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A Guide to

# Business Protection

Protecting the key people who are driving your business forward



# A Guide to Business Protection

Protecting the key people who are driving your business forward

Welcome to 'A Guide to Business Protection'. Every business has key people who are driving it forward. Many businesses recognise the need to insure their company property, equipment and fixed assets. However, they continually overlook their most important assets, the people who drive the business – a key employee, director or shareholder. In this guide we look at key person, shareholding director and partnership protection. In addition, we also cover Business Loan Protection and Private Medical Insurance.

**Q: What is key person insurance?**

**A:** Key person insurance is designed to compensate a business for the financial loss brought about by the death or critical illness of a key employee, such as a company director or other integral member of staff. It can provide a valuable cash injection to the business to aid a potential loss of turnover and provide funds to replace the key person.

**Q: How could my business benefit from key person insurance?**

**A:** You cannot replace the loss of a key person, but you can protect against the financial burden such an event may cause. Without the right cover in place you could also risk losing your business. Key person insurance can be utilised in a number of different ways – for example, to repay any loans taken out by the

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key person; to help recruit and fund the training costs for replacement staff; to meet the ongoing expenses while the level of sales recover; or to facilitate payments for outside consultants or expert advice that may be required.

**Q: What type of key person insurance is available?**

**A:** There are various options to choose from, including life cover only, critical illness cover, or combined life cover and critical illness cover. You can select different levels of cover and terms depending on your specific requirements and there are also policies available that pay out a regular income in the event of sickness.

**Q: How is a key person policy taxed?**

**A:** There are a number of issues to be aware of with regard to the taxation aspects of premiums and benefits. Because the premiums may be eligible for tax relief, HM Revenue & Customs (HMRC) require that the amount of benefit covered can be justified. The premiums paid will be allowed as a business expense for corporation tax purposes provided that: the only relationship between the proposer and the life assured is that of employer and employee (except in the case of shareholding directors); the plan is designed to cover loss of profits only; the term of the insurance is reasonable – a five-year term is normally acceptable but some HMRC inspectors may allow up to ten years; and the employee does not hold a significant shareholding. If the premium is a

permitted allowable expense, then the policy proceeds would normally be subject to taxation. However, there are no hard and fast rules regarding the tax treatment of premiums and benefits, which is the ultimate decision of HMRC. It is not the case that if the business decides not to apply for tax relief on the premiums, any proceeds will necessarily be tax-free. The taxation decisions rest with HMRC. It is therefore very important that the effects of taxation should be considered when arranging the policy.

**Q: How is the level of cover calculated?**

**A:** The cover required is measured by reference to the key person's contribution to the profits of the business. This may be based on the following information: past profits and projections for the future; the effect that the loss of the key person would have on future profitability; the anticipated cost of recruiting and/or training a replacement; the expected recovery period, for example, the length of time before a replacement is effective; and the amount of any loan(s) that would be called in on the death of the key person.

**Q: Should a key person policy be written in trust?**

**A:** No. Since the object of the policy is to pay a lump sum to the business on the death or incapacity of a key person, it follows that the policy should not be written in trust.

# Shareholder Protection

**Shareholder protection helps shareholders or partners keep control of their business if one of them dies or is diagnosed with a critical illness.**

The loss of a stakeholder (partner or shareholder) can have a huge impact on the success of a business.

A company can use Share protection to provide a sum of money to the remaining stakeholders if a major stakeholder dies or is diagnosed with a critical illness.

It helps the remaining stakeholders keep ownership and control of the business. It also offers financial security for the surviving stakeholders and the family of the late or ill stakeholder.

You may find that a partnership agreement or a company's articles of association already specify what would happen if a business partner suffers a critical illness or dies. Because they've already shown this level of consideration for the succession planning of their business, asking them to look at business protection should be a logical step.

## Problems you could face...

Several issues can arise if a stakeholder dies.

Here are some questions for you to think about:

Are you able to find or re-allocate funds to buy the late stakeholder's interest or shareholding in the business? Without having to take out a loan?

What would you do if a stakeholder's beneficiaries want a quick cash payment instead of shares or a share of the business?

What would you do if a stakeholder died and their interest passed to beneficiaries who don't have the necessary skills and experience to make a worthwhile contribution to the business?

Would you need to find a third party to provide the cash to buy out the late stakeholder's estate?

Being unprepared for situations like these can lead to serious financial problems and even loss of management control.

That means it's important to have money available to cover the value of shareholdings.

## ...and how share protection could help

With share protection, the product provider pays out a sum of money to the remaining stakeholders if one of them dies. They can use that money to buy the late stakeholder's share of the company and keep ownership of the business.

