For intermediaries only

Guide to business protection

Keeping things simple

Pensions | Investments | Protection

AEGON

Welcome to our guide to business protection

Who says business protection has to be complicated? With our easy-to-use guide, you'll have all the support and information you need at your fingertips to understand, discuss and write business protection.

The guide covers all aspects of business protection, from how to develop professional connections and identify potential clients to the more complex issues surrounding tax and trusts.

We've also created the Vault, your one-stop-shop for all the support material you'll need to help you in the business protection market. This includes sample material, sales aids, technical factsheets, videos and more. All are designed to help you discuss business protection with your clients and develop professional connections.

We're committed to making business protection easy and are delighted to be the first provider to win the Best Business Protection accolade at the Cover Excellence Awards 2020.

COVER EXCELLENCE AWARDS 2020 WINNER Best Business Protection Aegon

I'm confident this guide will quickly become your essential reference to all aspects of business protection.

If you have any feedback, please email us at businessprotection@aegon.co.uk

Stephen Crosbie
Protection Director, Aegon

Important information

This guide is for intermediaries only. It mustn't be distributed to, or relied on by, customers.

The information contained in this guide is based on our understanding of current taxation law and HM Revenue & Customs (HMRC) practice, as at May 2021, which may change. The tax treatment depends on the individual circumstances of each client and may be subject to change in future. The value of any tax relief depends on the individual circumstances of your client.

Trusts establish legal rights and entitlements and might have material financial and tax implications for the settlor, trustees and beneficiaries. Aegon UK isn't authorised to provide legal advice, so you should take your own legal advice before setting up a trust, to make sure that it meets your clients' requirements. Our trusts have been drafted for use by UK domiciled individuals.

Who will benefit from this guide?

We've designed this guide to help you develop business protection opportunities whether:

- you're a private client adviser or corporate adviser and want to move into the business protection market;
- you're a pensions adviser;
- you have commercial general insurance connections for referrals, or
- you have links with solicitors or accountants.

If you want to learn more about business protection and how to advise on it, this guide can help.

Even if you don't have any links into this market, we can help you develop opportunities.

And remember, if **YOU** don't look after your clients' business protection needs, someone else will. You could be losing out on genuine opportunities to:

- develop valuable relationships;
- expand your business, and
- increase your profitability.

How to use this guide

If you're new to this market, it's probably a good idea to follow the structure of each individual section. Start by identifying who your potential clients might be and then you can concentrate on what the next steps are.

If you're more familiar with the business protection market, you can find the information you're interested in quickly and easily, by clicking on the relevant icon below.

No matter where you are in this guide, you can always return to the beginning of the section you're in or to this page.

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Whenever you see this icon, you might want to visit our online **Vault**. This is your one-stop-shop for all the support material you'll need including sample material, sales aids, technical factsheets, videos and more.

Contents

Introduction to business protection

What is business protection?

Business protection is all about insuring for the unexpected. Put simply, it's a way of protecting a business should something go wrong. Business protection can help make sure a business continues to trade and allows the owners to maintain control while making sure dependants receive a fair value for their share of the business.

Why have business protection cover?

With a business protection arrangement in place, if people become ill or die, your clients will be able to:

- keep their business trading;
- replace key individuals;
- provide employee benefits;
- protect corporate debt, and
- buy out a shareholder, or their estate, if they become critically ill or die.

Despite its obvious benefits for clients, business protection is an area many advisers tend to avoid.

We can help.

Why discuss business protection with your clients?

There were 6 million[1] private sector businesses at the start of 2020. Small or medium-sized enterprises (SMEs) accounted for 99.9%[1] of them, each with their own specific financial needs.

By identifying potential clients and building relationships within the business community, you can:

- help meet your clients' business protection needs, and
- expand your own business.

Not only that but:

- offering business protection is a way into the lucrative corporate market;
- the value of business protection is often higher than other types of protection, which means increased revenue for your business, and
- you'll probably already have clients who need business protection.

While clients might be aware of the need to protect their business, they need advice to identify the right solutions. This guide covers a range of issues, from segmenting your existing client bank to developing professional connections. We also cover the tax and trusts solutions for the different types of business protection arrangements.

Did you know...?

At the start of 2020, there was an estimated
6 million businesses
in the UK[1] – each with their own specific financial needs[1]

An estimated
118.6 million working days
were lost due to sickness or injury in the UK in 2020[2]

Split of business in the UK[1]

- **2 million** limited companies
- **414,000** ordinary partnerships
- **3.5 million** sole traders

1 Department for Business, Energy & Industrial Strategy – Business population estimates for the UK and regions 2020, October 2020
2 Office for National Statistics – Sickness absence in the labour market 2020, March 2021

What are the different business types?

There are various types of businesses – each with their own individual business protection needs. Here, we give a brief introduction to the different business types.

Limited company

A limited company is a distinct legal entity with an independent legal existence, separate from its shareholders. It must have at least one shareholder and one director.

Partnership

A partnership (sometimes referred to as an ordinary or general partnership) is a business owned by two or more people, working together and sharing the profits or losses on an agreed basis. There are no legal requirements to register a partnership with Companies House (apart from certain Scottish general partnerships), however you should consider putting in place a formal written partnership agreement. A partnership can employ other people on a part-time or full-time basis. It's a separate legal entity in Scotland, but not in England and Wales.

Limited liability partnership

A limited liability partnership (LLP) is similar to an ordinary partnership, except that it's a corporate body with its own legal identity and the individual members have reduced personal liability for any potential business debts.

LLPs are also more complicated to set up and run than ordinary partnerships, as they have to meet many of the company law requirements that apply to limited companies, such as having to be registered with Companies House.

Sole trader

A sole trader or sole proprietor generally means a business that's owned and controlled by one person who makes all the decisions, has all the responsibility and profits from the business that they run. A sole trader may employ other people. Their protection needs will likely be taken on a personal basis.

Business continuity and succession planning

Now let's find out what business continuity and succession planning is, and why it's important to your clients' businesses.

What is business continuity planning?

Business continuity planning is the plan put in place by a business to make sure it could continue to trade if the unexpected happened.

Many businesses look to protect themselves against every eventuality, buying insurance for their buildings, fixtures and fittings, stock, cars and materials. But the majority don't insure their single biggest asset – their key employees. So what would happen if the business lost a key employee?

A key employee is someone whose death or disability would have a serious effect on the company's ability to continue trading – for example a sales director who has valuable sales contacts, which might be lost if they died. To make sure the business can continue, the owners – who may be key to the business themselves – need to consider if their business:

- could continue to trade, or would suffer financially, if it lost a key employee, and
- would have the necessary cash flow to replace any loss of profit or repay any outstanding loans, including directors' loans.

According to the Office for National Statistics[3], there were 2.75 million Value Added Tax (VAT) and/or Pay As You Earn (PAYE) registered businesses in the UK in March 2020.

Seventy-four per cent are limited companies with 46% of them being single employee limited companies. This highlights that there are a number of businesses whose financial viability relies on just one person.

It won't happen to me

Even though many of your clients may witness the consequences of ill health first hand among family and friends, they'll more than likely believe that it won't happen to them.

And why not? No-one wants to go about their daily life thinking the worst. But the reality is – the unthinkable does happen.

Case study – business continuity planning

In April 2015 a business support and advice firm, took out keyperson life cover for a female company director, aged 57.

In January 2020, the firm contacted us to tell us she had sadly passed away in July 2019, aged 62. She had been diagnosed with breast cancer in 2017, but it sadly came back in late 2018 and her consultant had confirmed there was nothing more that could be done.

We asked the business to confirm their payment details and we paid the claim as soon as we received this.

3 Office for National Statistics – UK Business; activity, size and location:2020, September 2020

Remember...

Business continuity planning may not be high on the priority list of many businesses. But it's important that they put plans in place to make sure they're protected. And you can help.

Having continuity plans in place can help their business:

- cover any short-term loss of income/profit;
- repay any outstanding loans;
- repay any directors' loans;
- fund a permanent or temporary replacement employee, or
- make it through a period of reduced activity.

We've developed a liability audit to use with your clients, which you can find in the Vault. By answering just a few simple questions, you can help your clients understand their business protection needs and how important it is to keep their businesses running smoothly.

We'll look at business continuity in more detail throughout this guide.

What is business succession planning?

Business succession planning takes two forms – long-term and short-term planning.

Long-term business succession planning involves transferring the ownership and control of a company, most likely through retirement, to new management. It's a key part in protecting the stability and continuity of the business.

More important however, is the short-term succession planning. Although similar to long-term planning, the needs are immediate and could be devastating for the business if not thought through properly.

Business owners must think about what they'd want to happen if they died or became critically ill. Who would they want to take control of their business? How would they make sure this happened, and where would the money come from?

Business succession works in three main ways:

- handing over the ownership to a family member;
- appointing an external successor, or
- disposing of the business through a sale, management buy-out, management buy-in or voluntary liquidation.

While there are no hard and fast rules on succession planning, it's important that business owners link it to the needs and interests of their business and employees. Planning should start as early as possible to avoid conflict and confusion at the time of handover. This will also increase the chances of future business success.


You: Do you have a business will?


Client: I'm not sure I have. What is it?


You: It's a formal agreement or special provision put in place that details what should happen to your share of the business and your liabilities if you die or become critically ill.


Client: I'm fit and healthy – nothing's going to happen to me.

This conversation might sound familiar. However, as we've already mentioned, business succession planning is a key part in protecting the stability and continuity of the business. Use our Business intestacy audit with your clients to help them match their business's aspirations with reality. You'll find this in the Vault.

It won't happen to me

The unthinkable does happen.

- Cardiovascular disease (disease of the heart and circulation) causes more than a quarter (27%) of all deaths in the UK – that's more than 160,000 deaths each year or one death every three minutes.[4]
- One in two people born after 1960 in the UK will be diagnosed with cancer at some point in their lifetime and every four minutes someone in the UK dies of cancer.[5]
- There are more than 100,000 strokes in the UK each year – that's around one stroke every five minutes.[6]

4 British Heart Foundation – UK factsheet, March 2021
5 Cancer Research UK – Cancer statistics for the UK, April 2021
6 Stroke Association – Stroke statistics, April 2021

As business owners, your clients need to consider the impact on their business, if they, their partners/shareholders or key employees, become ill or die.

Case study – business succession planning

In March 2013, a management consultancy company took out life protection for a 10 year term. The insured person was a 46-year-old male and the policy was placed in trust.

In April 2020, the company contacted us to let us know he had sadly passed away in March 2020 from pancreatic cancer. He'd started to suffer from severe stomach pains in July 2019 and lost weight. Medical investigations into possible gallstones revealed the cancer. A course of chemotherapy was given but was unsuccessful.

We paid the claim in June to the trustees of the policy.

Having business protection cover in place gave the company time to consider their succession planning options. It's important business owners think about what they'd want to happen to their business if their partners/shareholders or key employees become ill or die.

Remember...

Business succession planning may not be high on the priority list of many businesses. But, your business-owner clients will have worked hard to get to where they are today. Have they taken the steps needed to make sure their business succession plans are properly managed?

- Do they have a business will?
- Do they have an exit strategy?
- Do they know the value of their business?
- What do they want to happen to their share of the business on their death and/or critical illness?

These are just some of the questions they need to consider to make sure that what they want to happen to their share of their business – should they die or become critically ill – actually happens.

Use this short video with your clients to show the devastating impact the death of a business partner can have on a business – and the family that's left behind – when no business protection plans have been made.

We'll look at business succession in more detail throughout this guide.

Continuity and succession planning – is there a need?

Yes, definitely. As the tables below highlight.[7]

The likelihood of at least one partner/director dying before age 65[8]

	Number of partners/directors				
Age	2	3	4	5	10
35	10%	14%	19%	23%	40%
40	9%	14%	18%	22%	39%
45	9%	13%	17%	21%	37%
55	7%	10%	13%	16%	29%

The likelihood of at least one partner/director getting a critical illness before age 65[9]

	Number of partners/directors				
Age	2	3	4	5	10
35	24%	33%	42%	49%	74%
40	23%	32%	41%	48%	73%
45	22%	31%	39%	46%	71%
55	17%	24%	31%	37%	60%

The above figures are based on insured data – which means those people who have the appropriate insurance already in place. Equivalent figures applying across the whole population would result in the likelihood of such an event being even more likely.

It's all about paying claims

In the eyes of our Business Protection customers and their families, we're only as good as our last paid claim.

Our reputation as a trusted provider comes down to whether we pay claims or not. Paying claims is core to our business and central to why people take out protection in the first place.

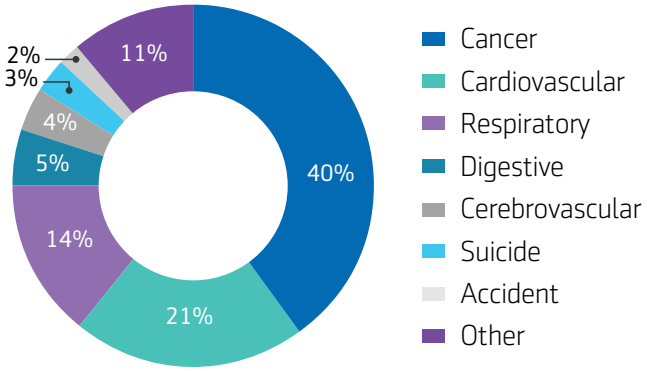
We know choosing a company with a good track record in paying claims is important. We've reported our claims experience for more than ten years and will continue to share this information. We're proud that our claims figures continue to be strong and consistent. Our goal is to make sure customers have the best claims experience.

We believe protection claims statistics should form a key part of all protection conversations, to alleviate any doubt about claims being paid. It's also an opportunity to highlight the importance of, and need for, the business protection being put in place.

In 2020, we paid 96% of life protection claims.

Life protection – main reasons for claims

The following chart shows the main reasons for the claims paid.



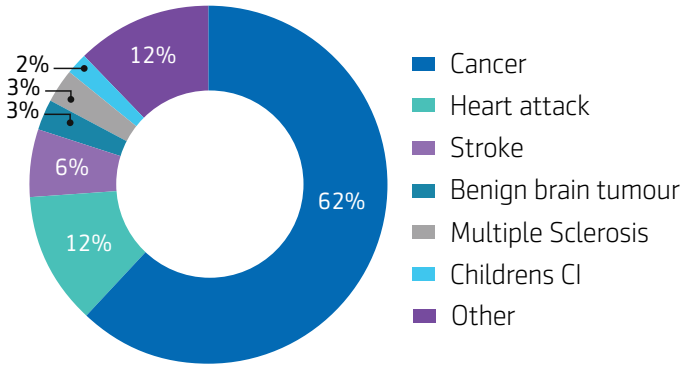
We're proud to have won Insurer of the Year at the British Claims Awards 2020.

7 Actuaries.org.uk/learn-and-develop/continuous-mortality-investigation/cmi-mortality-and-morbidity-tables, May 2020
8 Based on mortality data of 100% of TMNL08 mortality table (2007-2010 data collected by the CMI and published in Working Paper 94 (2017).Temporary assurances,male non-smokers at 5+ years duration).
9 Based on morbidity data of 100% (CMI Working Paper 75, calendar years 2007-2010) of SC04 morbidity table, male non-smokers at 5+ years duration.

In 2020, we paid 93% of critical illness protection claims.

Critical illness (CI) protection – main reasons for claims

The following chart shows the main reasons for the claims paid.



If your business-owner clients don't have business protection in place, the impact on their company could be devastating. However, have you considered the impact it could have on you and your business?

Sadly, your client loses a key individual and potentially their business stops trading. As a result you lose a client and part of your income stream.

Your client may have concerns around holistic financial planning and decide to go to another adviser. Again, you lose a client and part of your income stream.

If you don't advise on the need/importance of business protection, think of the opportunities you might miss.

Identifying and approaching clients

By identifying potential clients and building relationships within the business community, you can help meet your clients' business needs and expand your own business.

