GD

GIBBS DENLEY

FINANCIAL PLANNING

Financial Planners

Chartered

GUIDE TO BUSINESS PROTECTION

FOR GIBBS DENLEY FINANCIAL PLANNING

financial@gibbsdenley.co.uk

www.gibbsdenley.co.uk

INTRODUCTION TO BUSINESS PROTECTION

Business Protection is the umbrella term for a collection of life insurance policies that are designed to protect your business if a key member of staff were to die unexpectedly, or become incapacitated through accident or illness.

Like most forms of life insurance, we all hope that it is never needed. However, knowing that the policies are in place can give you and your employees peace of mind that if the worst should happen, your business will be protected, minimising disruption to the business and ensuring your family's inheritance is also protected.

When looking at Business Protection, a good place to start is by thinking about a business interruption plan. This should ensure the continuation of trade in extreme circumstances, such as a flood, fire or computer failure that prevent business continuing as usual.

Most people understand these key risks, and general insurance policies are available to provide the appropriate cover for buildings, stock, data and income.

However, the business interruption plan and general insurance policies won't necessarily address the impact of losing key staff through death or illness. Some key questions to ask yourself include:

- If you became ill, or died, would your business recover from the loss of profits caused by your absence?
- Does your business have loans that would have to be repaid?
- What contingency plans are in place in the event that one of your key staff or fellow directors falls ill, or dies?
- Would you or your colleagues be able to keep control of the company if a major shareholder died?

Failing to plan for events such as these could prove disastrous to the future of the business, but by taking out the appropriate insurance you can plan to mitigate their impact by:

- Ensuring any business debts are repaid
- Providing a cash injection to help find and replace key staff
- Purchasing shares from the estate of a deceased business partner or director

The cover required largely depends on the type and size of business you run and the risks that are identified.

This guide will lay out the four main aspects of Business Protection and help you to identify which might be correct for you. However, we recommend that you always seek the advice of a qualified professional before purchasing any cover.

BUSINESS PROTECTION INSURANCE AT A GLANCE

	What is it?	Who is covered?	Who benefits?
Shareholder Protection	Insurance bought by businesses to provide funds to help purchase shares, if an owner / shareholder dies or suffers a critical illness.	The business owners / partners / directors.	Policy proceeds are paid to the remaining owners so that they can buy the shares from the deceased's estate, thus retaining control of the business.
Key Person Protection	Life insurance purchased by a business, designed to pay out if a key member of staff dies or suffers a critical illness.	Any key member of staff, e.g. chief executive, finance director, salespeople, director or owner.	Policy proceeds would be paid directly to the business, giving it a vital cash injection to help recruit a suitable replacement, or mitigate lost profits.
Business Loan Protection	Life insurance purchased by a business, which aims to clear business debts if the guarantor dies. Cover for critical illness is often available as an option.	Anyone who has guaranteed these debts.	Policy proceeds are paid to the business, ensuring debts can be repaid.
Relevant Life Policies	A tax-efficient individual life insurance policy that company directors and owners can buy through their business, provided they are classed as an employee.	The employees of a small business.	The family of the insured individual.

SHAREHOLDER (OR PARTNERSHIP) PROTECTION

When an owner or partner in a business dies, their share of the business often passes to their family.

This could mean that control of the business passes to someone who has no experience of, or interest in, running the business; or who may have conflicting ideas on the firm's strategy.

Another possibility is that the beneficiary may wish to sell their stake, but the remaining owners struggle to raise funds to buy back the shareholding.

To mitigate these possibilities, Shareholder (or Partnership) Protection allows the remaining owners to buy back the shares, giving the deceased's family a cash sum and ensuring that the surviving business owners retain control of the company.

There are two parts to this arrangement:

1. A life insurance policy designed to pay out on the death of one of the owners
2. A legal agreement setting out how the shares are to be repurchased based on an agreed valuation method

How it works

Each owner takes out a life insurance policy equal to the value of their share in the business.

These policies are written in trust from the outset, for the benefit of the other business owners (or partners, if it is a partnership). Critical illness cover can also be included.

Each individual pays the premiums on their own policy; the cost will vary between owners, depending on their age, health and other factors.

If any of the owners die, their insurance policy will pay out, providing sufficient funds for the other owners to buy the remaining shares of the business.

The owners will also sign a Share Purchase Agreement, detailing how the shares of the business can be bought and sold. This legal document is used to ensure that the cash proceeds of the insurance policy are used to purchase the shares and that the inheritors of the shares will sell them if asked to.