A business may have a partnership agreement or articles of association in place that outline what would happen to the business shares if a partner suffers a critical illness or dies. This gives the surviving partners or shareholders a legal framework providing the right to buy the shares of the partners.

Share protection would give them the financial means to back up their legal right to buy the late partner's shareholding from the beneficiaries.

This ensures they can carry on doing business without the involvement of anyone else, like the beneficiaries, providing business continuity. In return, the beneficiaries will receive an agreed payment for their shares, giving them some financial security.

The sum assured for each partner or shareholder should match their individual holding. If that's not the case, the product provider will ask for the reason why before they decide whether to cover that person.

In partnership protection planning, the partners usually take out business protection policies individually. The policies may be written in trust from the start for the benefit of the surviving partners. We'll normally place these into a flexible business trust.



# Shareholder Protection

## Setting up share protection

Did you know a partnership will automatically dissolve if any of the business partners die unless an agreement exists to the contrary? You can set up an arrangement to legally protect the partners or shareholders.

Legal protection is different to financial protection. If a firm already has legal protection in place, it's definitely worth talking to the partners about a business protection policy. Should the worst happen, this will give them the cash to act on any legal agreement they have in place.

There are four main ways of setting up share protection:

### 1. Buy and sell agreements

These are legally binding agreements that lay down who can buy the interest in the business and at what price it will be sold.

If death is the trigger, the surviving stakeholders must buy the late partner's interest in the business from the estate using a pre-agreed method of valuation.

HM Revenue & Customs (HMRC) usually treats this as a contract for sale, which means you will lose business property relief for inheritance tax.

### 2. Buy/sell or cross-option agreements

Surviving partners or shareholders have an option to buy and the estate to sell shares within a pre-determined period. The estate is legally bound not to sell the shares to anyone else during that time.

Most cross-option agreements only cover death, not critical illness. This means clients may also need a single option agreement to cover critical illness.

HMRC doesn't see these agreements as contracts for sale, so they don't affect business property relief.

### 3. Single option agreements

A single option agreement gives choices to a partner or shareholder who becomes seriously ill. They can either stay in the business or sell their share to the other partners or shareholders, who must buy them out.

The main advantage is that the firm won't lose business property relief as HMRC doesn't see this as a contract for sale.



### 4. Automatic accrual method

Used mainly by partnerships, this method means that if a partner dies, their shares pass automatically to the remaining business partners.

All the partners in the business take out life policies to compensate their estate for their share of the business. The life policies are generally put in trust to make sure that the money goes to each partner's chosen beneficiaries.



# What is executive income protection?

## Best Answer

In terms of the cover provided by executive income protection there is absolutely no difference to a personal income protection plan. Both policies provide long-term earnings cover against the risk of having to take time off work due to sickness or injury.

## What is the difference?

The key difference is in how these two plans are set-up. A personal plan is simple, you would own the plan and pay the premiums from your own personal bank account. As tax is paid on the premiums the benefit paid out is usually free from income tax and national insurance contributions (NI).

However, an executive plan is often referred to as a 'life of another' policy as a business would pay the premiums and receive the benefit paid out, based on your life. The business would then pay the benefit to you.

## What are the tax implications?

Although you would need to consult your accountant and local tax inspector, it is usually the case that the premiums for an executive policy can be put through as a business expense. However, any benefit paid to you (via the company) would need to go through PAYE, thus incurring income tax and national insurance (both for yourself and the business).

Essentially, the premiums with a personal plan would be paid from after tax income and the benefit would be free from tax, whereas with an executive plan the business may be able to expense the premiums but the benefit would incur income tax and NI.

For this reason insurers will usually allow up to 80% of gross earnings to be covered with an executive plan but only 50-60% with a personal plan. Naturally, the premiums will be far higher with an executive plan as a higher amount will need to be insured to cover the tax.