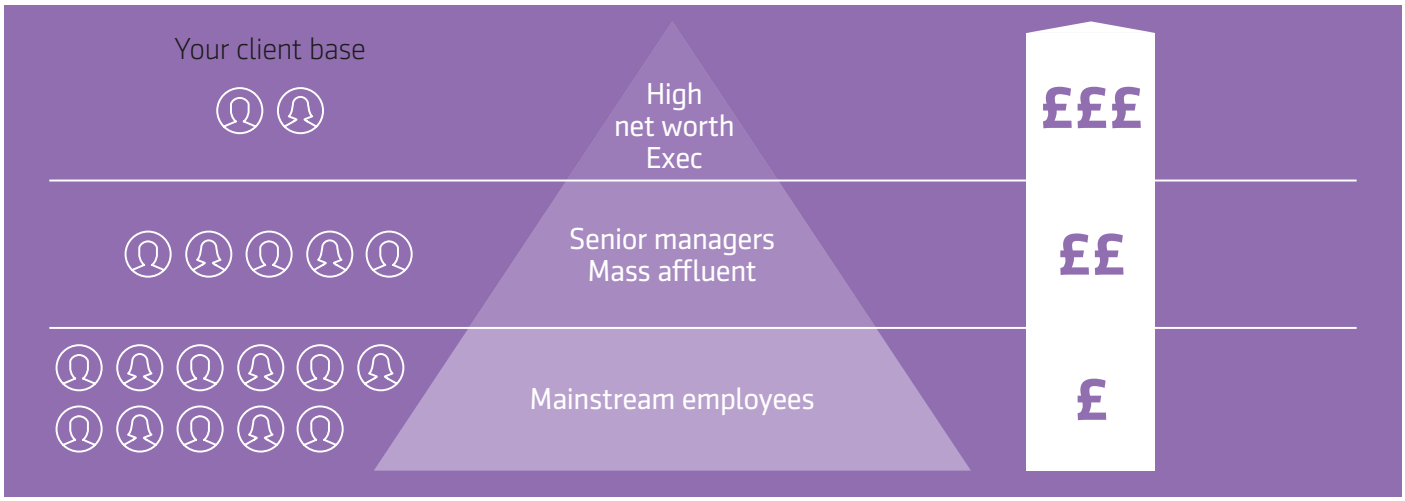
Segmenting your existing client base

By looking at your existing client bank in a different way, you could grow your business and take advantage of the rewarding opportunities within the business protection market.

Whether you advise director clients on a personal financial planning basis or on a corporate level, you'll already be speaking to the decision makers.

If business protection is something you haven't raised with them before, not only are you missing out on a potentially lucrative opportunity to increase your revenue, but your clients' businesses could be at risk if they haven't got protection in place.

Segmenting your client bank allows you to identify these executives and business owners and develop your relationship with them.



Approach methods

Once you've segmented your client base, you need to think about some possible ways to approach clients. Here are a few suggestions:

Existing clients

Face-to-face contact is best for your existing clients who don't currently have any business protection. You can do this at general financial review meetings or at insurance renewal meetings, taking along our Business protection factfind document to help you identify gaps in your clients' existing cover arrangements and, more importantly, to help you highlight the need for them to protect their business.

New clients

When approaching new clients, it isn't always possible to arrange face-to-face meetings, but there are other ways you can raise the subject of business protection. It's worth finding out if there are any business clubs in your local area. You could also try:

- organising seminars/breakfast clubs;
- sending out targeted mailshots to local businesses;
- approaching firms of solicitors and accountants with introductory letters to generate reciprocal business;
- advertising using social media, or
- cold calling – from entries in the local yellow pages or leads from the Chamber of Commerce.

Visit the **Vault** for example flyers, introductory letters and more.

Attracting new clients

Developing professional connections

Professional connections can generate a great deal of reciprocal business, for example through solicitors' partnerships, shareholder agreements and accountants' company valuations. We'll cover this in more detail in the next section.

Affinity groups

Why not find out about trade associations in your area? By carrying out a business protection campaign through them, not only could you generate some valuable business, you could also attract clients for the other types of financial services you offer.

Other referrals

For example, if you develop a campaign around the renewal of commercial insurance, you could identify potential business protection needs by highlighting that a company's most important asset could be a key employee rather than a building or piece of machinery.

Questions for your clients

As mentioned in **Part one**, there are various **types of businesses** – each with their own protection needs.

When approaching clients, you want them to consider the implications of not protecting their business. Whether it's a limited company, partnership or limited liability partnership (LLP), you can use our Continuity and succession planning forms to help your clients identify their own business protection needs.

It's important to highlight the risks and consequences, as well as knowing what questions to raise with them. You can use our Business intestacy audit to help them match their business's aspirations with reality. The table below gives you a few pointers.

Limited company/Partnership/Limited liability partnership

Possible risks	Questions to raise	Consequences to consider
One of the shareholders/ partners/ members dies unexpectedly	1. How much is the business worth? 2. Could the surviving shareholders/ partners/members afford to buy the share from the estate of the deceased shareholder/partner/member? 3. Can the surviving shareholders/partners/ members buy the deceased's share? 4. Do the surviving shareholders/partners/ members want to buy the deceased shareholder's/partner's/member's share? 5. Would a competitor want to buy into the business? 6. Would the beneficiaries get a fair price? 7. Do the beneficiaries want to join the business? 8. Do they have the necessary expertise? 9. Would the other shareholders/partners/ members want them?	Without shareholder/partnership protection arrangements in place, the following is likely: • The deceased's interest in the business passes to their estate. • The remaining shareholders/partners/ members don't have the funds or legal agreements in place to buy the deceased's interest. • The deceased's personal representatives or the remaining shareholders/partners/ members sell to a third party, or the deceased's beneficiaries get involved with the business themselves, often against the wishes of the remaining shareholders/ partners/members. • The beneficiaries of the deceased's estate don't see the true value of the business.

Sole traders

Possible risks	Questions to raise	Consequences to consider
The sole trader dies unexpectedly	1. Is there anyone else who could run the business? 2. What would this cost? 3. Are any business loans in place which are secured against the sole trader's family home?	The following is likely: • The business folding, leaving the sole trader's estate without any source of income. • The sole trader's dependants being left without support. • Any employees facing redundancy. • The family home being put at risk if loans are secured on it. • The business being sold at a loss if there's no-one to carry it on. • A possible inheritance tax liability which needs to be addressed.

Developing professional connections

Solicitor and accountancy practices can generate a great deal of reciprocal business, for example through shareholder/partnership agreements and company valuations. Putting some time and effort into building a good relationship with a solicitor or accountant can be very rewarding for your business.

Solicitors and accountants aren't allowed to give their clients financial advice. So they may well be looking to refer clients to a financial adviser who can give them the advice they need. That financial adviser could be you.

It makes sense for a solicitor or accountant to establish a strong relationship with a local adviser who they feel comfortable referring clients to. As with any relationship, this takes time to build up, but can be rewarding for all concerned because:

- the client gets the all-round advice they need;
- the solicitor or accountant is seen as looking after the client's interests, and
- the adviser gets more clients.

Here we show you how to make contact, handle objections, work together effectively and much more.

How do you become the solicitor or accountant's adviser of choice?

You need to show them what's in it for them:

- You'll be providing an essential service that's in line with their own business.
- You can help cement their relationship with clients as they'll be able to offer a comprehensive advice service, demonstrating that they value financial advice.
- It's an additional and potentially lucrative income stream for their business.

You'll also need to show:

Your technical ability – Compliance, in particular, is an area that worries solicitors and accountants when they're considering setting up a professional link with financial advisers. So you must be able to show that you're running a compliant business and that you can support them in the compliance aspects of any joint business.

A complementary business approach – You wouldn't want to do business with anyone who had a completely different approach to managing client relationships, and neither would the professional connection.

Your qualifications and reputation – You can strengthen your credibility as a fellow professional by setting out your qualifications. You could put these together as a form of CV, listing your certificates and examples of businesses you've been involved in.

So how can you show you're on the same wavelength?

- Do your research into the company before making an approach and make sure you can show an understanding of, for example, how they do business, their types of clients and how you can work in the same way.
- Make sure you've set out your business proposition clearly on your website as professional connections will often check your website before agreeing to meet you. You can always set up a link from their website if the relationship is successful.

How do you make initial contact?

- Make a call or send a letter. Keep it simple and straightforward.
- Get an appointment – maybe invite them to see your business.
- Demonstrate your specialist skills.
- Take samples of materials they can use.
- Be clear about costs up front.

What information should the solicitor or accountant give their clients?

Their clients need to know about data protection issues involved in any referral. If the solicitor or accountant hasn't covered these in any previous correspondence with their clients, they need to contact them. Their clients need to agree, in writing, to their solicitor or accountant passing their information to you, and vice versa, so you can give them advice.

- The solicitor or accountant should send you a letter referring their client to you. To help justify their referral fee, they can use this letter to demonstrate that they've given you appropriate information on their client. This could include:
  - proof of their client's consent for data protection purposes;
  - why their client needs advice and what kind of advice they need, and
  - evidence of their client's identity and address for money-laundering checks.
- The solicitor or accountant should write to their client once they've received your payment for the referral. The letter should make it clear that the client doesn't need to pay the solicitor or accountant anything for the work they've done during the referral process, as their adviser charges cover this.
- The solicitor or accountant could arrange an introductory meeting with you and their client at their office.
- Once you've carried out the usual factfind and decided on your recommendation, you should send a copy of your client report to the client and their solicitor or accountant.
- The solicitor or accountant could send their client a letter to say they've received the report and comment on it. This isn't strictly necessary but can be used to show their involvement in the process.

Developing the relationship for the future

You'll need to keep in contact with the solicitor or accountant to make sure everything stays on track, and to check that they remain happy with the arrangement.

You'll also need to agree the best way of doing this. Possible ways include:

- regular phone calls;
- regular face-to-face meetings;
- producing a quarterly report;
- email or web-based communication;
- social contact, or
- a combination of some or all of the above.

Read our Guide to developing professional connections for more information.

Other introducers

You may work with colleagues or other introducers that may have continuity and succession planning needs, such as:

- commercial brokers;
- general brokers;
- in-house specialist teams (for example, mergers and acquisitions and employee benefits);
- group pensions departments;
- existing clients;
- mortgage brokers, or
- commercial mortgage brokers.

The desirable position to be in is that they identify which clients have issues and pass these over to you as leads. We have a number of tools that you can position with these client-facing colleagues to allow them to get business protection on the agenda with their clients, without having to touch on insurance-based solutions.

Visit the Vault for client-facing support materials and our Guide to developing professional connections.

Introducer toolkit

Our introducer toolkit is specifically designed to help you introduce and focus more on the need for business protection – in particular how it could help clients and their business in times of difficulty.

You can use this toolkit with our Business protection liability audit, which helps your clients identify their need for business protection.

Read our Introducer toolkit for more information.

Business types

Important information

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The fundamentals of business continuity and succession planning are similar for all businesses. However, the actual protection needs of each business, including the legal issues and the tax treatment of the business protection arrangement, will vary.

Therefore, understanding the protection needs of your client's business, and the tax and legal implications of appropriate protection solutions, is essential. In this section, we'll cover, in detail, protection arrangements for the main types of businesses.

Limited companies

What's a limited company?

A limited company is a distinct legal entity with an independent legal existence, separate from its shareholders. It must have at least one shareholder and one director. At the start of 2019, 34% of businesses in the UK were limited companies.[11]

11 Department for Business, Energy & Industrial Strategy – Business population estimates for the UK and regions 2019, October 2019

About limited companies

Most registered companies are limited companies. The shareholders register their limited company by delivering certain documents to the Registrar of Companies. Once the company is registered, the shareholders will receive a certificate of incorporation, which shows the date of incorporation and the company number.

The documents which have to be delivered to the Registrar of Companies include:

- the Memorandum of Association, which is a document confirming the original company shareholders and their agreement to both form a company under the Companies Act 2006 and to take at least one share each in the company. Before the Companies Act 2006, the Memorandum of Association contained additional information, such as details of the company's objectives, the address of the company's registered office and the company's authorised capital;
- the Articles of Association, which set out the rules and regulations governing the internal management of the company, including the rules on share transfers, and
- the Application to register a company (form IN01).

A company's Articles of Association, together with its Memorandum, form the basis of the company's constitution. The Articles of Association are sometimes referred to as the internal rule book of the company. The articles are legally binding on the company and its shareholders. A company's articles are subject to the Companies Act 2006 and can't contain rules that would cause the company or its directors to operate outside the law.

A company incorporated on or after 1 October 2009 can choose to adopt:

- model articles in full;
- model articles with additional or amended provisions, or
- bespoke articles.

The latest version of statutory model articles are available to download from Companies House.

Companies incorporated before 1 October 2009, will commonly have used Table A articles. These will remain in force for companies incorporated under the Companies Act 1985, or earlier legislation. Companies with Table A articles can amend their articles by passing a special resolution of its members. They must also register an updated copy of the articles with Companies House.

The owners of a company are its shareholders. Unless any personal guarantees have been given for corporate borrowing, a shareholder's liability in relation to the company is limited to the capital they've invested for the shares they hold. However, the company's liability isn't limited – it must pay its debts and meet its liabilities where it has the funds available.

Because it has a separate legal identity, a limited company is seen as a 'legal person' and can enter into contracts in its own name.

Limited companies pay corporation tax of 19% on their profits. Its shareholders may receive a proportion of these profits after tax, as dividends.

Individuals qualify for a £2,000 tax-free dividend allowance, meaning the first £2,000 of dividend income they receive in the tax year is free of tax. Shareholders receiving more than £2,000 dividend income in the tax year, will pay tax on the remainder of their dividend income at their marginal rate of income tax, as shown in the table below.

Tax band	2021/22 rate of tax
Basic rate	7.5%
Higher rate	32.5%
Additional rate	38.1%

Dividends aren't subject to National Insurance.

Limited companies – business continuity

Who are the key people?

A key person is someone whose death, critical illness, disability or prolonged illness would have a serious effect on a company's future turnover and profits. Most shareholding directors in small to medium sized enterprises (SMEs) will be key. In addition, a company could have one or more employees who make a vital contribution to its revenue and profitability. Who is key will depend on the company and the relevant individuals contributing to it. A person may be key to a company because they:

- have valuable sales contacts, which might be lost if they died;
- are a key sales person who contributes a significant amount of profit;
- are one of the founders, and still the main driving force of the company;
- are a controlling director who has personally guaranteed loans made to the company by a bank – the bank may insist on life protection as a condition of the loan;
- are heavily involved in the development of a new product because of their knowledge and expertise – without their input, the product launch might not go ahead, or
- are at the top in their line of work and have been time-consuming and expensive to recruit. It might be difficult and expensive to recruit their replacement.

These are just some possible examples. Who's key in a company will depend on its individual circumstances.

Reasons to cover key people

Loan cover

If the company already has outstanding loans, the loss of a key individual could affect its ability to repay them. Financial institutions will often lend money to companies based on one or two key individuals remaining part of it. If something happens to either of these key people, the financial institution would probably want the company to repay the loan immediately.

As a result, it's becoming more common for financial institutions to ask companies for some form of protection to be in place to make sure it can repay any loans.

Directors' loan accounts

Many directors will have made loans to their companies. These are shown in the company accounts as directors' loan accounts. These exist when a director loans the company capital, either at the start or after the company was formed.

Where a director is entitled to dividends or remuneration but hasn't taken these, this will increase their

outstanding director's loan. If the director dies or becomes critically ill, the company would need to repay the loan in full, unless there's a loan agreement in place with different repayment terms.

Unless otherwise stated in their will or a formal loan agreement, the personal representatives of the deceased director would have to collect any outstanding debts due to the estate, including this outstanding loan.

Therefore, it's important the business protection arrangement covers the outstanding director's loan account to protect the company, the director and the director's estate.

Loss of profits

Many SMEs rely heavily on the expertise of one or a few people in the company. For example, they could be the founder and driving force behind the company or the sales director who has a list of valuable sales contacts. If they die, become seriously ill or disabled or suffer a prolonged illness, this could cause trading problems for the company, for example loss of experienced management skills, decline in customer orders and/or loss of goodwill, and result in a financial loss.

