

Business Protection

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Every Business, Limited Company or Partnership, should consider the benefits of Business Protection, in the same way that every business should take out consequential loss, loss of profits, cover. Most businesses insure what they regard as their main assets, property, contents, stock, loss of profits etc. However, relatively few businesses stop to think that in fact their biggest asset is in fact their key personnel. Every business will have at least one key person, this could be the business owner or a specialist member of the team. The effect of the key person dying or becoming critically ill would almost certainly be more damaging to the business than the loss of physical assets, which can relatively easily be replaced. Key person protection involves the business taking out an insurance policy on the life and/or health of the key person, the business pays the premium and in the event of a claim the benefit is paid directly to the company.

Key Person Insurance

Who is Key?

The first step is to identify who are the key people in the business, this can be the business owner or Managing Director / CEO, it can also include other key members of staff for example top salesmen, Finance Director, senior technical support staff, and any other individual regarded as being key to the business. The issue to identify is would the business suffer financially in the event of that key person either dying or becoming critically ill? The loss of a key person would usually mean that the company would suffer a reduction in turnover and profit, and would also be likely to incur significant additional expense whilst a replacement could be found if indeed a replacement could be found at all.

External Investor Protection

Another issue to consider is whether the business itself has been funded by external investors, if this is the case then quite often the external investors will insist that the key people are protected, external investors usually invest in a business on the back of a good management team more than anything else. This needs to be protected.

Which Type of Business?

Key Person Protection applies to all types of businesses, Limited Companies and Partnerships, both large and small. A larger business would usually have a greater depth of management expertise and would therefore be better positioned to suffer the consequences of a major loss, however protection should still be put in place although the benefit levels should reflect this.

Amount of Cover

Agreeing the precise amount of cover is calculated on a case by case basis depending on the size of the company, the expertise held by the individual(s) concerned, and how quickly the business can recover from a major loss. The issues to take into account include the amount of any external investment made by other Shareholders, the amount of any overdraft / business loan in place that may be called in by the Bank in the event of the key person dying, and what the costs are for the business to survive for a reasonable length of time whilst it finds a replacement and / or restructures the business.

Type of Cover

There are three areas of cover to consider:-

- Death – This provides a lump sum to the business in the event of the death of the key person.
- Critical Illness Protection – This provides a lump sum to the business in the event of the key person contracting a critical illness.

- Income Protection – This provides an income to the company for a set period in the event of the key person becoming disabled through accident and / or illness or disability which can be regarded as critical or otherwise.

Length of Term The term of the cover is usually set at either five or ten years and can be arranged on a renewable basis thereafter. Most key person policies are set up over a ten year term, if the key person ceases to become key because they leave, or alternatively if the company is sold, then cover can simply cease.

Premium Cost Examples The costs attached to Key Person Protection depend on a number of factors:-

- The age and sex of the individual
- Whether they smoke or not
- The size of the cover
- The term

Below are some examples:-

Death Only

Male aged 40 next birthday, non-smoker, £500,000 cover, ten year term: £37.00 per month

Female aged 40 next birthday, non-smoker, £500,000 cover, ten year term: £28.50 per month

Death or Critical Illness Protection

Male aged 40 next birthday, non-smoker, £500,000 cover, ten year term: £158.10 per month

Female aged 40 next birthday, non-smoker, £500,000 cover, ten year term: £144.54 per month

Taxation Issues In the majority of cases, Key Person Protection is arranged on a term assurance basis where the policy has no cash in or surrender value. On this basis, the premiums are payable by the business, and are treated as a tax deductible expense, and in the event of a claim the policy proceeds are paid directly into the company and are treated as a trading receipt, this may mean that in some situations some or all of the policy proceeds may be subject to corporation tax depending on the company's trading position. It may be possible to spread the payment of the benefit in instalments to reduce tax.