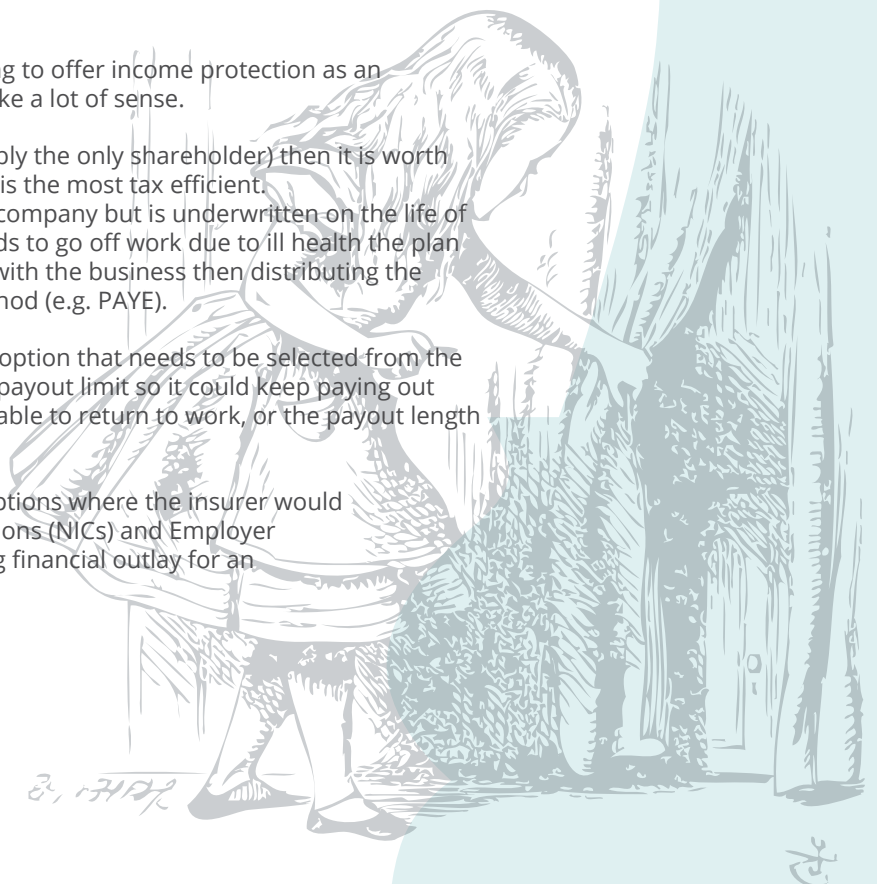
## Which is better?

If you are an employee and your employer is willing to offer income protection as an employee benefit then an executive policy can make a lot of sense.

However, if you are a shareholding director (possibly the only shareholder) then it is worth speaking with your accountant as to which option is the most tax efficient. With an Executive plan the policy is owned by the company but is underwritten on the life of an employee or director. If that staff member needs to go off work due to ill health the plan would pay out a monthly benefit to the business, with the business then distributing the funds to the employee via the usual payment method (e.g. PAYE).

How long the policy can continue paying out is an option that needs to be selected from the policy outset. It is possible for plans not to have a payout limit so it could keep paying out right up until retirement age if the employee is unable to return to work, or the payout length can be set at a maximum of 2 years or 5 years.

With this type of plan it is also possible to select options where the insurer would also cover Employer National Insurance Contributions (NICs) and Employer Pension Contributions, thus removing any ongoing financial outlay for an incapacitated employee.



# Are you a company director looking to provide financial security for your employees, or your own loved ones?

Providing death in service benefits for your employees can inadvertently create potential tax problems for those high earners with substantial pension funds. Are you having trouble getting access to a group scheme because your company is considered to have too few employees?

Taking out a Relevant Life Policy could be a tax efficient way of helping to provide the valuable life cover and financial security you want for your employees and for your family. These policies are designed for individual employees who may require:

- more life cover than the main Company scheme provides or,
- where the number of employees is too low for a company group scheme.

The policy premiums are paid in a more tax efficient way by the company compared to employees paying for their life cover benefits personally. The good news is, company directors like yourself working day to day in a business on a Pay As You Earn (PAYE) basis, are likely to qualify for this arrangement whereby you could also take out life cover to help protect the financial security of your loved ones

## Why should I take out a Relevant Life Policy?

The plan is restricted to providing life cover only and cannot contain any waiver of payment, critical illness or income protection benefits and must cease before the life assured's 75th birthday. Your company can pay the policy premiums usually as an allowable deduction without them being treated as a benefit in kind, which means:

- as the employer, your policy premiums are treated as a business expense and are likely to be an allowable deduction against Corporation Tax
- there is no liability for National Insurance for you or your employee
- there is no Income Tax liability for your employee
- the benefits are paid tax free to their nominated beneficiaries
- the policy premiums do not form part of an individual's annual allowance for pension contributions
- the life cover benefits do not form part of an individual's lifetime allowance for pension savings.

Tax treatment depends on your individual circumstances and may change in the future. You should discuss this with your financial adviser.

Take a look at the example.



## Compare the cost of Mr A arranging his own life assurance against the same cover arranged and paid for through his employer's scheme using a Relevant Life Policy. Can you benefit from this arrangement?