Having business continuity plans in place, including protection cover for key people, can help the company continue trading and mitigate the potential reduction in profits as a result of the death or illness of the key person.

One-off expenses

Even if it's only on a short-term basis, you should consider any recruitment costs to replace a key person. These may include advertising, agency fees and training costs.

Our Business protection liability audit can help you highlight your clients' business continuity needs to make sure their business can continue to run smoothly.

Calculating the level of cover

When considering the level of cover a company needs, the starting point is to estimate the impact on a company's future profits if a key person dies, becomes critically ill or disabled or suffers a prolonged illness. The company will need protection in place so it can continue trading and provide funds to replace the key person.

There's no hard and fast rule for assessing a key person's financial contribution to a company, although insurable interest must exist or the contract will be void.

Underwriters will look at each case to determine whether the level of cover makes sense and will assess each case on its own merit. The amount of evidence our underwriters need depends on how much cover your clients need. You can find full details in our Underwriting limits guide.

By completing our Business protection liability audit with your clients, you can easily identify the level of cover your clients need.

Levels of key person cover

There are various ways to calculate the level of key person cover needed, as shown in the table. If the insured person is a shareholder director, they might choose to take dividends rather than salary, so the multiple of salary calculation might not be a true measure. Instead, the profits-based approach might be a more accurate reflection of the cover required.

Key person lump sum benefits	Key person income protection
• Life protection • Critical illness protection • Total permanent disability benefit	To provide an income to pay for a replacement employee or to cover loss of profits.
• Payroll-based approach: (key person salary ÷ total payroll for business) x gross profit x expected years to recover from the loss of the key person • Multiple of salary for life protection: 10 x salary • Multiple of salary for critical illness protection/TPD: 5 x salary. • Profits-based approach: 2 x gross profits or 5 x net profits	• Multiple of salary: 2.5 x total yearly income (average of last three years) • Profits-based approach: 75% of average yearly gross profits attributable to key person for the last three years • Loan repayment that can be attributed to the insured person
These are only guidelines. We'll check that the cover applied for is reasonable. In some cases, for key person life protection and critical illness protection, we may be able to consider a higher salary multiple than stated. The important point here is that your clients can justify the level of cover.	

How to set up an arrangement

There are two ways to set up the arrangement.

Company owned

It's a life of another policy because it's the company who:

- will suffer the financial loss;
- applies for the policy, and
- is the policyholder.

The insured person is the key person.

As the policyholder, the company's responsible for paying the premiums. If the key person dies, becomes critically ill or disabled or suffers a prolonged illness, the company will receive the claim proceeds. These may be liable to corporation tax. You can find more details in the **Tax implications – company-owned policies** section.

As the company is taking out the cover, it decides how to use the claim proceeds.

Own life policy in trust

In many SMEs all the shareholder directors will be key people. And, if they're also entering into a share purchase agreement funded with a life policy under a business trust, they could increase the level of cover under the same policies to include key person cover.

In this scenario, the surviving shareholder directors would receive the claim proceeds from the trustees. They could then loan the company funds through their directors' loan accounts. This could be more tax efficient than a life of another arrangement as no corporation tax will be due on the claim proceeds.

Another benefit of setting up the arrangement in this way is that, if the policy is in trust, but the company is insolvent at the point of claim, the claim proceeds could be protected from the company's creditors.

Summary – advantages and disadvantages for each option

The main advantages and disadvantages of each option are as follows:

Advantages

Company owned	Own life in trust
No need to execute trust deeds.	Claim proceeds paid to the trustees rather than the company – not subject to corporation tax.
No need to deal with the tax compliance issues associated with a trust such as inheritance tax (IHT) 10-year and exit charges.	Claim proceeds could be protected from the company's creditors as the policy is in trust.
The claim proceeds will be in the right hands at the right time, as they'll be paid to the company which is suffering the financial loss.	

Disadvantages

Company owned	Own life in trust
The company's creditors could claim the proceeds if the company is insolvent.	Trustees need to deal with the tax compliance issues associated with a trust such as IHT 10-year and exit charges.
Claim proceeds could be subject to corporation tax, if the purpose of the policy is of a revenue nature. For example, to cover loss of profits.	The directors may have to pay for legal advice to get a suitable trust drafted.
	Premiums subject to income tax and National Insurance if the company pays.

See the **Our solutions** section for our professional approach to completing business.

Tax implications – company-owned policy

The company owns the life policy. The key person is the insured person and has no rights to the policy or the claim proceeds.

There are no tax implications for the key person, unless the company transfers the policy to them by assignment, or pays any of the claim proceeds to them, their estate or their family.

Before a company takes out a key person policy, it may want to know if the premiums will qualify for corporation tax relief and/or if the proceeds on a claim will be tax free.

Tax treatment of premiums

Unfortunately, there's no direct legislation covering the taxation of key person policies, but the principles that apply were set out in 1944 by the then Chancellor of the Exchequer, Sir John Anderson. These principles are known as 'the Anderson Rules'.

Following a parliamentary question, he said the 'treatment for taxation purposes would depend upon the facts of the particular case and it rests with the assessing authorities and the Commissioners on appeal if necessary to determine the liability by reference to these facts. I am, however, advised that the general practice in dealing with insurances by employers on the lives of employees is to treat the premiums as admissible deductions, and any sums received under a policy as trading receipts, if:

- the sole relationship is that of employer and employee;
- the insurance is intended to meet loss of profit resulting from the loss of services of the employee, and
- it's an annual or short-term insurance.

Cases of premiums paid by companies to insure the lives of directors are dealt with on similar lines.'

If the insured person is a significant shareholder (generally anyone with a shareholding of more than 5%), HMRC will usually argue that there's duality of purpose behind the cover. In other words, the protection cover is also to protect the value of the business, so HMRC won't allow corporation tax relief on the premiums.

> The tax treatment of premiums and proceeds can never be guaranteed. The local Inspector of Taxes will look at each case on its own merits.

The company will charge the premiums through the profit and loss account and submit the corporation tax return to HMRC. The company could highlight to HMRC that it's paid the premiums and confirm if it's claimed corporation tax relief and why. The Inspector will then decide whether to allow the company's claim for tax relief on the premiums.

It's commonly believed that if a company doesn't receive tax relief on the premiums it will receive the claim payment tax free and vice versa. Whether or not tax relief is available on the premiums depends on whether they're allowable as a business expense.

To be an allowable business expense, the premiums must be paid 'wholly and exclusively for the purposes of the business'.

So, it's important to look at the Anderson Rules in detail to determine the tax consequences. Read our Taxation of key person policies technical factsheet for more information, including example scenarios and possible tax consequences.

Tax treatment of the claim proceeds

Where key person cover is designed to meet the loss of profits, the company will pay tax on the claim proceeds at its marginal rate for that financial year. This is because the policy was to replace loss of profits and those profits would have been taxable.

It's commonly believed that if a company doesn't receive tax relief on the premiums it will receive the claim payment tax free and vice versa. Whether or not the proceeds are taxable isn't automatically linked to whether tax relief was granted on the premiums. The tax treatment of the claim proceeds will be determined using normal tax principles, which will usually mean identifying whether the receipt is of a capital or revenue nature.

If the purpose of the policy was to cover loss of profits, in other words of a revenue nature, the claim proceeds will be taxable. Revenue purposes include the costs of replacing a key person and absorbing loss of profits.

If the policy was taken out for a capital purpose, the claim proceeds should be tax free. Capital purposes include buying new premises or repaying a company bank loan.

The benefit amount could take into account the tax that the company might pay if the insured person dies, and the benefits are taxable as a revenue receipt. When applying for the policy, the company will have to consider whether the cover is for capital or revenue purposes to determine whether tax will be payable.

Chargeable event legislation

The chargeable event rules don't apply to limited companies. Instead, they're subject to the loan relationship rules. However, there won't be any tax charge as our protection policies have no investment content.

HMRC's Business Income Manual sections BIM45530, BIM45525 and BIM40751 provides detailed guidance to help businesses work out their trading and non-trading income for tax purposes, and check their calculations. It supplements the basic guidance given in the self-assessment tax return and associated helpsheets.

Tax implications – own life policy in a business trust

Each key person can apply for an own life policy and place it in trust for the benefit of the other shareholder directors. The trustees can pay the claim proceeds to the surviving shareholder directors who could then loan the company the funds through their directors' loan accounts.

Tax treatment of premiums

Where the company pays the premiums on behalf of the shareholder director, the shareholder director will pay income tax and National Insurance on the premiums. The company will also have to pay National Insurance on the premiums.

The company might get corporation tax relief if these additional earnings are deemed to be 'wholly and exclusively for the purpose of the business'.

Tax treatment of the business trust

Inheritance tax (IHT)

Providing the arrangement is commercial, the premiums aren't treated as gifts for IHT purposes. The trustees of the business trust will have to consider the potential ongoing IHT charges, such as exit charges and 10-year charges.

Tax treatment of the claim proceeds

The claim proceeds will be paid tax free to the trustees. The death of the insured person is a chargeable event. However, there won't be a chargeable gain, as our protection policies have no investment content.

Assigning the company-owned key person policy

The key person, as the insured person, doesn't have any rights to the policy, either in terms of its ownership or the claim proceeds. The key person could leave or retire from the company before the end of the policy term. The company may, therefore, choose to cancel the policy because it's no longer needed.

Alternatively, the company may decide to assign the policy to the departing key person. In this case, a solicitor would have to draft a suitable Deed of Assignment. If the key person leaves the company and the policy is transferred to them in the same tax year, they'll be taxed at their marginal rate on the total premiums paid at the date of transfer, due to the benefit-in-kind legislation.

If the policy is transferred to the key person in the tax year following their departure, the benefit-in-kind legislation won't apply. However, the termination of employment legislation will apply, so the tax liability will be calculated on the market value of the policy.

As the protection policy has no investment content, there won't usually be a market value, unless the insured person is critically or terminally ill. Once the policy is transferred to the key person, it becomes second hand and the capital gain (which is the claim proceeds less the premiums paid to date by the key person) could be liable for capital gains tax.

Limited companies – business succession

Business succession planning is one of the biggest issues the shareholders of limited companies have to face. So it's important that the owners sit down and discuss what they'd like to happen to their shares and the management of the company when or if anything happens to one of them.

For example, the remaining shareholders might not want a third party acquiring the shares of a majority shareholder, as they'd effectively take control of the business. Similarly, if a shareholder were to die, their family might simply prefer to receive the market value of their share in cash and not have anything more to do with the business.

Business succession planning, together with a business protection arrangement to provide the funds, allows the remaining shareholders to keep control of the company, while helping to make sure that the outgoing shareholder's family receive the value of their business interest should anything happen to them.

Choosing the most suitable succession and protection arrangement

There are various steps involved in setting up a succession (share purchase) arrangement.

- Consider whether the Articles of Association allow the shareholders to achieve their business succession objectives.
- Determine the value of each shareholder's shareholding.
- Put in place a legal agreement stating who is to, or who has the option to, buy the shares in the event of critical illness and/or death, and at what price.

The protection arrangement can be set up to provide the funds in the event of the critical illness or death of a shareholder.

There are different ways of providing funds to facilitate business succession planning:

- Own life policies held under business trust
- Life of another policies
- Company-owned policies

In all cases, shareholders should put a suitable option agreement for the share purchase in place. Our Business intestacy audit can help shareholders match their aspirations with reality.

The Articles of Association – why are they important?

Any form of business succession plan that the shareholders put in place must be consistent with the provisions detailed in their shareholder agreement and the company's Articles of Association (see **About limited companies** for more information). Otherwise, the shareholders will have to arrange for a solicitor to amend the articles.

When a shareholder dies, their shares will form part of their estate and ultimately pass to their beneficiaries under the terms of their will, or the laws of intestacy if they haven't left a valid will.

The deceased's personal representatives will have to provide the company with a grant of probate or letters of administration to prove their right to deal with the deceased's shareholding. The personal representatives' rights, for example in relation to the sale of the shares, are subject to the provisions of the company's articles and any shareholder agreement.

The articles are important because they might contain:

- restrictions on the transfer of the shares in the event of the death and/or critical illness of a shareholder;
- pre-emption rights – giving the other shareholders the rights to buy the shares at a price specified in the articles before the shares are offered for sale in the open market, or
- provisions which allow the directors to refuse to register a particular transfer of shares.

Company share purchase

A company's articles don't need to expressly allow this type of purchase. A company can buy its own shares, as long as this isn't restricted or prohibited in its articles (and it complies with the procedure set out in legislation). The shareholders should review their articles with their solicitors to make sure that the provisions of their articles match their aspirations.

Calculating the level of cover

The level of cover should be equal to the value of the respective shareholding. As share values may change, it's important to regularly check that the level of cover is enough for the surviving shareholders or the company to buy the deceased or critically ill shareholder's shares.

If there's not enough cover, the surviving shareholders or the company might not be able to afford the shares, and would have to find another way of paying for them.

This is a highly subjective area because the value of any company is, in effect, the price that somebody else is willing to pay for it. The benefit amount should reflect the value of the share in the company, based on a reasonable valuation method. We recommend getting an independent valuation from a qualified accountant.

There are several ways to value a company.

Net profit multiple

This will be averaged over the last three years.

- Companies demonstrating good growth year on year – up to 10 times.
- Companies with a fairly static but consistent trading position – 5 to 7 times.
- Companies with an inconsistent trading position, or decreasing profits – up to 5 times.

Net profit new business

Net profit as detailed in business plan projections – up to 5 times.

Net asset value

Suitable for stable businesses with significant tangible assets. This is the value of assets as detailed in the accounts, less any liabilities.

Taking a simplified view, this is the cash you could expect to receive for a company if it were broken up and sold. However, it takes no account of intangible assets, such as the value of brand name, skilled or specialist employees, goodwill etc. Also, assets may be understated, being recorded at their historic cost rather than current market value.

Price earnings ratio (PER)

The PER method of valuation focuses on a company's anticipated future profitability and the perceived present-day value of these profits. The higher the ratio, the greater future profits are expected to be, relative to the current profits.

The valuation is calculated by multiplying after-tax profits by a factor, the PER, which reflects the prospects for the company and the industry.

Company valuation

Net profit after tax x PER

Value of shareholding

Percentage of issued share capital owned x company valuation

The PER is the share price divided by the earnings per share. You can find a list of industry average PERs in the **Financial Times**, which indicate the maximum PER that's reasonable to use.

Generally, a company that has the potential for above-average growth will have a higher PER than a company managing only sluggish growth. However, it's important to remember that these multiples are the stock market's view of well-researched, quoted businesses, which offer much greater liquidity than a private company.

In a start-up situation, the PER may be very high in relation to current profits because of high initial costs. In this scenario, the valuation report or business plan should explain how the company will achieve its future level of profitability.

Where the PER is unknown, a multiple of five times net profit would be reasonable. You can add directors' basic salaries back into profit.

Earnings before interest, tax, depreciation and amortisation (EBITDA)

EBITDA is normally used as a comparison, over time, of the profitability of a company's operations without the potentially distorting effects of changes in depreciation, amortisation, interest and tax.

The main advantage of EBITDA over the PER is that it's unaffected by a company's capital configuration. It compares the value of a business, free of debt, to its earnings before interest. In a start-up situation, the EBITDA isn't suitable, so a valuation report or business plan is needed.

EBITDA

EBIT + Depreciation + Amortisation

Company value

EBITDA averaged over last two years x multiple

The multiple of EBITDA is determined by the industry the company operates in. However, we accept a multiple of five.

No matter what method you use to value a business, if there's key person protection in place, you may need to take the claim proceeds into account when valuing the company.

Types of shareholder agreement

Double option agreement

This is also known as a cross option agreement. The surviving shareholders have an option to buy the deceased's shares and the personal representatives have the option to sell. If either party exercises their option within a specified timeframe, the other party must comply. As the option agreement isn't a binding contract for sale, it helps to preserve any business property relief (BPR) that the shares attract. We cover BPR later.

