BUSINESS PROTECTION

PARTNERS' SHARE PROTECTION

WHAT IS PARTNERS' SHARE PROTECTION?

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

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

Where a share of a partnership has passed to the estate of a deceased partner, the family has two main options:

1. A member of the family could take over the deceased's position as partner.
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 partner.

If the family of the deceased wishes to sell their interest in the partnership, the remaining partner(s) may find themselves working with an unwelcome new partner. Also, it may be difficult to find buyers which could lead to financial problems for both the family and the business.

HOW DOES PARTNERS' SHARE PROTECTION WORK?

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

The individual partners will pay the policy premiums. Since premiums reflect the age, gender and sums assured of each individual partner, 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 partner's share in the business.

This is known as premium equalisation. The sum assured of each policy equals the value of each partner's share in the business.

WHY DOES A FORMAL PARTNERSHIP AGREEMENT MATTER?

A formal partnership agreement sets out what happens to the partnership if one of the partners dies. If no such agreement has been made, the partnership automatically dissolves if a partner dies.

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.

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.