It is sensible to consult the Articles of Association or Partnership Agreement to ensure it does not conflict with the Shareholder or Partnership Protection arrangement

Premium Equalisation

Where a significant difference in costs and benefits exists, HMRC may view this situation as conveying a gift between the participants, with the potential for the premiums and policy proceeds to be subject to Inheritance Tax (IHT).

Therefore it is recommended to equalise the premiums, so that each person covered pays their 'fair share' in line with their likelihood of benefiting from the cover. This helps demonstrate that there is a fair distribution of costs between participating individuals and that the arrangement is commercial in nature.

Gibbs Denley can assist with working out the equalisation of premiums for your arrangement.

Valuing your business

The business may be valued by a number of methods. For example, using the open market value, an agreed fixed value from the outset, or a ‘fair value’ determined by an independent auditor / valuer.

Don’t forget to review your Will

In their Will, business owners should state who will inherit their share in the business.

Where a Shareholder Protection arrangement has been entered into, it is important to ensure that this doesn’t contradict the Will. We therefore recommend that you review your Will with your legal adviser.

KEY PERSON PROTECTION

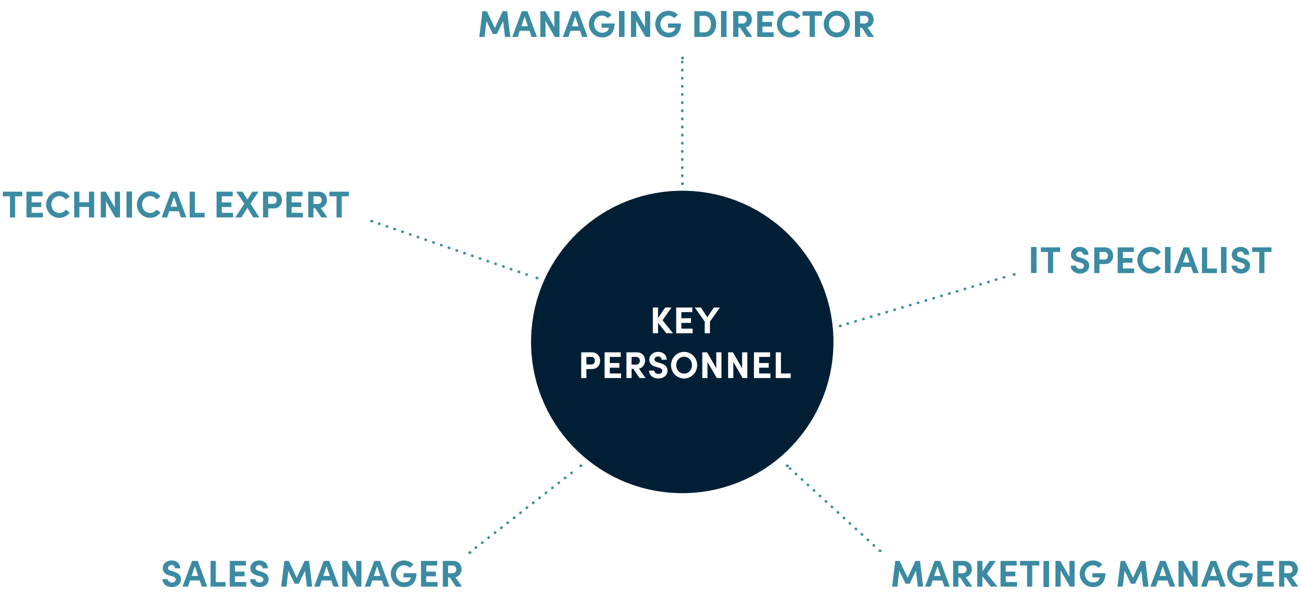
Insuring your business' key individuals is arguably just as important as the more obvious cover for the trading premises, fixtures and fittings. Vulnerability can occur where a vital employee becomes critically ill, or dies.

The absence of any key person can cause problems. As well as losing their knowledge and experience, you may find that it affects creditors' and lenders' attitudes, resulting in cashflow problems, or affects relationships with your key clients. You may have to rethink or even abandon plans for the company's future.

The first step is to identify those individuals who are essential to the success of your firm. If you think that their loss would have a significant financial impact, then Key Person Protection can provide a cash injection to the business while a replacement is found, or while the individual recovers.

Who is a key person?

Virtually anyone could be a key person, but the positions that are typically seen as key to a business are:



How is cover calculated?

Typically, cover will be arranged around the cost of replacing the individual based on a multiple of their earnings. For example, 10 x salary for life cover, with a lower figure (5 x salary) for Critical Illness cover.

Another method is to look at replacing the profits that the key person is responsible for. As a guide, cover may be arranged for, say, twice the gross annual profit they generate or five times the net profits attributable to that person.

The smaller the business, the greater the risk.