Our Sample double option agreement states that each shareholder must take out and maintain a policy in trust that provides the amount needed to buy their shares, and how the shares are to be valued when they die.

The shareholders should speak to a solicitor to make sure that our sample double option agreement meets their needs. However, as we've previously mentioned, it's important to check that the option agreement is consistent with the company's Articles of Association.

Single option agreement

Although a double option agreement is commonly used for life protection, it may not be appropriate for critical illness protection. This is because a double option agreement would mean that the other shareholders could force the critically ill shareholder to sell their shares following a critical illness claim. However, they may not want to sell their shares for various reasons, such as they:

- may recover and want to return to work;
- may have to pay capital gains tax when they sell their shares, or
- will lose the benefit of business property relief (BPR) if they sell their shares as the cash proceeds will form part of their estate and be liable for IHT.

The solution may be to have a single option agreement, which lets the critically ill shareholder sell their shares, but doesn't give the other shareholders an option to insist that they sell. We have a Sample single option agreement for shareholders who want critical illness protection.

However, a single option agreement for critical illness protection may not always be the best option as the shareholder may assume they're going to recover but don't. To get around this, the shareholders may prefer a double option agreement with different option periods.

The ill shareholder could have an option to sell within a fairly short time, such as three or six months, following diagnosis of the illness. The other shareholders could have an option to force a buyout, which they could use after a suitable period has passed. This will usually be longer than the option period of the ill shareholder, such as one or two years. The longer option period should put the other shareholders in a better position to decide whether they want to buy out the ill shareholder or not.

Buy and sell agreements

HMRC considers there to be a binding contract for sale where the shareholders enter into a buy and sell agreement. This means, if a shareholder dies, the deceased's personal representatives must sell and the other shareholders must buy the deceased's shares. When they die, the deceased's shares are viewed as cash and therefore business property relief (BPR) won't apply.

The loss of BPR might not be an issue if the deceased's estate is to pass to a surviving husband, wife or registered civil partner, because that would be an exempt transfer. In this case, there wouldn't be any inheritance tax to pay on a shareholder's death. However, this doesn't help if assets pass on death to someone other than a husband, wife or registered civil partner for example, children or to a trust. If the deceased's shares are to be sold to the surviving shareholders it's better to preserve the BPR, so the double option method would be the better option.

Choosing the most suitable business protection arrangement to meet your business succession plans

Let's now look at the three methods of shareholder protection in more detail.

Own life policy under a business trust

This type of arrangement makes sure the shareholders have the funds available to buy the shares from a critically ill shareholder or a deceased shareholder's personal representatives.

Setting up this arrangement

Each shareholder applies for an own life policy, generally for a term up to their retirement date, for the value of their shares. From the start, the policy is held in the business trust for the benefit of the other shareholders. It's very important that an existing policy isn't assigned into the trust, as this could result in a capital gains tax charge in the event of a claim. The capital gain is likely to be the difference between the claim proceeds and the premiums paid to date by the trustees.

Our Business trust is a flexible interest in possession trust. Flexible interest in possession trusts are trusts where the trustees must pass on all trust income to the default beneficiary(ies) as it arises (less any expenses). Where a business trust is created after 21 March 2006, it's taxed under the relevant property IHT regime, which we cover later.

If a shareholder dies or becomes critically ill, the other shareholders can use the funds from the trust to buy the shares from the critically ill shareholder or the deceased's legal personal representatives. For example, if there are four shareholders, each with a 25% shareholding, the three surviving shareholders could each buy one-third of the deceased's share, so the survivors would each have an equal 33.3% share. The claim proceeds would go to the trustees who would pay the funds to the surviving shareholders. The surviving shareholders would then buy the shares from the deceased's personal representatives so that whoever is named in the deceased's will, or according to the rules of intestacy if they don't have a will, receives the cash.

Each shareholder is known as the 'settlor' of the trust they've created and is automatically a trustee. Each shareholder should appoint additional trustees, which will usually include some or all of the other shareholders in the arrangement. The other shareholders will be the beneficiaries in their respective proportions. The settlor is also a beneficiary of the trust, so the trustees can assign the policy to the settlor before a claim arises, if they no longer own shares.

To help protect the benefits of the arrangement from IHT, it's important that the only shareholders who can benefit are those participating in the arrangement. In other words, each shareholder should take out a policy on their own life and put it into trust for the others. If any shareholders don't participate, they shouldn't be able to receive any benefit from the trust. We'll cover more about the IHT benefits later.

This arrangement will make sure the trustees receive the benefit amount if the settlor dies or becomes critically ill. This also provides the shareholders with the funds to buy the shares from the critically ill shareholder or the deceased shareholder's personal representatives in line with their option agreement.

What happens to the claim proceeds if the single option isn't exercised?

When a critical illness claim is made, the trustees, as the owners of the policy, receive the claim proceeds. The shareholder may decide that they want to remain a shareholder and not sell their shares. In that case, the trustees should think about keeping the claim proceeds within the trust in the short term until the succession issue has been resolved. However, this might result in a pre-owned assets tax (POAT) charge if the settlor is a beneficiary under the terms of the trust, and the trustees still hold the proceeds on 6 April. See the **Pre-owned asset tax** section for more information.

The purpose of the protection is to buy the shares from the shareholder if they become critically ill. If the trustees give some or all of the claim proceeds to the critically ill shareholder, this could raise a number of problems.

For example, the critically ill shareholder could suffer a second critical illness. But, if some of the claim proceeds have already been spent, the remaining shareholders won't have enough money to buy the shares from the critically ill shareholder. If it's a life with critical illness policy, the shareholders will again have to consider how they'll buy the deceased's shares in the future if the claim proceeds on the earlier critical illness have already been spent by the other shareholders or distributed to the critically ill shareholder.

What happens if a shareholder no longer holds shares in the company?

Our business trust is flexible. Any new shareholders joining the company are automatically included as beneficiaries of the existing business trusts, as long as the new shareholder takes out their own life policy in a business trust. The shareholders will also need to draft a new option agreement.

The business trust also states that, if the settlor no longer holds shares in the company for any reason other than their death, then the trustees hold the policy for the settlor. This means the settlor will be entitled to the claim proceeds. A shareholder may sell their shares if they leave or retire from the company or will no longer hold shares if the company goes out of business and is liquidated.

In the event that the settlor no longer owns shares, the trustees could assign the policy to them. They could then continue the policy and use it for some other purpose, such as putting it into a flexible trust for the benefit of their family.

Tax implications – own life policy under a business trust

Tax treatment of the premiums

If the shareholders pay the premiums, they won't receive any tax relief. Similarly, if the company pays the premiums and charges these back to the shareholders, the premiums won't qualify for tax relief.

If the company pays the premiums, then it will be meeting the pecuniary liability (personal debt) of the shareholder. This will result in the premiums being subject to income tax and National Insurance. The company might get corporation tax relief if these additional earnings meet the 'wholly and exclusively for the purpose of the business' test.

Tax treatment of the claim proceeds

The claim proceeds will be paid tax free to the trustees. The death of the insured person is a chargeable event. However, there won't be a chargeable gain, as our protection policies have no investment content.

IHT treatment of the business trust

Maintaining the commerciality of the arrangement

In an own life under business trust arrangement using our business trust, each shareholder is a potential beneficiary of the business trust they've created. This is because the policy can be assigned out of the trust to them if, for example, they no longer hold shares in the company. Usually if someone gives an asset away but can still benefit from the gifted asset, it's treated as a gift with reservation of benefit. However, if the arrangement is commercial without any element of gift, this will help to safeguard the IHT treatment of the arrangement making sure it doesn't trigger the gift with reservation of benefit provisions.

Also, as the shareholders are all applying for an own life policy in a business trust at the same time, and they're beneficiaries under each others' trusts, the arrangement has to be commercial to avoid triggering the gift with reservation of benefit associated operations rules. The potential beneficiaries of the business trust are restricted to the other shareholders only and don't include family members.

There are various ways of helping to protect the commerciality of the arrangement, such as:

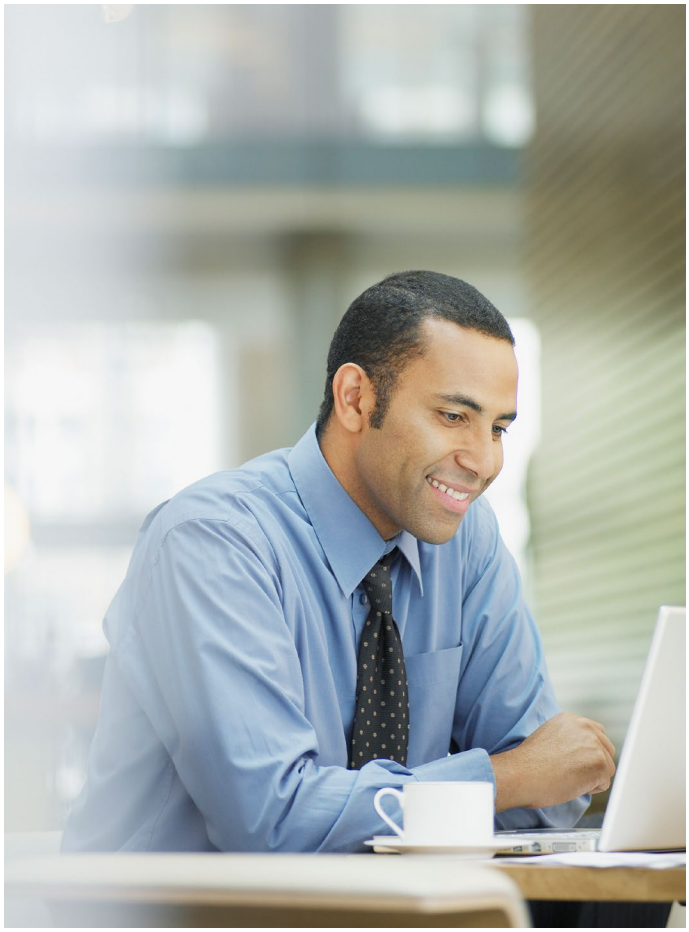
- restricting the beneficiaries under the trust to the shareholders who have taken out cover in trust for the same purpose;
- making sure the shareholders aren't overinsured, and
- equalising the premiums.

As previously mentioned, it's important that only shareholders who take part in the protection arrangement can receive any claim proceeds.

If one of the shareholders isn't able to get life cover, for example because of their age or bad health, they'll need to find an alternative way to buy the shares if one of the shareholders dies or becomes critically ill. Some options could be taking out a loan or ring-fencing savings.

Similarly, those taking part in the arrangement also need to consider how they'd buy the shares of the uninsured shareholder. For example, they could borrow money to buy the shares or they may decide that they can only afford to do so by paying for the shares in instalments over a number of years. In this case, they need to get a solicitor to draw up a suitable agreement.

The level of cover should equal the market value of the shareholding, if the option agreement gives the shareholders the option to buy the shares at market value. The shareholders should review their cover regularly. If there's a shortfall when a shareholder dies or becomes critically ill, the other shareholders will have to find the money elsewhere to make this up. If the level of cover is too high, then arguably there's an element of gift being made, so this could impact the commerciality and IHT effectiveness of the arrangement.



Equalising the premiums

Each shareholder takes out an own life policy. If the shareholders are different ages, the costs of their individual protection policies will vary. If the shareholders each pay the premiums for their policy held in trust, this would mean that older shareholders would generally pay more but be less likely to benefit because they're more likely to die before the younger shareholders. This could affect the commerciality of the arrangement.

Equalising the premiums can address this inequality, with the shareholders making cash payments between themselves. Alternatively, the company's accountant can adjust their directors' loan accounts to correct this. This makes sure that each shareholder contributes to the total cost of the arrangement in proportion to the benefit they're likely to receive, meaning there's no element of gift. Use our Premium equalisation calculator or read our Equalisation of policy payments factsheet for more information on how to equalise premiums to maintain the commerciality of share purchase arrangements.

IHT entry charge

Normally the premiums won't have any IHT consequences because each shareholder is putting their policy in trust for the other shareholders as part of a commercial arrangement. Therefore, the premiums aren't gifts, so the gift with reservation provisions won't apply.

Ten-yearly charge (also known as the periodic charge)

On each tenth anniversary of the trust's creation, the trust is assessed for IHT. There will be a 10-yearly tax charge if the value of the trust fund immediately before each tenth anniversary is more than the applicable nil rate band. As a protection policy won't usually have a market value, in most cases there shouldn't be any tax to pay.

A 10-yearly charge could be payable if the claim proceeds were still held in trust, or the insured person dies, or is critically or terminally ill, immediately before the tenth anniversary. In these cases, there would be value in the trust. However, tax will only be payable up to 6% on any value above the applicable nil rate band.

If there's a tax charge but the trustees don't have the funds to pay it, HMRC may try to recover the tax from the trust's beneficiaries or settlor.

These charges will apply even if the arrangement is commercial and there was no entry charge.

Exit charge (also known as the proportionate charge)

An exit charge between 10-year anniversaries is unlikely. When the trustees distribute all or some of the trust fund to the beneficiaries, exit charges might be triggered. The maximum rate of tax is 6%, although this reduces depending on whether the exit charge occurs before the first 10-year anniversary or after the last 10-year anniversary.

If the claim proceeds are distributed to the remaining shareholders before the first 10-year anniversary, this won't generally result in a tax charge. This is because the calculation of an exit charge takes into account the value of the trust fund at the start of the trust, which should be nil when the policy is issued to the trustees, and any additions to the trust before an exit charge is triggered. The premiums won't amount to transfers of value in a commercial arrangement.

If an exit charge occurs after the first 10-year anniversary, the rate of tax is based on the rate that applied at the last 10-year anniversary. However, in most cases, there won't be a 10-yearly charge at each tenth anniversary.

Pre-owned assets tax

Pre-owned assets tax (POAT) is a yearly income tax charge, which aims to counter certain IHT avoidance schemes, which don't meet the gift with reservation of benefit rules, but could still allow a shareholder (or donor) to benefit from assets given away.

As the settlor is included within the class of beneficiary under the business trust (this doesn't amount to a gift with reservation of benefit because the arrangement is 'commercial'), they'll be liable to a POAT charge while they're alive and resident in the UK. This is because unlike with IHT, there's no 'commerciality' exemption for POAT purposes.

POAT is a separate income tax charge, which applies to the settlor whether they actually receive a benefit from the trust or not. It's calculated by applying a prescribed rate (equal to the official rate of interest as defined in section 181 Income Tax (Earnings and Pensions) Act 2003) to the value of the trust fund at 6 April each year. This is subject to the settlor's overall £5,000 de minimis limit. Below this, there's no income tax charge.

If it looks like there will be value in the trust on 6 April, the trustees could remove the settlor by Deed of removal of beneficiaries in order to avoid a POAT charge applying. This could be as a result of a critical illness or terminal illness claim being in progress, or the claim proceeds being held in a trustee bank account on 6 April.

Life of another – individual owned

This type of arrangement will generally be suitable where there are only two shareholders.

Setting up this arrangement

Shareholder A would apply for a policy on the life of shareholder B and shareholder B would apply for a policy on the life of shareholder A. The benefit amount should equal the value of the insured person's shareholding. The shareholders should also put an option agreement in place. This provides the shareholders with the funds to buy the shares from the critically ill shareholder or the deceased shareholder's personal representatives in line with the terms of their agreement.

A double option agreement is the most attractive option agreement where the shareholder dies. Whereas a single option agreement could be preferable where the shareholder becomes critically ill. However, as the critically ill shareholder doesn't have to use their option, under a single option agreement, this could cause problems. For example, shareholder A has a life with critical illness policy on the life of shareholder B.

- If shareholder B suffers a critical illness, shareholder A would receive the claim proceeds as policy owner.
- If shareholder B sells their shares to shareholder A, the claim proceeds paid to shareholder A are outside shareholder A's estate when they buy the shares.
- If shareholder B has a single option agreement but decides not to exercise their option, shareholder A would still have the claim proceeds in their estate, which would potentially become liable for IHT at 40%, if shareholder A dies without buying shareholder B's shares.