Mr A is a shareholding director of LBD Ltd. He currently pays for his life assurance personally at a cost of £200 per month out of his post tax salary. As Mr A is also a business owner, we will look at both his personal and business costs and the effect of taxation of providing this cover. Mr A is a higher rate taxpayer, he pays 40% Income Tax on the higher part of his salary. He also pays the additional 2% rate above the upper earnings limit for National Insurance. We have assumed the policy premiums for his plan are taken from his higher marginal rate of tax and have used these rates in our calculation. LBD Ltd pay employer's National Insurance contributions at the 'contracted in' rate of 13.8%. In this example salary, National Insurance contributions and Relevant Life Policy premiums are all treated as allowable deductions for the purposes of Corporation Tax.

### Mr A paying personally for life assurance

Monthly policy premium paid from his post tax income. = **£200pm**

Pre-tax income needed to fund £200 at Income Tax rate of 40% and employee National Insurance at 2% additional rate. = **£344.83**

Employer's National Insurance contributions at 13.8% on this amount of salary paid by LBD Ltd. = **£47.59**

Total cost to LBD Ltd and Mr A = **£392.41**

Less Corporation Tax at 20% as an allowable deduction. Salary, Income Tax and National Insurance are allowable expenses against Corporation Tax.

Total cost to Mr A and LBD Ltd = **£313.93**

### LBD Ltd paying for a Relevant Life Policy

Monthly policy premium paid by LBD Ltd. = **£200pm**

No Income Tax, employee's or employer's National Insurance payable. = **£200**

No employer's National Insurance contribution.

Less Corporation Tax at 20% as the plan is an allowable deduction.

Total cost to LBD Ltd = **£160.00**

Mr A paying personally costs him and the business **£313.93pm**  
LBD Ltd paying through a Relevant Life Policy costs **£160.00pm**

**A saving of £153.93pm or a saving of over 49%**

# Business loan protection

**Business loan protection makes sure your business can repay a loan if the worst were to happen to the guarantor.**

When a company takes out a loan, it needs to be sure it can meet the repayments, no matter what happens to the business.

## Problems you could face...

Here are some questions for you to think about:

Would the families of directors or key people who have acted as fund guarantors be directly affected if the business were to default on payments for any reason?

If you lost a key person through death or critical illness, would you be able to pay off any existing loans?

## ... and how business loan protection could help

A lender will often make business loan protection a condition of the arrangement before releasing funds, and the directors may be asked to sign a personal guarantee for the loan.

A lender will usually consider life cover, critical illness cover or a combination of both for key people in the business as adequate protection. The cover doesn't have to be the same for each person, but it must be possible to assign the policies to the lender if that is a condition of the loan.

For each business, the total sum assured of all individual policies must be equal to the full amount of the loan. The initial sum assured is the amount of the loan at that time. You'll have to provide confirmation that the loan has been drawn down, when you ask for the cover to start.

Fixed-term policies remain in place for the duration of the arrangement, with decreasing or level term assurance as necessary. Should the key person covered by the plan die, we'll pay out a claim and the remaining partners can put the money towards repaying the outstanding loan amounts.



# What is private medical insurance?

**Private medical insurance is designed to cover the cost of private medical treatment for 'acute conditions' that start after your policy begins.**

An acute condition is a disease, illness or injury that is likely to respond quickly to treatment that aims to return you to the state of health you were in immediately before suffering the disease, illness or injury, or which leads to your full recovery. Your insurer can tell you about their cover for this and whether or not they will provide any cover for longer-term conditions (typically referred to as chronic conditions). A chronic condition is a disease, illness, or injury that has one or more of the following characteristics: it needs long-term monitoring, control or relief of symptoms, it requires rehabilitation, it continues indefinitely, and it has no known cure or is likely to come back.

PMI is designed to work alongside not to replace all the services offered by the NHS and in all cases customers retain their right to use the NHS. Some policies may cover certain types of, or elements of, long-term treatment or treatment for chronic conditions, but this is not usually the main purpose of PMI.

## Why buy private medical insurance?

People buy this type of insurance to have:

### Timely access to healthcare

- Prompt referral to a consultant
- Quick admission to hospital
- Treatment at a convenient time

### Choice of healthcare

- Direct care by a consultant
- Advanced treatment options

### High-quality private clinic and hospital accommodation

- Privacy of an en-suite room
- Home amenities such as TV
- Comfort and cleanliness

In addition, PMI can pay you a cash benefit when you choose to use the NHS instead of having private treatment.

To arrange a no obligation meeting  
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email: [enquiries@cl4women.co.uk](mailto:enquiries@cl4women.co.uk)



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