Shareholder Protection

If a Shareholder in a business dies or becomes seriously ill, Shareholder Protection gives the remaining Shareholders in the business the option of buying their Shares and therefore keeping control of the business. The intention is to provide the financial power to prevent unwelcome Shareholders becoming involved in the running of the company, and also to provide a cash benefit to the deceased Shareholders' Estate. Individual Shareholders usually regard this as being a vital form of protection, protecting not just themselves as Shareholders but also ensuring that in the event of their death their family receive an appropriate payment to compensate them for their value in the business. This benefit works equally for Limited Companies with Shareholders and also Partnerships.

Why have Cover?

In the event of the death of a Shareholder or Partner, the deceased Shareholder's Estate would automatically inherit their Shares, this would mean that the surviving Shareholders would be faced with a situation whereby a family member may demand a seat on the Board and could influence the direction of the business, against their wishes. Properly arranged protection means that the Estate would offer up the inherited Shares to the remaining Shareholders for a pre-agreed sum of money to make sure the surviving Shareholders continue to control the business.

From the point of view of the deceased Shareholder's family, usually all they want is a financial payment in return for handing over the Shares.

Type of Businesses	Shareholder Protection works equally well for Limited Companies and also Partnerships.
Amount of Protection	The amount of cover arranged on each Shareholder should be based on their proportion of the overall value of the business. It may be necessary to arrange for the business to be valued, or quite often the Shareholders themselves decide on what they feel is a fair value for the business. The value of the business is usually estimated and can take account of future growth.
Who Pays the Premiums?	Unlike Key Person Protection, this is protection for the individual Shareholders personally, and as such the premiums are paid personally by the individual Shareholders. If the business pays the premiums, then this would usually be taken into account as a benefit in kind and appear on P11D returns.
Cross Option Agreement	We recommend that a simple Cross Option Agreement is put in place to run alongside the Shareholder Protection arrangements. A Cross Option Agreement would set out a summary of the intentions of all the Shareholders, and usually confirms that in the event of the death of a Shareholder, the business is valued professionally at market value rather than forced sale value. This confirms the basis on which the deceased Shareholder's Shares are purchased. The Shareholder Protection policy is then used to pay for the purchase of the Shares. If the market value of the business is less than the Shareholder Protection Policy, then deceased Shareholder's Estate receives the amount of the policy in full; if the business is valued at more than the Shareholder Protection Policy, then the balance of the Share purchase payment is agreed separately with the Shareholders and may be paid immediately or in instalments. In either situation, the Shareholder Protection insurance policy should be expected to cover the vast majority if not all the costs of purchasing back the Shares. It is important that the sums assured are kept up to date as much as possible to avoid a shortfall in the event of a claim.
Types of Cover	Types of cover available are death only or death including critical illness protection.
Placing in Trust	An important part of Shareholder / Partnership Protection is making sure the policies are placed into a simple Trust (provided by the Insurance Company as part of the set up process). This makes sure that in the event of the death of a Shareholder, the proceeds pass free from tax to the surviving Shareholder(s) to be used to buy back the Shares.
Taxation Issues	As mentioned above, premiums are payable by the individuals concerned on a personal basis, if the company pays the premiums they are subject to a P11D taxable benefit in kind charge. In the event of a claim, proceeds are payable tax free via the Trust.
Costs	The type of policy arranged for Shareholder Protection is the same as Key Person Insurance, the cost for £500,000 cover are the same as those quoted above for Key Person Insurance. Below are the figures for a reduced amount of cover of £250,000:- Death Only Male aged 40 next birthday, non-smoker, £250,000 cover, ten year term: £18.50 per month Female aged 40 next birthday, non-smoker, £250,000 cover, ten year term: £14.25 per month Death or Critical Illness Protection Male aged 40 next birthday, non-smoker, £250,000 cover, ten year term: £79.00 per month Female aged 40 next birthday, non-smoker, £250,000 cover, ten year term: £72.00 per month

Contact

If you require any further information on Key Person or Shareholder Protection covers or wish to discuss any particular client in more detail, please call one of our Directors at HFS Milbourne Financial Services Limited on 01483 468888.