The policy shouldn't be written in trust. Each shareholder will own the policy on the life of the other shareholder and will pay the premiums for it. It isn't necessary to equalise the premiums, as the shareholders aren't paying premiums that reflect their personal circumstances.

If an insured person dies, the shareholder who has taken out the policy would receive the claim proceeds. The policy owned by the deceased shareholder would form part of their estate, with the value being the market value on the date they died.

There are some disadvantages with this arrangement. If there's a wide gap in the ages of the shareholders, the younger shareholder will pay higher premiums for the policy they own on the life of the older shareholder.

If there are several shareholders, many policies will be needed making this an unattractive option. For example, three shareholders would need six policies, while four shareholders would need 12.

This type of arrangement is also inflexible, as it doesn't provide a revolving door facility when new shareholders join or leave the company.

Tax implications – life of another individual owned

Tax treatment of premiums

If the shareholders pay the premiums, they won't receive any tax relief. Similarly, if the company pays the premiums and charges these back to the shareholders, the premiums won't qualify for tax relief.

If the company pays the premiums then it will be meeting the pecuniary liability (personal debt) of the shareholders. This will result in the premiums being subject to income tax and National Insurance.

The company might get corporation tax relief if these additional earnings meet the 'wholly and exclusively for the purpose of the business' test.

Tax treatment of the claim proceeds

The claim proceeds will be paid tax free to the policyholder. A claim on the death of the insured person is a chargeable event. However, there won't be a chargeable gain, as our protection policies have no investment content.

IHT

Each shareholder will own a policy on the life of the other shareholder. The value of this policy will form part of their IHT estate. As there's no trust involved there will be no other IHT implications.

Company share purchase

Rather than having an arrangement where the shareholders buy the shares of a deceased shareholder, a company can buy back its shares. While this arrangement is easy to set up as no trust is involved, it's complicated in terms of tax and company law so shouldn't be attempted unless the company's auditors, tax advisers and corporate lawyers are all involved in the advisory process.

Setting up this arrangement

The company takes out policies on the lives of each of its shareholders with a benefit amount that reflects the value of each shareholding, generally for a term up to their retirement date.

If a shareholder dies or becomes critically ill, the claim proceeds will be paid to the company, giving it the necessary capital to buy the shares of the deceased or critically ill shareholder.

No trusts are required in this arrangement.

There should be a written agreement between the company and each of its shareholders setting out the terms of a potential share purchase. Commonly, this will be an option agreement rather than a binding contract for sale, to protect any business property relief the shares attract. A solicitor should draft this.

A double option agreement, containing a provision that the buyback of the shares is subject to the company being able to make the necessary solvency statement and meeting the legal requirements outlined below, would generally be preferable.

The solvency statement is a statement that each of the directors believes that the company will be able to meet its obligations and pay its debts over the next 12-month period.

If the company is insolvent, the claim proceeds from the protection policy will be used to pay off the company's creditors in the first instance, so the shareholder or the shareholder's beneficiaries might not receive the value of the shares.

Legal requirements

For a company share purchase to take place, the company must meet a number of legal requirements. These are set out in Part 18, Chapter 4 of the Companies Act 2006. The main legal requirements are:

- A company can buy its own shares unless this is specifically restricted or prohibited by its Articles of Association. This is helpful, as the articles of some older companies didn't provide the necessary authority.
- The contract to buy shares must be authorised by an ordinary resolution (simple majority of shareholders with more than 50% of the voting rights) before any share purchase.
- The company must first buy any shares out of distributable profits or from the proceeds of any new share issue, with only the balance coming from capital. Where the company is using capital to buyback the shares, this has to be authorised by a special resolution (requires at least 75% of the shareholder votes to approve this).
- The company must pay for the shares when it buys them.
- The company can't buy back 100% of its share capital, as there still has to be existing shares.
- When a company buys shares, it must deliver a return to the Registrar of Companies within 28 days, beginning on the date it receives the shares.
- The company must cancel the shares it buys, so they become unissued share capital. It must also tell the Registrar of Companies of the cancellation within 28 days, beginning on the date it receives the shares. It must also include a statement of capital.

The authorised share capital (the maximum amount of share capital that a company's permitted to issue to shareholders) stays the same, while the shares become unissued share capital. This effectively increases the proportionate shareholdings of the remaining shareholders.

Let's look at an example to see what this means in practice.

- A company has an issued share capital of 100 shares, with each of its four shareholders having 25 shares or a one-quarter interest. When a shareholder dies or becomes critically ill, the company buys their shares and they're cancelled. This would leave 75 shares with each shareholder now having a one-third interest.
- If the share purchase is to be funded from capital, there are other points to consider.
- The directors must make a statement about the solvency of the company (confirming that the company will be able to continue trading for the next year) and include a report addressed to the directors by the company's auditors.
- Within the week following the resolution, the share purchase must be publicised in the London Gazette and a national newspaper, or they must give notice to each of the company's creditors.
- As capital is leaving the company, it can get clearance under section 1033 Corporation Tax Act 2010.

You can also read about this in our Shareholder protection – an unquoted company buying its own shares factsheet.

Tax implications – company share purchase

Tax treatment of premiums

As the company is the policyholder, it pays the premiums and won't receive any corporation tax relief. This is because the policy isn't designed to meet loss of profits and is on the life of a shareholder. Instead, the company will use the claim proceeds for the capital purpose of buying back the shares when a shareholder dies or becomes critically ill. This means the expense doesn't meet the 'wholly and exclusively for the purpose of the business' rule.

As the company owns the policy and pays the premiums, there are no tax implications for the shareholder.

Tax treatment of claim proceeds – company

The claim proceeds will be paid to the company and shouldn't be liable to corporation tax as they're treated as a capital rather than a revenue receipt. When the company receives the claim proceeds, the share value could increase because of this cash injection. Therefore, the shareholders might want to consider this at the start, and on an ongoing basis, when determining the value of their shareholdings and the level of cover needed.

Tax treatment of claim proceeds – outgoing shareholder

As previously mentioned, when the company receives the claim proceeds, it won't be liable for corporation tax. However, when the company uses these to buy the shares, the proceeds in the hands of the person selling the shares could either be treated as:

- a capital receipt subject to capital gains tax (obviously preferable scenario), or
- a distribution liable for income tax at the following rates:
  - The outgoing critically ill shareholder will be liable at their marginal dividend rate of income tax.
  - The deceased's personal representatives will be liable for income tax at the dividend basic rate during the estate administration period, and the beneficiaries will be liable at their highest marginal dividend tax rates when the proceeds are distributed to them.

Generally, capital gains tax will be preferable as the current rate is 20% (or 10% for gains falling within the basic rate band) compared with income tax rates on dividends.

Business asset disposal relief (formerly Entrepreneurs' relief) may also be available which would reduce the capital gains tax rate from 20% to 10% on the first £1 million of gains made since 2008.

When a shareholder dies, there's an automatic tax-free uplift on the value of shares for capital gains tax purposes. This could result in there being no gain when their personal representatives sell their shares, where the value on the date they died (the base cost) is equal to the selling price.

The critically ill shareholder or the personal representatives of the deceased shareholder must meet the following conditions for capital gains tax treatment:

- The company must be an unquoted trading company or a holding company of a trading group. Investment companies are excluded.
- They must be a UK resident and have owned the shares for at least five years (for the personal representatives, this will be the deceased shareholder's residence immediately before their death). The five-year period is reduced to three years if:
  - the sale is by the personal representatives following the death of a shareholder;
  - the shares were received under the terms of the will of the previous owner, or
  - the shares were received in exchange for other shares as part of a company reconstruction.
- Their interests must be eliminated, or substantially reduced, as defined by HMRC.
- The purchase must be for the benefit of the company's trade or its 75% subsidiary.
- The purchase must not be part of a tax avoidance scheme.

Single member companies

What are single member companies?

Since the introduction of the Companies (Single Member Private Limited Companies) Regulations 1992, it's been possible for a private company to have just one shareholder – referred to as 'a single member company'. This provision is confirmed in the Companies Act 2006, which also allows private companies to have just one director. The only other statutory requirement is that a director must be at least 16 years old.

Since April 2008 there's no requirement for a private company to have a company secretary, although one can still be appointed. Individuals who prefer to run their business on their own can register with Companies House to receive a certificate of incorporation (where they want to limit their liability or for tax reasons), without involving other people.

Practical problems for single member companies

One potential problem of operating as a single member company is, should anything happen to the individual shareholder director, issues can arise around who has control of the company in the short term.

Companies which have adopted the default Model Articles under the Companies Act 2006, have the necessary provisions to allow personal representatives to appoint directors. However if the old Table A Articles apply (for companies incorporated before 1 October 2009), these don't allow personal representatives to make decisions on behalf of the company, for example appointing a new director to run the company. In this scenario, if the Table A Articles aren't amended, the personal representatives will need to apply to the Court to correct the register of shareholders by removing the deceased's name and replacing it with the names of the personal representatives, before they can appoint a new director.

Business protection planning for single member companies

When thinking about business continuity or succession planning for single member companies, the points to consider will be similar to those involving sole traders. A key consideration is whether the business will carry on following the death or serious illness of the owner or whether it will, effectively, die with the owner. We cover this in more detail in the **Sole traders** section.

Management buy-outs

What's a management buy-out?

Where the co-shareholders don't want to enter into share purchase arrangements but there's a strong management structure involving non-shareholding employees, it may be possible for business succession plans to be put in place. The management team could arrange to buy the shares of the deceased shareholder from their estate (assuming the shares aren't going to pass to family members who will continue to be involved in the business). This is usually referred to as a 'management buy-out'.

Management buy-out agreement

The management team's 'right to buy' should be documented by the relevant shareholder and the management team entering into an agreement to buy the shares. In most cases, for tax reasons, the agreement to buy the shares would be in the form of an option agreement between the relevant shareholder and the management team and not a binding agreement for sale. Using an option agreement rather than a binding agreement is particularly relevant for agreements that cover the purchase of shares on death, as any available business property relief for inheritance tax purposes would not be affected.

A management buy-out arrangement may be put in place for all the shareholders' shareholdings (where there's more than one owner) or the shareholding of one or more particular shareholder.

The relevant shareholder and the management team should speak to a solicitor to make sure any option agreement meets their needs.

Funding a management buy-out

Whenever the sale takes place, having access to funds is important for the management team. To make sure the funds are available, the management team should take out a life policy on the life of the relevant shareholder.

The level of cover should reflect the value of the shares to be sold/bought and should be split between all the employees/managers participating in the arrangement. The employees/managers will pay the premiums, which may be covered by an increase in their salaries – which would need to be agreed by all the shareholders. Making sure the business transfer goes smoothly is clearly in the interests of the company and, as far as the relevant shareholder is concerned, they know their family will be compensated for the value of their share of the business on their death.

Granting an option to sell may have capital gains tax implications for the relevant shareholder. This will depend on the age and state of health of the shareholder and is particularly important if the price for the purchase is fixed. Therefore, for any succession arrangement involving a transfer of a business to the management team, it's important all parties involved seek professional advice.

Need more help?

If you need more help and support with putting protection in place for limited companies, speak to your usual Aegon sales contact or email us.

Important information

The following information is based on our understanding of current taxation law and HM Revenue & Customs (HMRC) practice, as at May 2021, which may change.

The tax treatment depends on the individual circumstances of each client and may be subject to change in future. The value of any tax relief depends on the individual circumstances of your client.

Trusts establish legal rights and entitlements and might have material financial and tax implications for the settlor, trustees and beneficiaries. Aegon UK isn't authorised to provide legal advice, so you should take your own legal advice before setting up a trust, to make sure that it meets your clients' requirements. Our trusts have been drafted for use by UK domiciled individuals.

Partnerships

What's a partnership?

A partnership is an arrangement where two or more people:

- own a business;
- work together, and
- share the profits or losses on an agreed basis.

There are no legal requirements to register a partnership with Companies House (apart from certain Scottish general partnerships), however you should consider putting in place a formal written partnership agreement. A partnership can employ other people.

About partnerships

Partnership is defined in the Partnership Act 1890 as 'the relation which subsists between persons carrying on a business in common with a view of profit'. Although a partnership can be formed without any legal formalities, it's best for the partnership to be based formally on a written memorandum known as the Partnership Deed. The partners are bound by the terms of the Deed. The Partnership Act 1890 applies, in general, only where particular points aren't covered by the Deed or there's no formal partnership agreement in place. For example, if the provisions of the Partnership Act 1890 apply, a partnership will automatically dissolve on the death or bankruptcy of a partner.

In England, Wales and Northern Ireland, a partnership doesn't have a legal identity separate from the individuals who own it, unless it's a limited liability partnership (LLP). The partners can't apply for a life policy in the name of the partnership. However, it's usually possible for two nominated partners to apply for a life policy on behalf of a partnership, for example A Brown and B Brown for A Brown & Sons.

In Scotland, a partnership is a separate legal entity, so it can apply for a life policy in its own name. However, for tax purposes, Scottish partnerships are treated in the same way as English partnerships, with each partner being assessed for tax on their share of partnership income and gains at their personal tax rates.

Partners, whether in England, Wales, Northern Ireland or Scotland, may register as a LLP under the Limited Liability Partnerships Act 2000. See the **Limited liability partnerships** section for more information.

Partnerships – business continuity

Who are the key people?

A key person is someone whose death, critical illness, disability or prolonged illness would have a serious effect on a business's future turnover and profits. Each partner will usually be a key person. In addition, a business can have one or more employees who make a vital contribution to its revenue and profitability. Who is key will depend on the business and the relevant individuals contributing to it. A person may be key to the business because they:

- have valuable sales contacts, which might be lost if they died;
- are a key sales person who contributes a significant amount of profit;
- are one of the founders, and still the main driving force behind the business;
- are a partner who has personally guaranteed loans made to the business by a bank – the bank may insist on life protection as a condition of the loan;

- are heavily involved in the development of a new product because of their knowledge and expertise – without their input, the product launch might not go ahead, or
- are at the top in their line of work and have been time-consuming and expensive to recruit. It might be difficult and expensive to recruit their replacement.

These are just some possible examples. Who is key in a partnership will depend on its individual circumstances.

Reasons to cover key people

Loan cover

If the business already has outstanding loans, the loss of a key individual could affect its ability to repay them. Financial institutions will often lend money to businesses based on one or two key people remaining part of it. If something happens to either of these key people, the financial institution would probably want the business to repay the loan immediately.

As a result, it's becoming more common for financial institutions to ask businesses for some form of protection to be in place to make sure they can repay any loans.

Partners' loan accounts

It's common for partners to make loans to their business. These are shown in the partnership accounts as the partner's loan account. They exist when a partner loans the business capital, for example, when the business is set up.

If a partner dies or becomes critically ill, the business would need to repay the loan in full, unless there's a loan agreement in place with different repayment terms. Unless otherwise stated in their will or a formal loan agreement, the personal representatives of the deceased partner would have to collect any outstanding debts due to the estate, including this outstanding loan.

The business may not have the money available to repay the loan. Therefore, it's important the partner's loan account is covered to protect the partnership, the partner and the partner's estate.

Loss of profits

Many small or medium-sized enterprises (SMEs), including partnerships, rely heavily on the expertise of one or two people. Partners or employees of the partnership can be considered key. For example, they could be the founder and driving force behind the partnership or the sales manager who has a valuable list of sales contacts. If they die, become seriously ill or disabled or suffer a prolonged illness, this could cause trading problems for the partnership, for example loss of experienced management skills, decline in customer orders and/or loss of goodwill, and result in a financial loss.

Having business continuity plans in place, including protection cover for key people, would help the partnership continue trading and mitigate the potential reduction in profits due to the death or illness of a key person.

One-off expenses

If a key person is an employee, there may be a need, even if it's only on a short-term basis, to recruit someone to replace them. The recruitment costs may include advertising, agency fees and training costs.

Our Business protection liability audit can help you highlight your clients' business continuity needs to make sure their business can continue to run smoothly.

