Guidance: Business Succession

This factsheet provides details on various business succession issues and should be read in conjunction with your suitability report and any provider documentation.

What is Shareholder and Partnership Protection?

This type of cover is designed to provide the remaining shareholders or partners the funds to purchase the shares of a colleague who has died or become too ill to carry on working.

What protection is available to protect my business interests?

There are a number of protection policies available to protect your business interest in the event that a key person dies or falls seriously ill. The main types have been summarised below;

- **Term Assurance** – a life insurance policy that pays out a monetary lump sum on the death of an individual during a predetermined time period.
- **Whole of Life** – a life assurance policy that pays out a specified lump sum on the death of the life assured whenever this may occur, provided premiums are maintained. This type of policy may have an investment element where part of your monthly premium is invested in a collective investment life fund. Typically, policies will be established on a guaranteed premium basis with no investment element. The premiums for this type of policy will be higher than a unit linked policy as the cost of the cover is fixed at outset.
- **Critical Illness** – an insurance policy that pays out a monetary lump sum when the life assured is diagnosed with a serious illness as specified within the policy document. Critical illness cover can be set up on a stand-alone basis or be incorporated into a Term Assurance policy.

What additional options are usually available?

The following additional options may be available although you should consult your policy documents for confirmation;

- **Waiver of premium** - Your premiums will continue to be paid should you become ill and are unable to work. The waiver of premium cover will take effect after a set period of time, as defined in the policy terms, and will continue to be paid until either you return to work, the waiver of premiums benefit ends or the end of the policy term.

- **Terminal Illness Benefit** - In the event of the life assured being diagnosed with a terminal illness, i.e. expected to live for 12 months or less, the sum assured under the contract will become payable.
- **Guaranteed insurability** – You may be able to increase the level of cover up to a set amount without having to provide further medical evidence, in order to meet changing business circumstances. This increase in benefit will generally result in an increase in the premium payable.
- **Indexation** – The level of cover will automatically increase at each anniversary in line with an index such as the Retail Prices Index or National Average Earnings Index to ensure that the sum assured remains appropriate. Your premium will increase annually to pay for the increase in cover.

How long will the cover be in place for?

Term assurance and stand-alone critical illness policies will be taken out for a set period of time. This is known as the term. The length of time your policy will be in place for will be dependent on your particular circumstances and requirements.

A whole of life policy, as the name suggests, is taken out for the whole of your life.

How do I calculate what the sum assured should be?

The amount of cover should reflect the value of each owner's share in the business. This is a proportion of:

- the capital value of the business (which should be assessed professionally) plus
- the goodwill included in the accounts plus
- any undistributed profits plus
- the individuals loan or partnership account

Can I vary the sum assured?

Depending on what your requirements are, the sum assured can stay the same, be reduced or increased throughout the term of the policy.

Why is commerciality so important for shareholder or partnership protection?

As long as the policy is written on a commercial basis then depending on who is paying the premiums, HMRC will treat the premiums in a certain way for tax purposes.

If an individual is paying the premium, HMRC will accept it is for a business purpose and treat it as exempt for Inheritance Tax purposes. When an individual pays the premium it is not subject to tax relief and as such should the policy pay out, the proceeds will not be subject to taxation, as long as it has been set up in the correct manner.

If the company is paying the premium on behalf of an individual then the premium is treated as additional salary. The individual would pay Income Tax and National Insurance on the premium and the company would also have additional National Insurance to pay.

If the premium is treated as salary then it is also tax deductible as an expense. However, on payment of a claim the proceeds of the policy would be subject to Corporation Tax. HMRC has made clear this is not a hard and fast rule and that each case should be looked at individually.

Why are premiums equalised?

Equalisation of premiums ensures that the level of benefit each shareholder or partner receives is a fair representation of the overall benefit they are likely to receive. Usually the older the person the more expensive the life cover; however, they are more likely to die first. This potentially means that an older person is least likely to benefit but have paid the most. This also has Inheritance Tax consequences, in that part of their premium could be deemed a gift to the other shareholders or partners.

A formula is used to ensure that each person pays their fair share in accordance with how likely they are to benefit from the policy. Generally shareholders make cash payments between themselves or make adjustments to their director's loan account to ensure that each shareholder contributes to the total cost in proportion to the benefit they are likely to receive under the arrangement.

What is automatic accrual?

A method used by some partnerships that allows the deceased's share of the partnership to pass automatically to the surviving partners. This cannot be used by shareholders.

What is underwriting?

When an application is made to an insurance company they will review all the information provided in the application form to decide whether to offer cover and what the cover will cost. The insurance company will normally undertake financial underwriting to ensure that the sum assured is not excessive. Generally, you will need to provide your latest accounts and business plan and may be asked to complete a more detailed financial questionnaire.

Depending on the information provided and if you require a high level of cover, they may require further information from the life assured's Doctor or would like them to consult a health practitioner and/or go for additional medical tests. It is important that the questions on the application form are answered as truthfully as possible as this could cause problems in the event of a claim.

What factors will affect the premium paid?

Insurance companies take into account a wide range of factors when considering how much the premium will be. The list below gives an indication of the information that is considered but is by no means exhaustive.

- Age
- Smoker status
- Own medical history
- Family medical history
- Occupation
- Hobbies & interests
- Current health
- Lifestyle

Can an existing life policy be used?

It may be possible to assign an existing life cover policy to another legal entity or a business trust, although this may incur additional taxation and specialist advice should be sought.

Where can I find out more information?

Further information can be found in your key features document, personal illustration and policy conditions. You can also contact us at any time with any questions you may have using our contact details on the front of this report.