreed value of their share of the partnership.

## How would this help the partners?

This ensures that each partner has arranged for the remaining partners to have adequate capital available to fulfil their obligations under the

Partnership Agreement. This would result in the family of each partner having the peace of mind that the estate would be able to realise the capital value of the partnership in a timely and tax-efficient manner.

## How is this arranged?

Dependant upon the requirements of the partnership agreement, partners can effect individual life and critical illness policies written in trust, either for their fellow partners under the “cross option” agreement or for their family under the automatic accrual agreement.

## What are the tax implications?

Where a partner effects a policy on his or her own life, the premiums will not be an allowable business expense. The policy proceeds may well be tax free, but may have inheritance implications, so it is essential that expert legal and tax advice is sought in drafting a tax efficient agreement and the subsequent life policies.

### Just the Facts

- Consider drafting Partnership Agreement to meet loss of partner.
- Partners agree to life assurance to value of their share in the partnership.
- Enables family to realise partner’s capital value without destabilising partnership.
- Get expert advice on appropriate sun assured and tax relief.



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