Calculating the level of cover

When considering the level of cover a partnership needs, the starting point is to estimate the impact on the partnership's future profits if a key person dies, becomes critically ill or disabled or suffers a prolonged illness. The business will need protection in place so it can continue to trade and to provide funds to replace the key person.

There's no hard and fast rule to assess a key person's financial contribution to the business, although insurable interest must be shown or the contract will be void.

Underwriters will look at each case to determine whether the level of cover makes sense and will assess each case on its own merit. The amount of evidence our underwriters need depends on how much cover your clients need. You can find full details in our Underwriting limits guide.

Our Business protection liability audit can help you arrive at an appropriate benefit amount and makes the risk impact real.

Levels of key person cover

Key person cover for a partnership falls into two areas:

- cover required on the life of an employee of the partnership, or
- cover required on the life of a partner.

There are various ways of arriving at a suitable level of key person cover – we cover some of them on the next page.

Levels of key person cover for employees

Method	Formula	Life/critical illness	Income protection
Salary-based approach	Salary x multiple	Yes	No
This method is based on the assumption that a salary reflects an employee's contribution to the partnership. The cover is estimated by multiplying the key person's total salary, including any benefits. This can be up to 10 times salary for life protection and up to five times salary for critical illness protection. This method may not be suitable if a key person's salary doesn't reflect their contribution to the partnership's profits. If they aren't being paid their 'true worth', the estimate of the cover required may be too low. Equally, the cover may be too high if they're close to retirement. As the cover is to replace loss of profits, it may be more appropriate to link the cover level to the partnership's profits.			

Method	Formula	Life/critical illness	Income protection
Payroll-based approach	(key person's salary ÷ total payroll) x gross profit x expected years to recover	Yes	No
This method estimates the key person's contribution to the partnership's profits by dividing their salary by the partnership's total wage bill and then multiplying by the gross profit times years to recovery. This method may not be suitable for a new or unprofitable partnership.			

Method	Formula	Life/critical illness	Income protection
Profits-based approach	Gross profits x multiple (for example, two)	Yes	No
	Net profits x multiple (for example, five)	Yes	No
This method estimates the required cover by multiplying either the gross profits or the net profits. The usual multiples are two times gross profits or five times net profits. This method may not be suitable where several key people are covered, as it may be difficult to determine the contribution each individual makes to profits, although a higher multiple may be justified for a rapidly expanding business.			

Levels of key person cover for partners

Even where partners receive an agreed salary from the business, it's unlikely to reflect their contribution to the business. Therefore, the salary-based approach and the payroll-based approach described above won't be appropriate.

The profits-based approach described above will be most suitable to calculate the level of cover on the life of the partner.

How to set up an arrangement

There are two ways to set up the arrangement depending on who the key person is and where the business is based.

Employees as key people

The usual way for a business to apply for cover on the life of an employee would be for the business to take out a policy on the life of the employee on a life of another basis. The employer/employee relationship, combined with a potential financial loss, should normally be sufficient to establish the necessary insurable interest at outset. However, it's not as straight forward for partnerships, as you'll see below.

(i) Partnerships in Scotland

A partnership in Scotland could take out the policy and hold it as an asset of the partnership.

(ii) Partnerships (except in Scotland)

In England, Wales and Northern Ireland, a partnership doesn't have a legal identity separate from the individuals who own it, so can't take out a protection policy. Instead, the individual named partners must take out any contracts (including life insurance policies) for the benefit of a partnership.

This could cause a problem if the partners who took out the original policy, are different from the partners at the time when the proceeds of the policy are paid out. Therefore, where the intention is that a life insurance policy is to be for the benefit of the business as a whole (in other words all the partners of the business), rather than particular individuals, the only method available is to use a special trust known as a 'partnership trust'.

The trust makes sure the trust asset, or the life insurance policy, is held as a partnership asset on the partnership's balance sheet. This means it belongs absolutely to the partners in the partnership for the time being, including the estate of a deceased partner. It's treated as a capital asset of the partnership with its value split between the partners in the same way as other capital assets owned by the partnership.

It would be usual for one partner, for example the managing partner, or two partners to apply for the policy. They would be the settlor(s) under the trust and the other partners would be appointed to act as additional trustees. In the event of a claim, the trustees would receive the claim proceeds and, acting on behalf of the partnership, would have the power to use the funds they receive exclusively for the benefit of the partnership. This could include the repayment of any borrowing, to replace lost profits or in any other way as agreed by the partners.

In small businesses, for example with only two partners, where it's unlikely that there will be changes of partners, the two partners could simply take out a policy on the life of the key employee for their own benefit. In this scenario, the policy would belong to the partners personally, but the arrangement would be totally inflexible, as it wouldn't allow for a change in the partners.

Partners as key people

(i) Partnerships in Scotland

As a partnership in Scotland is a separate legal entity, it can apply for a policy as a contracting party in its own right, through the 'life of another' route. This avoids the need for trusts with the policy being held, effectively, as a capital asset on the balance sheet.

Alternatively, if all the partners are key people, cover can be set up on an 'own life in business trust' basis as described in point (iii) opposite.

(ii) Partnerships (except in Scotland) – partnership trust

The partnership trust approach will be appropriate if the policy is to be an asset of the partnership. In these circumstances, each partner who is considered a key person would take out a policy on his or her own life subject to a partnership trust.

In particular, if the partnership needs cover for their business borrowing, the cover should be set up for the benefit of all of the partners, by using a partnership trust. This is because a business liability reduces the value of the partnership and, therefore, the value of the business interests of all of the partners will also reduce. Therefore, the partnership should settle the liability, and make a corresponding increase in the values of the business interests of all the partners.

(iii) All partnerships

If all of the partners are considered key people and are also funding to buy a deceased partner's business interest, they may wish to put an 'own life in business trust' arrangement in place. This arrangement would provide the funds required to meet the needs of both business continuity (key person) and business succession (share purchase) planning.

In the event of a claim, the partners could loan the business the amount it needs. This loan would be used exclusively for the benefit of the partnership and could include repayment of any borrowing or to replace lost profits. The partners could use the remainder of the cover to buy out the business interest of the deceased or critically ill partner.

However, if only one of the partners is a key person and the policy is set up on their life only, the business trust won't be appropriate. Instead, the partnership trust should be used as explained in point (ii).

Summary – advantages and disadvantages of each option

The main advantages and disadvantages of each option are as follows:

Advantages

Partnership trust/life of another policy	Own life in business trust
Funds belong to the business.	Claim proceeds paid to the trustees – outside the business – not subject to income tax.
No need to deal with the tax compliance issues associated with a personal/business trust such as IHT 10-year and exit charges.	Claim proceeds could be protected from the business's creditors as the policy is in trust.
The claim proceeds will be in the right hands at the right time, as they'll be paid to the business, which is suffering the financial loss.	

Disadvantages

Partnership trust/life of another policy	Own life in business trust
The business's creditors could claim the proceeds if the business is insolvent.	Trustees need to deal with the tax compliance issues associated with a trust such as inheritance tax (IHT) 10-year and exit charges.
Claim proceeds could be subject to tax, if the purpose of the policy is of a revenue nature. For example, to cover loss of profits and the insured person is an employee.	Not suitable for cover on an employee and not suitable unless all partners are key.
Value of the policy increases the value of the share of each partner.	

See the **Our solutions** section for our professional approach to completing business.

Tax implications of key person policies

Policy on the life of a partner

Tax treatment of premiums

There will be no tax relief for the business or the partners.

Tax treatment of the claim proceeds

The claim proceeds will be paid tax free to the trustees or to the partnership in Scotland. The death of the insured person is a chargeable event. However, there won't be a chargeable event gain, as our protection policies have no investment content.

Policy on the life of an employee

Tax treatment of premiums

Unfortunately, there's no direct legislation covering the taxation of key person policies, but the principles that apply were set out in 1944 by the then Chancellor of the Exchequer, Sir John Anderson. These principles are known as 'the Anderson Rules'.

Following a parliamentary question, he said the 'treatment for taxation purposes would depend upon the facts of the particular case and it rests with the assessing authorities and the Commissioners on appeal if necessary to determine the liability by reference to these facts. I am, however, advised that the general practice in dealing with insurances by employers on the lives of employees is to treat the premiums as admissible deductions, and any sums received under a policy as trading receipts, if:

- the sole relationship is that of employer and employee;
- the insurance is intended to meet loss of profit resulting from the loss of services of the employee, and
- it's an annual or short-term insurance.

Cases of premiums paid by companies to insure the lives of directors are dealt with on similar lines.'

Although the rules were designed for dealing with life policies on the lives of employees and directors of limited companies, the same principles apply regardless of whether the employer is a limited company or a partnership. In the case of partnerships, for tax purposes, the employer is the individual partners.

The tax treatment of premiums and proceeds can never be guaranteed. The local Inspector of Taxes will look at each case on its own merits.

It's commonly believed that if an employer doesn't receive tax relief on the premiums it will receive the claim payment tax free and vice versa. Whether or not tax relief is available on the premiums depends on whether they're allowable as a business expense. To be an allowable business expense, the premiums must be paid 'wholly and exclusively for the purposes of the business'.

So, it's important to look at the Anderson Rules in detail to determine the tax consequences. Read our Taxation of key person policies technical factsheet for more information.

Tax treatment of the claim proceeds

Where key person cover is designed to meet the loss of profits, the employer (for tax purposes the partners) will pay tax on the claim proceeds at its marginal rate for that tax year. This is because the policy was to replace loss of profits and those profits would have been taxable.

If the policy was taken out for a capital purpose, the claim proceeds should be tax free. Capital purposes include buying new premises or repaying a bank loan.

Assigning a life of another key person policy to a former employee

The key person, as the insured person, doesn't have any rights to the policy, either in terms of its ownership or the claim proceeds. If the key person is an employee and leaves or retires from the business before the end of the policy term, the business could choose to cancel the policy as it's no longer needed.

Alternatively, instead of cancelling the policy, it could be assigned to the departing key person. In this case, a solicitor would have to draft a suitable Deed of Assignment. If the key person leaves the business and the policy is transferred to them in the same tax year, they'll be taxed at their marginal rate on the total premiums paid at the date of transfer, due to the benefit-in-kind legislation.

If the policy is transferred to the former key person in the tax year following their departure, the benefit-in-kind legislation won't apply. However, the termination of employment legislation will apply, so the tax liability will be calculated on the market value of the policy.

As the protection policy has no investment content, there won't usually be a market value, unless the insured person is critically or terminally ill. Once the policy is transferred to the key person, it becomes second hand and the capital gain (which is the claim proceeds less the premiums paid to date by the key person) could be subject to capital gains tax.

Assigning a life of another key person policy from a Scottish partnership to a former partner

There are no tax implications if a Scottish partnership assigns the policy to the former partner. A solicitor would have to draft a suitable Deed of Assignment.

Inheritance tax (IHT)

When a partnership trust or business trust is used, it's essential to make sure there are no adverse IHT implications. Provided the arrangement is a commercial one without any element of gift, this will help to safeguard the IHT treatment of the arrangement making sure it doesn't trigger the gift with reservation of benefit provisions.

Maintaining the commerciality of the arrangement

One way of maintaining the commerciality of an arrangement is to equalise the premiums. This makes sure that each partner contributes to the total cost of the arrangement in proportion to the benefit they're likely to receive – meaning there's no element of gift. Use our Premium equalisation calculator or read our Equalisation of policy payments factsheet for more information on how to maintain the commerciality of share purchase arrangements.

For commerciality using the business trust route it's also essential to make sure the only beneficiaries under the trust are the partners joining in the arrangement. This means that there will be no gift and, if there's no gift, there can be no 'gift with reservation'. Also, the absence of a gift would mean that the settlor/insured person could be a potential beneficiary. Under the trust the benefit could automatically revert to the insured person if they leave the partnership or retire – giving valuable flexibility.

You should also consider the IHT relevant property regime with the business trust. Under the relevant property regime, IHT charges can occur on the 10-yearly anniversaries of the creation of the trust and when property leaves the trust. However, where the underlying investment is a term policy, this shouldn't normally cause a problem because the policy is only likely to have any value in the event of a claim.

Where a partnership in Scotland owns the policies, there should be commerciality so long as the same kind of benefits are provided under each policy and the benefits are fixed at an appropriate level for each partner/member.

On the death of an insured person the benefits would pass free of IHT to the partnership in Scotland or to the trustees of the partnership trust. The value of the deceased partner's share of the policy would be an asset of his or her estate for IHT purposes where the partnership owns the policy, in the same way as a partnership trust.

Under the business protection trust, assuming it's fully discretionary or a post-2006 flexible trust, there would be no value in the deceased partner's estate as they're only a discretionary beneficiary.

Income tax and capital gains tax (CGT)

While the only asset of the trust is a life insurance policy, there will be no income tax or CGT implications regardless of how the arrangement is structured.

Partnerships – business succession

Business succession planning is one of the biggest issues that partners, other than in family businesses (where succession within the family is secured), have to face. So it's important that the owners sit down and discuss what they'd like to happen to their business interest and the management of the business when or if anything happens to one of them.

For example, the remaining partners might not want a third party joining the business as a partner. It may not even be possible. Similarly, if a partner were to die, their family might simply prefer to receive the market value of their share in cash and not have anything more to do with the business.

Business succession planning, together with a suitable arrangement to provide the funds, allows the remaining partners to keep control of the business, while helping to make sure that the outgoing partner's family receive the value of their business interest should anything happen to them.

For partners there are two types of arrangement available to support business succession planning:

- share purchase by the co-partners, or
- automatic accrual.

Choosing the most suitable succession and protection arrangement

There are various steps involved in setting up a (succession) share purchase arrangement.

- Consider what the provisions of the Partnership Agreement are in relation to business succession objectives.
- Determine the value of each partner's share in the business.
- Put in place a legal agreement stating who is to, or who has the option to, buy the business share in the event of critical illness and/or death, and at what price.

The protection arrangement can be set up to provide the funds in the event of the critical illness or death of a partner.

There are two ways of providing funds to facilitate business succession planning:

- own life policies held in trust, or
- life of another policies.

Different funding arrangements apply where the method of succession is automatic accrual.

In all cases, partners should put a suitable option agreement for the share purchase in place. Our Business intestacy audit can help partners match their aspirations with reality.

The Partnership Agreement – why is it important?

Any form of business succession plan (whether an option agreement for share purchase or an automatic accrual) that the partners put in place, must be consistent with the provisions detailed in their partnership agreement (which may be called a Partnership Deed – see **About partnerships** for more information). Otherwise, the partners will have to arrange for a solicitor to amend the agreement.

Calculating the level of cover

The level of cover should be equal to the value of the partner's interest, which will include:

- the capital value of the partner's share in the business, including the partner's capital account;
- the forecast value of undistributed profits (in other words profits made but not distributed), and
- the value of goodwill – if it appears in the accounts as an asset.

As the value of the partnership may rise or fall in the future, it's important to regularly check that the level of cover is enough for the surviving partners to buy the deceased or critically ill partner's interest.

If there's not enough cover, the surviving partners would have to find an additional way of paying for the partnership interest.

This is a highly subjective area because the value of any business is, in effect, the price that somebody else is willing to pay for it. The benefit amount should reflect the value of the business interest, based on a reasonable valuation method. We recommend getting an independent valuation from a qualified accountant.

There are several ways to value a business.

Net profit multiple

This will be averaged over the last three years.

- Businesses demonstrating good growth year on year – up to 10 times.
- Businesses with a fairly static but consistent trading position – 5 to 7 times.

- Businesses with an inconsistent trading position, or decreasing profits – up to 5 times.

Net profit new business

Net profit as detailed in business plan projections – up to 5 times.

Net asset value

Suitable for stable businesses with significant tangible assets. This is the value of assets as detailed in the accounts, less any liabilities.

Put simply, this is the cash you could expect to receive for a business if it were broken up and sold. However, it takes no account of intangible assets, such as the value of brand name, skilled or specialist employees, goodwill etc. Also, assets may be understated, being recorded at their historic cost rather than current market value.

