

DIRECTORS' SHARE PROTECTION

WHAT IS DIRECTORS' SHARE PROTECTION?

Directors' Share Protection provides money so that should one of the shareholding director's die or suffer a terminal illness, the remaining shareholder(s) in the business may be able to afford to exercise an option to buy the deceased shareholder's interest from his or her estate. Provision can also be made if a shareholder suffers a critical illness.

KEY ISSUES FOR PARTNERS TO CONSIDER IF NO PROTECTION IS IN PLACE

Where the shares of a director have passed to their estate, the family has two main options:

1. A member of the family could take over the deceased's position as a director.
2. The family could realise the value of the interest by selling it.

Neither of these avenues is problem-free. Commercial experience, age, qualifications, ability, commitment or other reasons could prevent any members of the deceased's family being capable of becoming a director. If the family of the deceased wishes to sell their interest in the company, the remaining director(s) may find themselves working with an unwelcome new director. Also, it may be difficult to find buyers, which could lead to financial problems for both the family and the business.

HOW DOES DIRECTORS' SHARE PROTECTION WORK?

Each director takes out either life assurance or life assurance and critical illness cover written in trust for the other directors. They also enter into an agreement, typically a cross option agreement. In the event of a death or specified critical illness (if policy chosen) of a director, the other directors then have the money to help buy the director's share.

The business would usually pay the premiums and this is taxable on each individual director. Since premiums reflect the age, gender and sums assured of each individual director, the amounts paid do not reflect the benefits each may receive in the event of a claim. However, premiums can be apportioned according to each director's stake in the business. This is known as premium equalisation. The sum assured of each policy equals the value of each director's share in the business. The directors will need to pay income tax on the equalised premium.

DETERMINING THE LEVEL OF COVER

For help with working out how much cover is needed, why not try our Business Valuation calculator, which is available on our Business Protection website.

CROSS OPTION AGREEMENT

A written agreement, known as a 'Cross Option Agreement', is a reciprocal arrangement that helps the surviving partners to keep control of the business, by giving them the option to buy the interest of any partner who dies.

Similarly, it also provides the estate of the deceased with the option to sell to the remaining partner(s). Such agreements also outline how an interest in the business is to be valued. For copies of our Cross Option Agreements, please visit our Business Protection website.

TAX

The partners will typically pay the life assurance premiums themselves and will not get income tax relief on those premiums. Where the arrangement is on a commercial basis there will be no inheritance tax on the payment of the premiums of the trust policies.

Where policies are in trust, any proceeds will not normally form part of the partner's estate for inheritance tax.

TRUSTS

Each partner may request that the life assurance company issue the policy on their life under trust for the benefit of the other partners. Typically, the other partners will be appointed as trustees. This way, in the event of the death, terminal illness or critical illness of a partner any proceeds will be paid to the trustees. The other partners, as beneficiaries of the trust, will then have the money with which to buy the share of the ill or deceased partner.

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