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GUIDE TO BUSINESS PROTECTION



WHAT IS BUSINESS PROTECTION?

Business protection is an insurance that helps business owners plan for the unexpected by providing cover to ensure the business can continue with minimal disruption following the loss of one of their key employees or one of the business owners through death, critical illness or temporary disablement. It is an area often overlooked by many businesses.

In this guide we provide information on the different types of business protection policies available to you and provide you with the questions you should be asking yourself to determine whether you and your company need business protection or not.

Please note: This is just a guide and does not constitute any financial advice or advice on what business protection is right for you and your business. To ensure you have the right policies in place, please seek regulated financial advice.

What different types of business protection are available?

There are several different types of business protection available, these include policies for partnerships (including limited liability partnerships), shareholders, sole traders and key employees.

Business protection can also be used to ensure the repayment of a business loan in the event of death or critical illness of a partner, key person or sole trader.

How the arrangement is set up will depend on the type of business and its particular needs. Below is a summary of the most common types of business protection arrangement.

Key person protection and you

Limited Companies

Where you are deemed a key person, where key person protection for companies is concerned, there are two solutions:

- Life of another
- Own life in trust

Under the 'life of another' solution, the company takes out a policy on the life of you, the key person. If you suffer a critical illness or die, the policy benefits will be paid directly to the company. The funds can also be used to meet the company's financial needs while it re-organises or recruits a replacement.

In the case of a critical illness claim, it's possible you will return to work, so the funds can be used to pay for your temporary replacement or replace lost profits.

If, however, you are a key person and a shareholding director, you can take out a policy on your own life and write it in to trust.

Your other shareholders would be the potential beneficiaries of the trust. In the event of you suffering a critical illness or dying, your other shareholders will receive the proceeds of the policy from the trustees and if needed, they can inject additional capital into the business.

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Limited liability partnerships

Similar to a limited company, a limited liability partnership has a separate legal persona. Therefore, it is possible for a limited liability partnership to take out a policy on the life of a key person in the same way a company would.

Partnerships

It depends on whether you are a partner or an employee, as there are different solutions for partnerships. Below we explore this further.

If you are a Partner

Where you are a partner, you can take out a policy on your own life and write it in to trust for the benefit of the other partners of the company. Usually, the other partners of the company will also enter into reciprocal arrangements.

In the event of death or diagnosis of a critical illness of one of the partners, the proceeds of the policy can be paid to the remaining partners.

If you are an Employee

Partnerships in England, Wales and Northern Ireland are not separate legal entities. Therefore, if you are an employee, the partnership cannot take out a policy on a 'life of another' basis.

In this situation, one of the partners can take out a policy on the life of the key person and write the policy in to trust for the benefit of the partners of the firm. If the key person suffers a critical illness or dies, the partners can receive the plan proceeds from the trust.

Please note: Partnerships in Scotland are separate legal entities. This means in Scotland, if the key person is an employee, the partnership can take out a policy on a 'life of another' basis.

Sole Traders

If you are a sole trader, you may require protection for both yourself and a key employee. As a sole trader you could take out a policy on your own life and write the policy in a discretionary split trust for the benefit of your family.

This will ensure that in the event of death, your family will have funds available to settle any business liabilities, like a business loan for example.

The split trust contains a carve-out provision so that in the event of the settlor of the trust (in this case you, the sole trader) surviving diagnosis of a critical illness by 30 days, the proceeds of the policy will be held for you – the settlor. In this case, you can then meet the financial responsibilities of the business.

Clearly, if you are a sole trader, you will be a key person in the business. However, it is possible you may employ someone who is also key to the success of the business.

In this situation, as a sole trader, you can take out a policy on the life of that other key person so there are funds available to meet the financial responsibilities of the business in the event of the key person's death or critical illness.

Ownership protection

The loss of a partner, member or shareholder, whilst being a difficult period, can also have a major impact on the success of a business in terms of ensuring continued control for the remaining owners.

Individual purchase – Companies, Limited Liability Partnerships and Partnerships

Under an individual purchase arrangement, each business owner takes out a protection policy on their own life for the value of their share of the business. The policies are written in to trusts for the benefit of the other co-shareholder, members or partners.

In the event of the death or critical illness of one of the business owners, the others will receive the proceeds of the policy from the trust to enable them to fund the purchase the shares of the deceased or critically ill business owner.

Alternatively, if there are only two or three owners, it is possible for each owner to take out plans on each other's lives so that in the event of one of the owners dying or suffering a critical illness, the proceeds of the plan will be payable to the surviving business owners.

In both cases it is recommended that a cross-option agreement is made between the business owners in order to regulate the sale and purchase of the share of the business.

The cross-option agreement provides that on death or critical illness, the deceased's personal representatives have the option to sell the deceased business owner's share of the business and the surviving business owners have the option to buy it.

The cross-option agreement usually provides that the options must be exercised within 3 months of the date of death or critical illness and once either party to the agreement exercises an option, the agreement becomes binding on the other party. For critical illness it is also possible for the agreement to give the person suffering a critical illness the option to sell immediately.