Research has shown that if a key person died or became critically ill, four out of ten businesses would cease trading within a year.

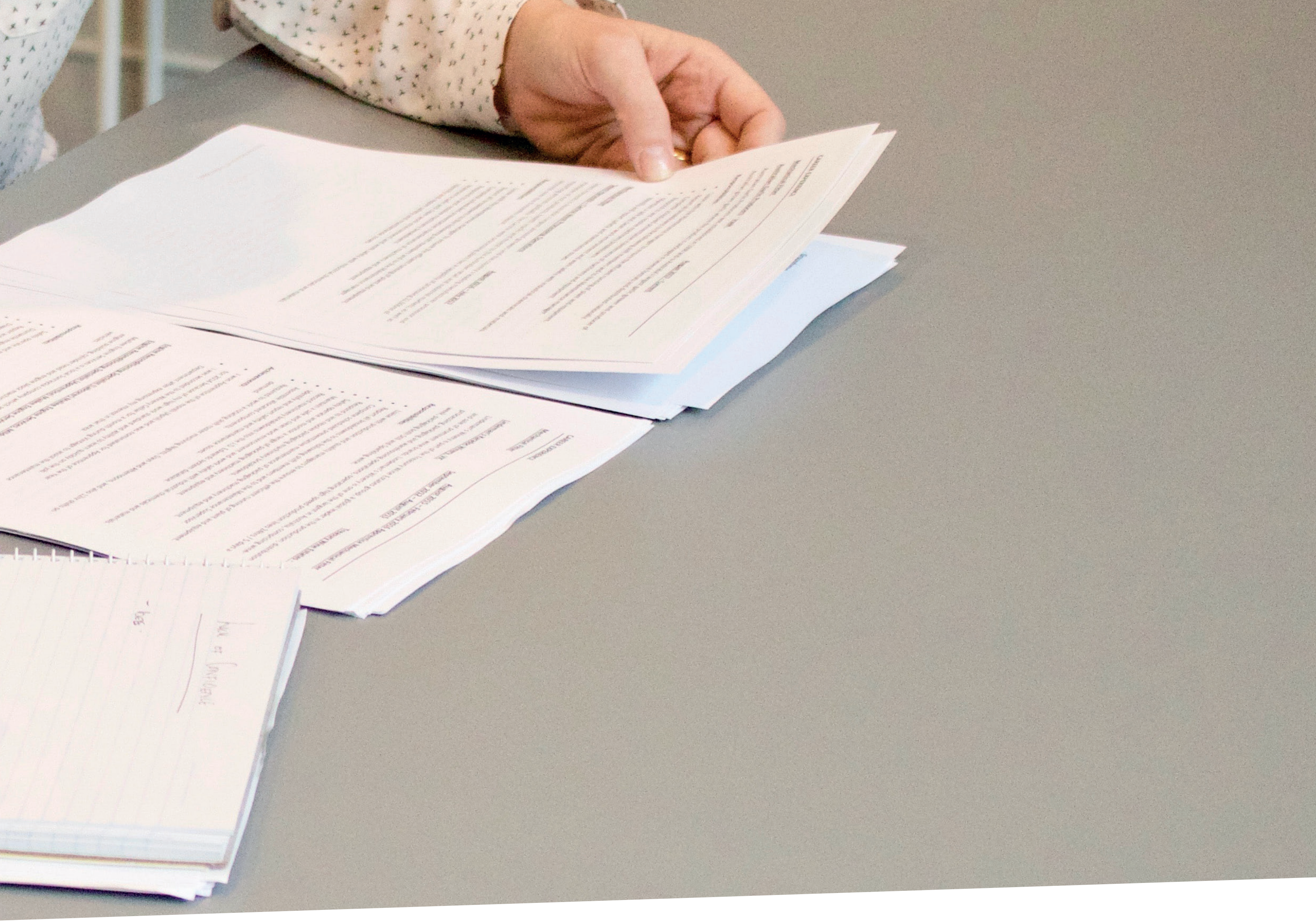
Taxation of Key Person policies

It may be possible to offset the cost of Key Person Protection insurance against your Corporation Tax bill, as it is often treated as an allowable business expense.

If the premiums have been offset against profits, any payout from the policy will form part of the company's revenue (trading receipts) for that year, which may increase your overall Corporate Tax bill.

In order to offset the cost of this insurance against tax, certain criteria conditions have to be met:

- The policy is a short-term insurance. HMRC does not stipulate a length of time, but takes into account how long the employee will be of benefit to the business. The policy should not be for 'whole of life', or extend beyond the employee's contract of employment.
- The policy is intended to cover loss of profits.
- The relationship is between employer and employee. Owners and controlling directors can be covered, although they are unlikely to receive tax relief on the premiums as HMRC may argue that the policy proceeds are primarily for the benefit of the person covered, because they own a majority of the shares.



