Co-Shareholder/Partnership Assurance

Our experience is that for many business people their share of their business is often left to their loved ones via their Will, or in the absence of one, via the Rules Of Intestacy, however at such a time it is often the case that the beneficiaries of the shares (such as a wife and family) would need and/or prefer to know they could sell these shares for an agreed and fair value rather than having to either work in the business or rely upon profit distributions outside of their control in order to make ends meet.

Many of our clients have in their Articles Of Association or Partnership Agreements a pre-emption clause dealing with the offering of any shares to the existing shareholders **but unfortunately this neither insists any shares are purchased, nor provides the resources with which to do so.** Business assurance can therefore help with both these issues and insure that funds are available to surviving shareholders/partners to purchase any available shares and ensure that they maintain control of the business and also that the critically ill or deceased persons family are paid a pre-agreed and fair value for their interests.

It is possible therefore for each of the stakeholders to take out life assurance equal to the value of their stake holding and to place this policy in Trust so that any potential payout would be paid to each of the surviving stakeholders. A separate legal agreement known as a Cross Option agreement then provides options to both the deceased beneficiaries and the remaining stakeholders so that if either party wants to buy or sell the shares then the funds and the mechanics are in place to enable it to happen. This is known as a Double Option agreement.

The consequences of the above ensure that the beneficiaries get a pre-agreed and fair value for their shares and the remaining stakeholders purchase these shares increasing their own holdings and maintaining control over the business. What is currently an uncertain future/outcome for all parties has now become clear and agreed along with the resources to make it happen via the life assurance.

Critical Illness

In addition to a payout in the event of a stakeholder's death it is also possible to arrange the same level of cover to be paid out in the event that a stakeholder was diagnosed with having suffered from one of an agreed list of critical illnesses. The list for these is extensive and some additional information on these and some claims statistics are available upon request.

Unlike Life Assurance, this is an opportunity for the stakeholder themselves to directly benefit from the policies payout and therefore gives the stakeholder the peace of mind of knowing that they could, if they wanted to, resign from the business and sell their shares at an agreed and fair price to the remaining stakeholders.

Use Of Trusts

In itself, the establishment of business assurance policies will not provide an adequate solution to the problem of your business share value being unprotected. For the policy to pay out directly to the remaining stakeholders, and for the proceeds to be protected from inheritance tax, the business assurance must be set up within trusts. We can advise you on the appropriate type of trust to be established and inform you of your options in relation to issues such as the appointment of trustees, etc.

Cross-Option Agreements

A cross option agreement is required to set out the terms of the disposal of shares in the event of a stakeholders premature death or, if applicable, critical illness.

Under the terms of a cross option agreement, the surviving stakeholders have an option to buy ("call") the shares from the deceased stakeholders executors, and the legal representatives of the deceased stakeholder have an option to sell ("put") the shares to the surviving stakeholders.

If the surviving stakeholders want to buy the deceased stakeholders shares then the latter's legal representatives must sell them. Likewise, if the stake holding is offered to the surviving stakeholders then they must buy. *Because it is possible that neither party exercises their option there is no binding sale and business property relief for inheritance tax purposes is preserved.*

The agreement needs to specify the method of valuing the shares and the time limit for exercising the options. We therefore recommend that you instruct a solicitor to draft your cross option agreement as this is an essential part to the whole exercise.

In the event of a critical illness the Cross Option agreement referred to above has an additional “Single Option” clause added so that the decision whether to sell the shares or not rests only with the ill stakeholder and this person has an agreed length of time to make up their mind, usually 6 – 12 months

Valuing the shares

This is an important but sometimes difficult task as there are so many different ways to value a business and therefore you should certainly consider consulting with your accountants on this in order to make sure you arrive at a fair and commercially sensible figure.

It will then be this figure that is used to dictate the level of cover put in place on each of the shareholders or partners in the arrangement. Please note however that the value of your business is likely to change overtime, hopefully upwards, and therefore you should plan to review any cover you put in place to make sure it corresponds with the valuation formula in the cross-Option agreement and with your own/accountants opinion.

Cover should not however be excessive as this may lead to potential inheritance tax problems nor should it fall short by much at anytime otherwise it may leave remaining stakeholders looking to find cash or borrowings to meet their obligations to beneficiaries.

The Premiums For Life Cover & Critical Illness

Please note that HMRC do not regard the premiums to be tax deductible against business income as the policies are not wholly and exclusively for the purposes of the business.

Also, in order to avoid any potential inheritance tax on any potential payout, the whole transaction must be a fair and commercial transaction and therefore the premiums would need to be apportioned to stakeholders in accordance with their stake holding, their age and their likelihood of benefiting from the arrangement. This has the effect of the younger stakeholders paying (according to their stake holding) more of the premiums of the older shareholders on the basis, say HMRC, that they are more likely to benefit under the arrangement because they are younger.

The premiums for each stakeholders policy can either be paid by them in full out of after tax income and then the accountant can adjust the figures when carrying out an equalisation exercise at the end of the year or the premiums can be paid from the business bank account and then the equalised figures taxed as a P11D benefit. For personal cash flow reasons many clients often choose the latter.

I hope the above has been reasonable enough to follow however if you have any questions then please do not hesitate to give me a call on 01792 234875.

Many thanks for your time and interest.