The option for the other owners would be deferred for a period, typically 12 months, and could only be exercised if the ill person does not return to work within that period.

Company share purchase

The rules are extremely strict, however, it is possible for a company to purchase the shares of a deceased or critically ill shareholder.

In this situation, the Company would take out a policy on the life of the shareholder so that in the event of their death or critical illness, the proceeds of the policy would be payable to the company enabling it to purchase the shares of the deceased or critically ill shareholder.

A cross-option agreement should also be made between the Company and the shareholder.

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The pros & cons of the different types of business protection

THE PROS:

Provide a financial safety net in the event of the death or critical illness of a key person.

Provide funds to the remaining partners or shareholders so they can buy-out the critically ill partner or shareholder or purchase the deceased's shares from his or her estate.

Provide funds to ensure repayment of a business loan in the event of death or critical illness.

Ensure business continuity by providing funds available to the remaining shareholders or partners to enable them to purchase the deceased or critically ill shareholder or partner's share of the business.

Ensure the deceased's family or the critically shareholder or partner receives a fair value for their share of the business

THE CONS:

For own life plans written in trust, it is recommended the premiums on each of the plans are equalised to ensure commerciality.

A charge to income tax under the Pre-Owned Asset Tax (POAT) legislation may arise where an own life plan is written in to trust. This is because the settlor of the trust is usually also included as a discretionary beneficiary of the trust. Accordingly, where the policy pays out on critical illness or terminal illness and the funds continue to be held in trust, a charge to income tax could arise under POAT.

The Companies Act 2006 sets out strict rules which must be complied with in relation to a company buying back its own shares.

Company buy back arrangements are generally not suitable for new companies since the shares must have been held by the seller for at least five years. Otherwise, the buyback may not be treated as a disposal for capital gains tax but rather a distribution which could result in a higher tax liability on the sale of the shares.

Life-of-another plans may not be suitable where there are more than two or three partners or shareholders in the business as this could result in multiple plans being written. For example, a four-shareholder company could require twelve plans – shareholder A takes out plans on each of the lives of B, C, and D etc.

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Do you need business protection for your company?

As we mentioned at the beginning of this guide, business protection is often an area to often overlooked. It is critical to consider and understand the impact the loss of a key person, partner or shareholder would have on your company. In addition to understanding the impact, it's crucial to understand the role trusts play in business protection.

Here are some questions for you to consider:

- What would happen if your top sales person was to suffer a critical illness?
- What impact would this have on your revenue?
- Could your business survive until a replacement was found?
- What would happen if you or one of the partners in the company died?
- Would the remaining partners have enough funds to buy out the deceased's partner's shareholding from their estate?

If you're unsure on the answers to any of the above questions, or would like further clarity/input on the possibilities available to you and your business, speak to a regulated financial adviser.

A financial adviser will be able to provide you with the best type of policy to take out and whether the policy should be placed in to trust.

There are also possible tax implications to consider where business protection is concerned – this will depend on the type of arrangement in place. Tax relief is possible if the life assured is an employee and the policy is for a short term (less than 5 years).

Policy proceeds paid to a limited company or limited liability partnership are likely to be taxed as a trading receipt. However, if the policy is taken out by a partner on the life of a key employee and written in to trust, the policy proceeds will generally be paid out free of any tax.

A financial adviser can explain any potential tax implications in full detail, helping you to understand any policy in full before you decide on which business protection to take out.

Other things to consider

- Charges to income tax under the Pre-Owned Asset Tax (POAT) legislation may arise where an own life plan is written in to trust. This is because the settlor of the trust is usually also included as a discretionary beneficiary of the trust. Accordingly, where the plan pays out on critical illness or terminal illness and the funds continue to be held in trust, a charge to income tax could arise under POAT.
- Periodic and exit charges – It is usually the case that where a policy is written in trust in a business protection arrangement, the trust will be a discretionary one. This means that it will fall within the relevant property regime. Although unusual in a business protection arrangement, in the event that the proceeds of the policy are left in the trust following the tenth anniversary of the creation of the trust, any proceeds which exceed the nil rate band applying at the tenth anniversary, will be subject to Inheritance Tax (IHT) at a maximum of 6%. In addition, any capital distributed from the trust between tenth anniversaries will also be subject to an “exit” charge which is calculated with reference to the periodic charge.