BUSINESS LOAN PROTECTION

Most people take out life assurance to cover their personal debts in the event of their death, for example to clear their residential mortgage.

Small businesses often carry some form of debt too, such as overdrafts or commercial mortgages and loans (including Directors' Loans), but neglect to put in place an insurance policy to cover these.

This means that if the owner died, or was taken critically ill, there may not be sufficient liquid funds available to redeem the loans.

If a business fails due to the death of the owner (or a partner), and there are insufficient assets to cover the debts, the lender could seek repayment from the guarantor or their estate.

This could mean that your personal assets (including your home) may be at risk, and could mean that your family is liable for repaying any business debts.

Similarly, Directors' Loan accounts must be repaid upon the individual's demise. This means that the business may have to sell assets at short notice to raise the necessary funds. If your business operates a Directors' Loan facility, how would this be redeemed in the event of your demise?

Business Loan Protection can insure any outstanding debt so that, in the event of the guarantor's death, funds are made available to ensure the loan will be repaid.

This helps to protect the business, including the partners, directors and employees, as well as their families.

Sadly, only around half of small to medium-sized companies insure their debts, meaning that they are at risk if the guarantor dies.

RELEVANT LIFE POLICIES

A Relevant Life Policy is life assurance that is paid for by the business, to cover directors or employees.

If the insured person dies, their family receives the payout, not the business itself.

This type of insurance is also sometimes known as a ‘death-in-service’ benefit. Larger employers usually have a policy covering all of their staff, although this is often linked to their pension scheme.

For smaller businesses it isn’t always possible or cost effective to set up a group death-in-service scheme. This is where a Relevant Life Policy can be useful.

Relevant Life Policies only cover individuals who receive a salary from the business. Therefore, sole traders / partners are not eligible for this type of cover (however, this does not preclude them from arranging individual life assurance, paid for out of their personal income).

A Relevant Life Policy can be used to cover company directors and business owners, provided it is a UK company and they receive a PAYE salary.

Taxation of Relevant Life Policies

Relevant Life Policies are tax-efficient because the premiums are usually an allowable business expense, which means that they can be offset against the Corporation Tax bill.

Contrast this to setting up personal life assurance paid for out of your post-tax (or net) income, which effectively works out much more expensive after your remuneration has been subject to Income Tax, Employers’ National Insurance and Employees’ National Insurance Contributions.

Therefore, higher-rate Income Taxpayers in particular can find that it is much cheaper to purchase the same level of life assurance cover through a Relevant Life Policy.

Other benefits of Relevant Life Policies

- It is distinct from pension contributions, meaning the pension ‘lifetime allowance’ (£1,073100 for 2022/23) is unaffected.
- Individual cover, meaning that if a director or employee leaves the company, they can maintain their policy without further underwriting, simply by taking over payment of the ongoing premiums personally.
- More comprehensive cover. Typical death-in-service cover pays out three or four times an employee’s salary; Relevant Life Policies can insure up to 25 times your earnings (depending on your age and the insurance provider).

Furthermore, total remuneration can be taken into account, including (for example) salary and dividends, opening up further tax planning opportunities without affecting the level of life cover in place.

FURTHER SUPPORT: GIBBS DENLEY'S COMMITMENT TO YOU

Gibbs Denley Financial Planning are Chartered Financial Planners, with over 30 years' experience. We offer independent and impartial planning advice on a wide range of investments and wealth management, retirement and Inheritance Tax planning, as well as workplace and personal pension schemes.

We are committed to providing high standards of customer service and continual professional development of our staff, offering advice that is tailor-made for your personal circumstances.

In relation to the tax implications of business protection, this guide has only outlined the current practice for the more common situations.

Tax treatment can vary depending on the structure of the business, the purposes for which the insurance has been taken out, the legislation in force at the time and the individual tax position of the plan holders.

Gibbs Denley are happy to provide individual advice tailored to your requirements and will engage with your finance team, accountant and legal advisers, to arrive at the most appropriate solutions for your business.

Please contact a member of our team to discuss your requirements.

We look forward to working with you.

Cambridge

Crystal House, Buckingway
Business Park, Swavesey,
Cambridge. CB24 4UL

Tel: 01954 233 650

Bury St. Edmunds

55 Abbeygate Street,
Bury St Edmunds,
Suffolk. IP33 1LB

Tel: 01284 722 600

Chelmsford

59 New London Road
Chelmsford,
Essex. CM2 0ND

Tel: 01245 290 702