Types of share purchase agreement

Double option agreement

This is also known as a cross option agreement. The surviving partners have an option to buy the deceased's business interest and the personal representatives have the option to sell. If either party exercises their option within a specified timeframe, the other party must comply. As the option agreement isn't a binding contract for sale, it helps to preserve any IHT business property relief (BPR) that the business interests attract. We cover BPR later.

Our Sample double option agreement states that each partner must take out and maintain a policy that provides the amount needed to buy their business interest, and how the business interests are to be valued when they die.

The partners should speak to a solicitor to make sure that our sample double option agreement meets their needs. However, as we've previously mentioned, it's important to check that the option agreement is consistent with the Partnership Agreement.

Single option agreement

Although a double option agreement is commonly used for life protection, it may not be appropriate for critical illness protection. This is because a double option agreement would mean that the other partners could force the critically ill partner to sell their business interest following a critical illness claim. However, they may not want to sell their interest for various reasons, such as they:

- may recover and want to return to work;
- may have to pay capital gains tax when they sell their interest, or
- will lose the benefit of business property relief (BPR) if they sell their interest as the cash proceeds will form part of their estate and be liable for IHT.

The solution may be to have a single option agreement, which lets the critically ill partner sell their interest, but doesn't give the other partners an option to insist that they sell. We have a Sample single option agreement for partners who want critical illness protection.

However, a single option agreement for critical illness protection may not always be the best option as the partner may assume they're going to recover but don't. To get around this, the partners may prefer a double option agreement with different option periods.

The critically ill partner could have an option to sell within a fairly short time, such as three or six months, following diagnosis of the illness. The other partners could have an option to force a buyout, which they could use after a suitable period has passed. This will usually be longer than the option period of the critically ill partner, such as one or two years. The longer option period should put the other partners in a better position to decide whether they want to buy out the critically ill partner or not.

Buy and sell agreements

HMRC considers there to be a binding contract for sale where the partners enter into a buy and sell agreement. This means, if a partner dies, their personal representatives must sell and the other partners must buy their interest. When they die, the deceased's business interest is viewed as cash and therefore IHT BPR won't apply.

The loss of business property relief might not be an issue if the deceased's estate is to pass to a surviving husband, wife or registered civil partner, because that would be an exempt transfer. In this case, there wouldn't be any inheritance tax to pay on a partner's death. However, this doesn't help if assets pass on death to someone other than a husband, wife or registered civil partner for example, children or to a trust. If the deceased's business interest is to be sold to the surviving partners, it's better to preserve any BPR, so the double option method would be the better option.

Choosing the most suitable business protection arrangement to meet your business succession plans

Let's now look at the two methods of share purchase protection in more detail.

Own life policy under a business trust

This type of arrangement makes sure the partners have the funds available to buy the business interest from a critically ill partner or a deceased partner's personal representatives.

Setting up this arrangement

Each partner applies for an own life policy, generally for a term up to their retirement date, for the value of their business interest. From the start, the policy is held in the business trust for the benefit of the other partners. It's very important that an existing policy isn't assigned into the trust, as this could result in a capital gains tax charge in the event of a claim. The capital gain is likely to be the difference between the claim proceeds and the premiums paid to date by the trustees.

Our Business trust is a flexible interest in possession trust. Flexible interest in possession trusts are trusts where the trustees must pass on all trust income to the default beneficiary(ies) as it arises (less any expenses). Where a business trust is created after 21 March 2006, it's taxed under the relevant property IHT regime, which we cover later.

If a partner dies or becomes critically ill, the other partners can use the funds from the trust to buy the partnership interest from the critically ill partner or the deceased's personal representatives. For example, if there are four partners, each with a 25% interest, the three surviving partners could each buy one-third of the deceased's interest, so the survivors would each have an equal 33.3% interest. The claim proceeds would go to the trustees who would pay the funds to the surviving partners. The surviving partners would then buy the interest from the deceased's personal representatives so that whoever is named in the deceased's will, or according to the rules of intestacy if they don't have a will, receives the cash.

Each partner is known as the 'settlor' of the trust they've created and is automatically a trustee. Each partner should appoint additional trustees, which will usually include some or all of the other partners in the arrangement. The other partners will be the beneficiaries in their respective proportions. The settlor is also a beneficiary of the trust, so the trustees can assign the policy to the settlor before a claim arises, if they no longer own an interest in the partnership.

To help secure the IHT benefits of the arrangement, it's important that the only partners who can benefit are those participating in the arrangement. In other words, each partner should take out a policy on their own life and put it into trust for the others. If any partners don't participate, they shouldn't be able to receive any benefit from the trust. We'll cover the IHT benefits in more detail later.

This arrangement will make sure the trustees receive the benefit amount if the settlor dies or becomes critically ill. This also provides the partners with the funds to buy the partnership interest from the critically ill partner or the deceased partner's personal representatives in line with their option agreement.

What happens to the claim proceeds if the single option isn't exercised?

When a critical illness claim is made, the trustees, as the owners of the policy, receive the claim proceeds. The partner may decide that they want to remain a partner and not sell their interest. In that case, the trustees should think about keeping the claim proceeds within the trust in the short term until the succession issue has been resolved. However, this might result in a pre-owned assets tax (POAT) charge if the settlor is a beneficiary under the terms of the trust, and the trustees still hold the proceeds on 6 April. See the **Pre-owned asset tax** section for more information.

The purpose of the protection is to buy the partnership interest from the partner if they become critically ill. If the trustees pay some, or all, of the claim proceeds to the critically ill partner, this could create a number of problems.

For example, the critically ill partner could suffer a second critical illness. But, if some of the claim proceeds have already been spent, the remaining partners won't have enough money to buy the interest from the critically ill partner. If it's a life with critical illness policy, the partners will again have to consider how they'll buy the deceased's interest in the future if the claim proceeds on the earlier critical illness have already been spent by the other partners or distributed to the critically ill partner.

What happens if a partner has left the business and a new partner joins?

Our business trust is flexible. Any new partners joining the business are automatically included as beneficiaries of the existing business trusts, as long as the new partners take out their own life policy in a business trust. The partners will also need to draft a new option agreement.

The business trust also states that, if the settlor no longer holds an interest in the business for any reason other than their death, then the trustees hold the policy for the settlor. This means the settlor will be entitled to the claim proceeds. A partner may sell their interest if they leave or retire from the business or if the whole business is sold or liquidated.

In the event that the settlor is no longer a partner, the trustees could assign the policy to them. They could then continue the policy and use it for some other purpose, such as putting it into a flexible trust for the benefit of their family.

Tax implications – own life policy under a business trust

Tax treatment of the premiums

If the partners pay the premiums, they won't receive any tax relief. Similarly, if the partners pay the premiums from the partnership business account and charge these back to the partners, the premiums won't qualify for tax relief.

Tax treatment of the claim proceeds

The claim proceeds will be paid tax free to the trustees. The death of the insured person is a chargeable event. However, there won't be a chargeable event gain, as our protection policies have no investment content.

IHT treatment of the business trust

Maintaining the commerciality of the arrangement

In an own life under business trust arrangement using our business trust, each partner is a potential beneficiary of the business trust they've created. This is because the policy can be assigned out of the trust to them if, for example, they're no longer a partner. Usually, if someone gives an asset away but can still benefit from the gifted asset, it's treated as a gift with reservation of benefit. However, if the arrangement is commercial without any element of gift, this will help to safeguard the IHT treatment of the arrangement making sure it doesn't trigger the gift with reservation of benefit provisions.

Also, as the partners are all applying for an own life policy in a business trust at the same time, and they're beneficiaries under each others' trusts, the arrangement has to be commercial to avoid triggering the gift with reservation of benefit associated operation rules. The potential beneficiaries under the business trust are restricted to the other partners only and don't include family members (unless they're also partners).

There are various ways of helping to protect the commerciality of the arrangement, such as:

- restricting the beneficiaries under the trust to the partners who have taken out cover in trust for the same purpose;
- making sure the partners aren't over-insured, and
- equalising the premiums.

As previously mentioned, it's important that only partners who take part in the protection arrangement can receive any claim proceeds.

If one of the partners isn't able to get life cover, for example because of their age or bad health, they'll need to find an alternative way to buy the business interest if one of the partners dies or becomes critically ill. Some options could include taking out a loan or ring-fencing savings.

Similarly, those taking part in the arrangement also need to consider how they'd buy the interest of the uninsured partner. For example, they could borrow money to buy the interest or they may decide that they can only afford to do so by paying for the interest in instalments over a number of years. In this case, they need to get a solicitor to draw up a suitable agreement.

The level of cover should equate to the market value of the partnership interest if the option agreement gives the partners the option to buy the interest at market value. The partners should review their cover regularly. If there's a shortfall when a partner dies or becomes critically ill, the other partners will have to find the money elsewhere to make this up. If the level of cover is too high, then arguably there's an element of gift being made, so this could impact the commerciality and IHT effectiveness of the arrangement.

Equalising the premiums

Each partner takes out an own life policy. If the partners are of different ages, the costs of their individual protection policies will vary. If the partners each pay the premiums for their policy held in trust, this would mean that older partners would generally pay more but be less likely to benefit because they're more likely to die before the younger partners. This could affect the commerciality of the arrangement.

Equalising the premiums can address this inequality, with the partners making cash payments between themselves. Alternatively, the firm's accountant can adjust the partners' loan accounts or current accounts to correct this. This makes sure that each partner contributes to the total cost of the arrangement in proportion to the benefit they're likely to receive, meaning there's no element of gift. Use our Premium equalisation calculator or read our Equalisation of policy payments factsheet for more information on how to maintain the commerciality of share purchase arrangements.

IHT entry charge

Normally the premiums won't have any IHT consequences because each partner is putting their policy in trust for the other partners as part of a commercial arrangement. Therefore, the premiums aren't gifts, so the gift with reservation provisions won't apply.

Ten-yearly charge (also known as the periodic charge)

On each tenth anniversary of the trust's creation, the trust is assessed for IHT. There will be a 10-yearly tax charge if the value of the trust fund immediately before each tenth anniversary is more than the applicable nil rate band. As a protection policy won't usually have a market value, in most cases there shouldn't be any tax to pay.

A 10-yearly charge could be payable if the claim proceeds were still held in trust, or the insured person dies or is critically or terminally ill, immediately before the tenth anniversary. In these cases, there would be value in the trust. However, tax will only be payable at up to 6% on any value above the applicable nil rate band.

If there's a tax charge but the trustees don't have the funds to pay it, HMRC may try to recover the tax from the trust's beneficiaries or settlor.

These charges will apply even if the arrangement is commercial and there was no entry charge.

Exit charge (also known as the proportionate charge)

An exit charge between 10-year anniversaries is unlikely. When the trustees distribute all or some of the trust fund to the beneficiaries, exit charges might be triggered. The maximum rate of tax is 6%, although this reduces depending on whether the exit charge occurs before the first 10-year anniversary or after the last 10-year anniversary.

If the claim proceeds are distributed to the remaining partners before the first 10-year anniversary, this won't generally result in a tax charge. This is because the calculation of an exit charge takes into account the value of the trust fund at the start of the trust, which should be nil when the policy is issued to the trustees, and any additions to the trust before an exit charge is triggered. The premiums won't amount to transfers of value in a commercial arrangement.

If an exit charge occurs after the first 10-year anniversary, the rate of tax is based on the rate that applied at the last 10-year anniversary. However, in most cases, there won't be a 10-yearly charge at each tenth anniversary.

Pre-owned assets tax

Pre-owned assets tax (POAT) is a yearly income tax charge, which aims to counter certain IHT avoidance schemes, which don't meet the gift with reservation of

benefit rules, but could still allow a partner to benefit from assets given away.

As the settlor is included within the class of beneficiary under the business trust this doesn't amount to a gift with reservation of benefit because the arrangement is 'commercial' therefore, they'll be liable to a POAT charge while they're alive and resident in the UK. This is because there's no 'commerciality' exemption for POAT purposes.

POAT is a separate income tax charge, which applies to the settlor whether they actually receive a benefit from the trust or not. It's calculated by applying a prescribed rate (equal to the official rate of interest as defined in section 181 Income Tax (Earnings and Pensions) Act 2003) to the value of the trust fund at 6 April each year. This is subject to the settlor's overall £5,000 de minimis limit. Below this, there's no income tax charge.

If it looks like there will be value in the trust on 6 April, the trustees could remove the settlor by Deed of removal of beneficiaries in order to avoid a POAT charge applying. This could be as a result of a critical illness or terminal illness claim being in progress, or the claim proceeds being held in a trustee bank account on 6 April.

Life of another – individual owned

This type of arrangement will generally be suitable where there are only two partners.

Setting up this arrangement

Partner A would apply for a policy on the life of partner B and partner B would apply for a policy on the life of partner A. The benefit amount should equal the value of the insured person's partnership interest. The partners should also put an option agreement in place. This provides the partners with the funds to buy the interest from the critically ill partner or the deceased partner's personal representatives in line with the terms of their agreement.

A double option agreement is the most attractive option agreement where the partner dies. However, a single option agreement could be preferable where the partner becomes critically ill. However, as the critically ill partner doesn't have to use their option, under a single option agreement, this could cause problems. For example, partner A has a life with critical illness policy on the life of partner B.

- If partner B suffers a critical illness, partner A would receive the claim proceeds as policy owner.
- If partner B sells their interest to partner A, the claim proceeds paid to partner A are outside partner A's estate when they buy the interest.
- If partner B has a single option agreement but decides not to exercise their option, partner A would still have the claim proceeds in their estate, which would potentially become liable for IHT at 40%, if partner A dies without buying partner B's interest.

The policy shouldn't be written in trust. Each partner will own the policy on the life of the other partner and will pay the premiums for it. It isn't necessary to equalise the premiums, as the partners aren't paying premiums that reflect their personal circumstances.

If an insured person dies, the partner who has taken out the policy would receive the claim proceeds. The policy owned by the deceased partner would form part of their estate, with the value being the market value on the date they died.

There are some disadvantages with this arrangement. If there's a wide gap in the ages of the partners, the younger partner will pay higher premiums for the policy they own on the life of the older partner.

If there are several partners, many policies will be needed, making this an unattractive option. For example, three partners would need six policies, while four partners would need 12.

This type of arrangement is also inflexible, as it doesn't provide a revolving door facility when new partners join or leave the business.

Tax implications – life of another individual owned

Tax treatment of premiums

If the partners pay premiums, they won't receive any tax relief. Similarly, if the partners pay the premiums from the business account and charge these back to the partners, the premiums won't qualify for tax relief.

Tax treatment of the claim proceeds

The claim proceeds will be paid tax free to the policyholder. A claim on the death of the insured person is a chargeable event. However, there won't be a chargeable event gain, as our protection policies have no investment content.

IHT

Each partner will own a policy on the life of the other partner. The value of this policy will form part of their IHT estate. As there's no trust involved there will be no other IHT implications.

Automatic accrual

What is an automatic accrual?

Automatic accrual is an arrangement that lets a deceased partner's business interest (or, sometimes, only the value of the goodwill in the business) pass automatically to the surviving partners. The beneficiaries of the deceased partner's estate will receive the value of the deceased partner's business interest in cash from a separate life policy.

Although automatic accrual is a method of business protection, it's only suitable for partnerships and can't be used for shareholder protection.

Setting up an automatic accrual agreement

The partners should complete an automatic accrual agreement drawn up by their solicitors in line with their partnership agreement. As part of the arrangement, each partner should set up an own life policy for the value of their business interest, and place it in trust for the benefit of their family.

This method doesn't involve actually buying a deceased partner's business interest. Under the terms of the agreement, a deceased partner's business interest would pass automatically to the surviving partners when they die. The beneficiaries of the deceased partner's estate will receive the claim proceeds of the life protection policy from the trustees.

The trusts used with an automatic accrual arrangement will be personal flexible or discretionary trusts. Business trusts and partnership trusts are not suitable.