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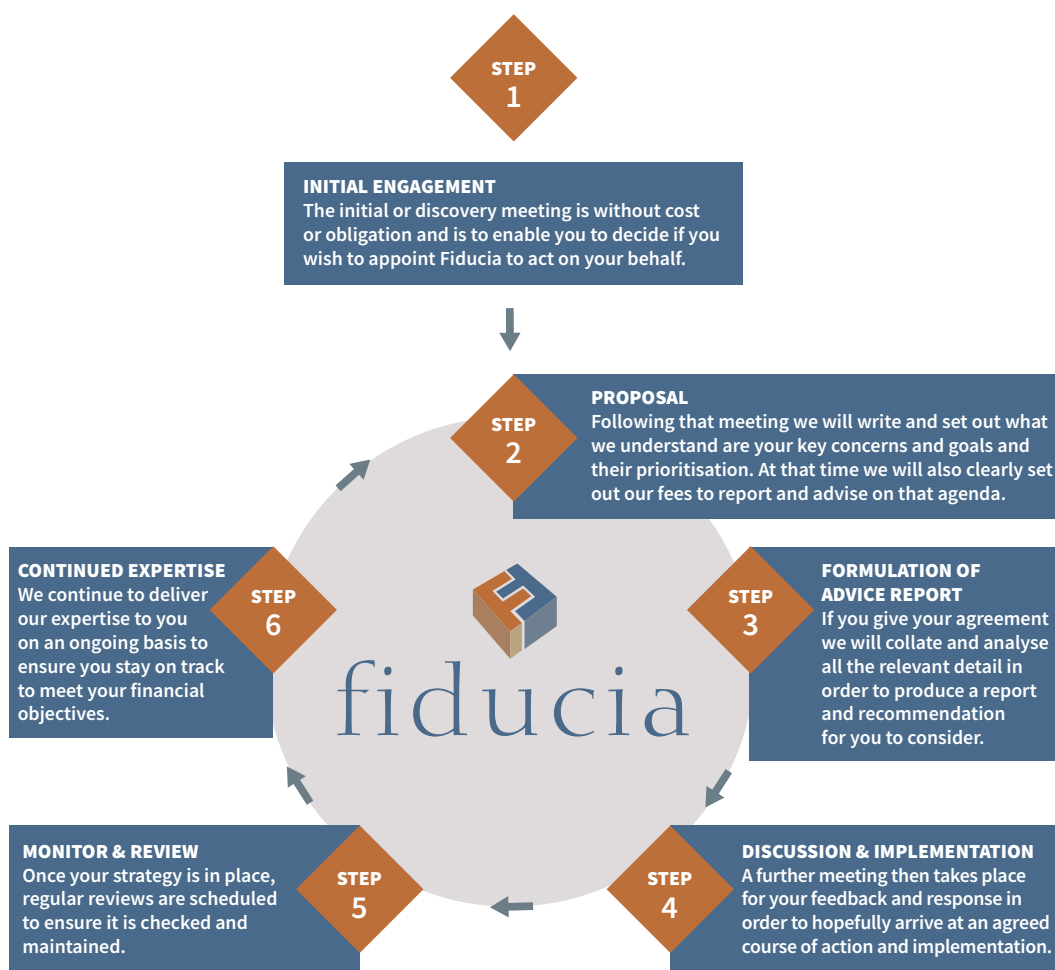
HOW CAN FIDUCIA HELP YOU?

Fiducia Wealth Management are a well-established multi award-winning firm of Chartered Financial Planners with a proven track record of delivering outstanding wealth management and financial advice to private clients, business owners, family estates, charities, pension funds and trustees on tax, investments, and financial planning.

Our offices are in Dedham on the Essex/Suffolk border and in Chelmsford.

We provide our expertise to a diverse range of clients throughout the East of England, London, and the UK nationwide. Integrity, openness and transparency are our core values, and we recognise that no two client's requirements, situations and objectives are the same – our solutions are therefore bespoke to help you meet your financial goals and later life needs in the most tax efficient way.

We follow a tried and tested six step process to identify your financial objectives to determine the right business protection you need for you and your business.



Are you ready to identify what business protection you need?

Speak to our team today, arrange your FREE initial discovery meeting and start your journey to achieving your financial goals.

Visit: www.fiduciawealth.co.uk

Email: email@fiduciawealth.co.uk

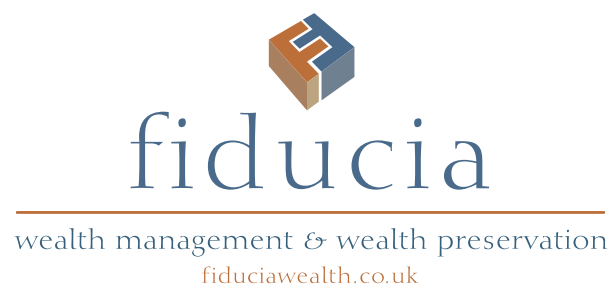
Telephone: 01206 321045

Visit our office:

Dedham Hall Business Centre
Brook Street,
Dedham
Colchester
Essex CO7 6AD.

Also at: Saxon House,
27 Duke Street,
Chelmsford,
Essex CM1 1HT.
Telephone: 01245 950922.

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Dedham Hall Business Centre, Brook Street, Dedham, Colchester Essex CO7 6AD. Telephone: 01206 321045
And at: Saxon House, 27 Duke Street, Chelmsford, Essex CM1 1HT. Telephone: 01245 950922