

HELPING YOU PROTECT
THE LONG-TERM FUTURE
OF YOUR BUSINESS



PROTECTING
YOUR BUSINESS

PROTECTING YOUR BUSINESS



There are over 2.3million business enterprises in the UK, comprising a mixture of corporate bodies, sole traders and partnerships*.

They range in both structure and size, with 89% of businesses employing less than 10 people, while 98.1% employing less than 50 people*.

Whilst there is huge diversity amongst the type and size of each business - with many facing unique challenges in the current economic climate - there is often a common theme in the success of these businesses over the longer term. The secret is their key employees.

This is where much of the entrepreneurial flair and drive originates, where the products and services are designed and built, and where the sales and marketing knowledge is developed to promote the business. It is also where much of the success derives from – yet it is also where a significant risk exists when this expertise is lost.

This may be the loss of a managing director with vision and drive; the losing of a market-leading technical expert, or the long-term illness of key sales and marketing staff. A recent survey suggests that as few as 10% of companies have suitable planning in place to protect themselves against this type of loss**.

This guide is designed to explain the main issues a business may face, and to suggest possible solutions and benefits of taking appropriate action alongside the company accountant, solicitor and Independent Financial Adviser.

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*Source ONS Online May 2009
<http://www.statistics.gov.uk/cci/nugget.asp?id=1238>

**Swiss Re Insurance Report 2005

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.

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.

BUSINESS PROTECTION FOR SOLE TRADERS



A sole trader is someone who trades on their own without the use of a company structure or partners. They are entirely liable for the debts of the business, so any protection they take out will be on a personal basis.

The sole trader needs to think carefully about what will happen to their business if they become critically ill or die.

Protection solutions for sole traders can be different to protecting a company or its shareholders, so this section looks at what business protection solution may be suitable for a sole trader. In the event of the death or the serious illness of a sole trader, the business could experience some of the following:

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

The main areas for the company to consider are:

- Protecting key employees - protecting profits
- Protecting business loans
- Protecting the sole trader's and their families

PROTECTING SOLE TRADERS KEY EMPLOYEES



Why is it needed?

The loss of a key employee could adversely effect 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 sole trader do about this?

The sole trader can insure against the loss of the key employee to ensure there is sufficient cash available in the business. It will also ensure the business can continue to trade for a period of time.

How would this help the business?

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

How is this arranged?

The sole trader can insure the life of the key employee, on the life of another basis. The sole trader would be the policy owner and the life assured the key employee, with the sole trader receiving the benefits in the event of a claim.

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.

Just the Facts

- Insure against loss of key employee
- Sole Traders owns the policy.
- Ensures business can continue to trade for a period of time.
- Get expert advice on tax relief

PROTECTING SOLE TRADERS BUSINESS LOANS



Why is it needed?

When a sole trader has sought additional finance to support their business activities, the lender may insist that the loan is repaid in the event of death or serious illness.

What can the sole trader do about this?

The sole trader can effect a life and critical illness policy, written in trust for the benefit of their family for the potential liability, to ensure that they have adequate cash available to repay the loans.

How would this help the business and family?

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

How is this arranged?

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

What are the tax implications?

If the sole trader applies for their own policy, then there would be no tax relief because of the personal nature of the cover. If the business pays the premiums, then this is treated as drawings, although the benefits may be tax free.

Just the Facts

- Insure the business against the repayment of loans on loss of sole trader.
- Sole trader effects own life policy.
- Ensures lump sum to help family repay loans.
- Get advice on appropriate sum assured and best solution.

PROTECTING THE SOLE TRADER FAMILY



Why is it needed?

As the sole trader is the owner of the business, then their fortunes and financial security is directly related to the success or failure of the business.

What can the sole trader do about this?

They can look to review their overall level of protection policies by identifying the issues that would arise in the event of death or critical illness. In addition, they should understand how they can protect their personal income in the event of long-term disability.

How is this arranged?

The business owner should look to ensure that their own personal life, critical illness and income protection are adequate to meet their financial objectives.

What are the tax implications?

There are very few, if any, tax benefits available as this is essentially personal protection cover.

Just the Facts

- Review overall protection policies.
- Need to protect personal income.
- Protection to meet financial objectives.
- Get good advice



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