If any partners have loan accounts or current accounts with undrawn profits, these would be excluded from automatic accrual so the surviving partners would still need cash to repay these.

Life policies under automatic accrual

The automatic accrual agreement will normally require each partner to take out a life policy written in trust for their family.

The deceased partner (their family after their death) receives the benefit amount payable under their own policy to compensate for their partnership interest automatically passing to the surviving partners.

Each partner takes out and owns their own policy and can use it for any purpose. A partner will normally place the policy in a flexible trust or another type of 'personal' trust, so the policy proceeds don't form part of their estate. However, for the trust to be effective for IHT purposes, the other partners shouldn't be beneficiaries of the trust.

As a settlor can't benefit from our Flexible trust, there aren't any pre-owned assets tax implications.

Premiums under all the partners' policies will normally be paid by the partnership and treated as a first charge on the firm's profits and then be rateably apportioned among the partners according to age and cover provided. This will make sure the commerciality of each policy is maintained. If there's some inequality of cost between the partners, the premiums should be equalised, for example by treating the premiums as an expense of the partnership in the distribution of profits. The premiums will not be deductible for income tax purposes.

If the policy is held in our flexible trust, you should be aware of the IHT treatment of such trusts. The premiums should not generally be treated as gifts for IHT purposes, particularly where the premiums are equalised. The trustees will be subject to 10-year charges and exit charges.

If the value of the claim proceeds is less than the value of the deceased's share of the partnership when they die, the surviving partners will have to make up the difference to compensate the deceased partner's estate for the shortfall.

Read our Partnership protection – the automatic accrual method technical factsheet for more information.

Need more help?

If you need more help and support with putting protection in place for partnerships, speak to your usual Aegon sales contact or email us.

Important information

The following information is based on our understanding of current taxation law and HM Revenue & Customs (HMRC) practice, as at May 2021, which may change.

The tax treatment depends on the individual circumstances of each client and may be subject to change in future. The value of any tax relief depends on the individual circumstances of your client.

Trusts establish legal rights and entitlements and might have material financial and tax implications for the settlor, trustees and beneficiaries. Aegon UK isn't authorised to provide legal advice, so you should take your own legal advice before setting up a trust, to make sure that it meets your clients' requirements. Our trusts have been drafted for use by UK domiciled individuals.

Limited liability partnerships (LLPs)

What's a LLP?

A limited liability partnership (LLP) is similar to an ordinary partnership, except that it's a corporate body with its own legal identity and the individual members have reduced personal liability for any potential business debts.

LLPs are more complicated to set up and run than ordinary partnerships, as they have to meet many of the company law requirements that apply to limited companies.

About LLPs

Partners in business, whether in England, Wales, Northern Ireland or Scotland, may register as a LLP under the Limited Liability Partnerships Act 2000. A LLP is a hybrid. It takes the form of a corporate entity with a legal personality separate from that of its members. This allows it to employ individuals and apply for a life policy in its own name.

A LLP partner is referred to as a member or corporate member and can be a company or an individual.

All LLPs are incorporated and registered at Companies House by following a procedure similar to that for limited companies.

LLPs are normally governed internally by a formal agreement between the members known as a Members' Agreement. In the absence of such an agreement default statutory provisions apply.

For tax purposes, a LLP is treated in the same way as an ordinary partnership, with each partner being assessed for tax on their share of partnership income and gains at their personal tax rates, except where the LLP is in liquidation. This is commonly referred to as being 'tax transparent'.

Corporate members are liable to corporation tax on their share of the LLP's profits and capital gains. Individual members are liable for tax and National Insurance contributions in the same way as partners in an ordinary partnership.

The liability of a LLP member is limited to the amount of their subscribed capital. This is different to an ordinary partnership, where the partners are jointly and severally personally liable for all of the partnership liabilities.

For the purpose of business continuity and business succession, we'll consider LLPs with only individual (not corporate) members.

LLPs – business continuity

Who are the key people?

A key person is someone whose death, critical illness, disability or prolonged illness would have a serious effect on a business's future turnover and profits. Each LLP member will usually be a key person. In addition, a LLP can have one or more employees who make a vital contribution to its revenue and profitability. Who is key will depend on the business and the relevant individuals contributing to it. A person may be key to the business because they:

- have valuable sales contacts, which might be lost if they died;
- are a key sales person who contributes a significant amount of profit;
- are one of the founders, and still the main driving force behind the business;

- are a member who has personally guaranteed loans made to the business by a bank – the bank may insist on life protection as a condition of the loan;
- are heavily involved in the development of a new product because of their knowledge and expertise. Without their input, the product launch might not go ahead, or
- are at the top in their line of work and have been time-consuming and expensive to recruit. It might be difficult and expensive to recruit their replacement.

These are just some possible examples. Who is key in a LLP will depend on its individual circumstances.

Reasons to cover key people

Loan cover

If the business already has outstanding loans, the loss of a key individual could affect its ability to repay them. Financial institutions will often lend money to businesses based on one or two key people remaining part of it. If something happens to either of these key people, the financial institution would probably want the business to repay the loan immediately.

As a result, it's becoming more common for financial institutions to ask businesses for some form of protection to be in place to make sure they can repay any loans.

Members' loan accounts

It's common for members to make loans to their LLP. These are shown in the LLP's accounts as the member's loan account. They exist when a member loans the business capital, for example when the business is set up.

If a member dies or becomes critically ill, the business would need to repay the loan in full, unless there's a loan agreement in place with different repayment terms. Unless otherwise stated in their will or a formal loan agreement, the personal representatives of the deceased member would have to collect any outstanding debts due to the estate, including this outstanding loan.

The business may not have the money available to repay the loan. Therefore, it's important the member's loan account is covered to protect the business, the member and the member's estate.

Loss of profits

Many SMEs, including LLPs, rely heavily on the expertise of one or two people. For example, they could be the founder and driving force behind the company or the sales manager who has a list of valuable sales contacts. Members or employees of the LLP can be considered key. If they die, become seriously ill or disabled or suffer a prolonged illness, this could cause trading problems for the LLP, for example loss of experienced management skills, decline in customer orders and/or loss of goodwill, and result in a financial loss.

Having business continuity plans in place, including protection cover for key people, would help the LLP continue trading and mitigate the potential reduction in profits due to the death or illness of a key person.

One-off expenses

If a key person is an employee, there may be a need, even if it's only on a short-term basis, to recruit someone to replace them. The recruitment costs may include advertising, agency fees and training costs.

Our Business protection liability audit can help you highlight your client's business continuity needs to make sure their business can continue to run smoothly.

Calculating the level of cover

When considering the level of cover a LLP needs, the starting point is to estimate the impact on the firm's future profits if a key person dies, becomes critically ill or disabled or suffers a prolonged illness. The business will need protection in place, so it can continue to trade and to provide funds to replace the key person.

There's no hard and fast rule to assess a key person's financial contribution to the business, although insurable interest must be shown or the contract will be void.

Underwriters will look at each case to determine whether the level of cover makes sense and will assess each case on its own merit. The amount of evidence our underwriters need depends on how much cover your clients need. You can find full details in our Underwriting limits guide.

You can also use our Business protection liability audit to help you arrive at an appropriate benefit amount and make the risk impact real.

Levels of key person cover

Key person cover for a LLP falls into two areas:

- cover required on the life of an employee of the LLP, or
- cover required on the life of a member.

There are various ways of arriving at a suitable level of key person cover – we cover some of them on the next page.

Levels of key person cover for employees

Method	Formula	Life/critical illness	Income protection
Salary-based approach	Salary x multiple	Yes	No
This method is based on the assumption that a salary reflects an employee's contribution to the LLP. The cover is estimated by multiplying the key person's total salary, including any benefits. This can be up to 10 times salary for life protection and up to five times salary for critical illness protection. This method may not be suitable if a key person's salary doesn't reflect their contribution to the LLP's profits. If they aren't being paid their 'true worth', the estimate of the cover required may be too low. Equally, the cover may be too high if they're close to retirement. As the cover is to replace loss of profits, it may be more appropriate to link the cover level to the LLP's profits.			

Method	Formula	Life/critical illness	Income protection
Payroll-based approach	(key person's salary ÷ total payroll) x gross profit x expected years to recover	Yes	No
This method estimates the key person's contribution to the LLP's profits by dividing their salary by the LLP's total wage bill and then multiplying by the gross profit times years to recovery. This method may not be suitable for a new or unprofitable LLP.			

Method	Formula	Life/critical illness	Income protection
Profits-based approach	Gross profits x multiple (for example, two)	Yes	No
	Net profits x multiple (for example, five)	Yes	No
This method estimates the required cover by multiplying either the gross profits or the net profits. The usual multiples are two times gross profits or five times net profits. This method may not be suitable where several key people are covered, as it may be difficult to determine the contribution each individual makes to profits, although a higher multiple may be justified for a rapidly expanding business.			

Levels of key person cover for members

Even where members receive an agreed salary from the business, it's unlikely to reflect their contribution to the business. Therefore, the salary-based approach and the payroll-based approach described above won't be appropriate.

The profits-based approach described above will be most suitable to calculate the level of cover on the life of the member.

How to set up an arrangement

There are two ways to set up the arrangement depending on who the key person is.

Employees as key people

The usual way for a LLP to apply for cover on the life of an employee would be for the LLP to take out a policy on the life of the employee on a life of another basis. The employer/employee relationship, combined with a potential financial loss, should normally be sufficient to establish the necessary insurable interest at outset.

As a LLP is a separate legal entity, the LLP itself could take out the policy and hold it as an asset of the LLP.

In small LLPs, for example with only two members, where it's unlikely that there will be changes of members, the two members could simply take out a policy on the life of the key employee for their own benefit. In this scenario, the policy would belong to the members personally, but the arrangement would be inflexible, as it wouldn't allow for a change in the members.

Members as key people

(i) Life of another policies

As a LLP is a separate legal entity, it can apply for a policy as a contracting party in its own right, through the life of another route. This avoids the need for trusts with the policy being held as a capital asset on the balance sheet.

Alternatively, if all the members are key people, cover can be set up on an 'own life in business trust' basis as described in (ii) on the next page.

(ii) Own life policy in a business trust

If all of the members are considered key people and are also funding to buy a deceased member's business interest, they may wish to put an 'own life in business trust' arrangement in place. This arrangement would provide the funds required to meet the needs of both business continuity (key person) and business succession (share purchase) planning.

In the event of a claim, the members could loan the business the amount it needs. This loan would be used exclusively for the benefit of the LLP and could include repayment of any borrowing or replacement of lost profits. The members could use the remainder of the cover to buy out the business interest of the deceased or critically ill member.

However, if only one of the members is a key person and the policy is set up on their life only, the business trust won't be appropriate. Instead, the life of another route should be used as explained on the previous page.

Summary – advantages and disadvantages of each option

The main advantages and disadvantages of each option are as follows:

Advantages

Life of another policy	Own life in business trust
Funds belong to the business.	Claim proceeds paid to the trustees – outside the business – not subject to income tax.
No need to deal with the tax compliance issues associated with a personal/business trust such as IHT 10-year and exit charges.	Claim proceeds could be protected from the business's creditors as the policy is in trust.
The claim proceeds will be in the right hands at the right time, as they'll be paid to the business, which is suffering the financial loss.	

Disadvantages

Life of another policy	Own life in business trust
The business's creditors could claim the proceeds if the business is insolvent.	Trustees need to deal with the tax compliance issues associated with a trust such as inheritance tax (IHT)10-year and exit charges.
Claim proceeds could be subject to tax, if the purpose of the policy is of a revenue nature. For example, to cover loss of profits and the insured person is an employee.	Not suitable for cover on an employee and not suitable unless all members are key.
Value of the policy increases the value of the share of each member.	

See the **Our solutions** section for our professional approach to completing business.

Tax implications of key person policies

Policy on the life of a member

Tax treatment of premiums

There will be no tax relief for the business or the members.

Tax treatment of the claim proceeds

The claim proceeds will be paid tax free to the trustees or to the LLP. The death of the insured person is a chargeable event. However, there won't be a chargeable event gain, as our protection policies have no investment content.

Policy on the life of an employee

Tax treatment of premiums

Unfortunately, there's no direct legislation covering the taxation of key person policies, but the principles that apply were set out in 1944 by the then Chancellor of the Exchequer, Sir John Anderson. These principles are known as 'the Anderson Rules'.

Following a parliamentary question, he said the 'treatment for taxation purposes would depend upon the facts of the particular case and it rests with the assessing authorities and the Commissioners on appeal if necessary to determine the liability by reference to these facts. I am, however, advised that the general practice in dealing with insurances by employers on the lives of employees is to treat the premiums as admissible deductions, and any sums received under a policy as trading receipts, if:

- the sole relationship is that of employer and employee;
- the insurance is intended to meet loss of profit resulting from the loss of services of the employee, and
- it's an annual or short-term insurance.

Cases of premiums paid by companies to insure the lives of directors are dealt with on similar lines.'

Although the rules were designed for dealing with life policies on the lives of employees and directors of limited companies, the same principles apply regardless of whether the employer is a limited company or a LLP. In the case of LLPs, for tax purposes, the employer is the individual members.

> The tax treatment of premiums and proceeds can never be guaranteed. The local Inspector of Taxes will look at each case on its own merits.

It's commonly believed that if an employer doesn't receive tax relief on the premiums it will receive the claim payment tax free and vice versa. Whether or not tax relief is available on the premiums depends on whether they're allowable as a business expense. To be an allowable business expense, the premiums must be paid 'wholly and exclusively for the purposes of the business'.

So, it's important to look at the Anderson Rules in detail to determine the tax consequences. Read our Taxation of key person policies technical factsheet for more information.

Tax treatment of the claim proceeds

Where key person cover is designed to meet the loss of profits, the employer (for tax purposes the members) will pay tax on the claim proceeds at its marginal rate for that tax or financial year. This is because the policy was to replace loss of profits and those profits would have been taxable.

If the policy was taken out for a capital purpose, the claim proceeds should be tax free. Capital purposes include buying new premises or repaying a bank loan.

Assigning a life of another key person policy to a former employee

The key person, as the insured person, doesn't have any rights to the policy, either in terms of its ownership or the claim proceeds. If the key person is an employee and leaves or retires before the end of the policy term, the LLP could choose to cancel the policy as it's no longer needed.

Alternatively, instead of cancelling the policy, it could be assigned to the departing key person. In this case, a solicitor would have to draft a suitable Deed of Assignment. If the key person leaves the LLP and the policy is transferred to them in the same tax year, they'll be taxed at their marginal rate on the total premiums paid up to the date of transfer, due to the benefit-in-kind legislation.

If the policy is transferred to the former key person in the tax year following their departure, the benefit-in-kind legislation won't apply. However, the termination of employment legislation will apply, so the tax liability will be calculated on the market value of the policy.

As the protection policy has no investment content, there won't usually be a market value, unless the insured person is critically or terminally ill. Once the policy is transferred to the key person, it becomes second hand and any capital gain (which is the claim proceeds less the premiums paid to date by the key person) could be subject to capital gains tax.

Assigning a life of another keyperson policy from a LLP to an former member

There are no tax implications if a LLP assigns the policy to the former member, however a solicitor would have to draft a suitable Deed of Assignment.

Inheritance tax (IHT)

When a business trust is used, it's essential to make sure there are no adverse IHT implications. Provided the arrangement is a commercial one without any element of gift, this will help to safeguard the IHT treatment of the arrangement making sure it doesn't trigger the gift with reservation of benefit provisions.

Maintaining the commerciality of the arrangement

One way of maintaining the commerciality of an arrangement is to equalise premiums. This makes sure that each member contributes to the total cost of the arrangement in proportion to the benefit they're likely to receive – meaning there's no element of gift. Use our Premium equalisation calculator or read our Equalisation of policy payments factsheet for more information on how to maintain the commerciality of share purchase arrangements.

For commerciality using the own life in business trust route, it's also essential to make sure the only beneficiaries under the trust are the members joining in the arrangement. This means that there will be no gift and, if there's no gift, there can be no 'gift with reservation'. Also, the absence of a gift would mean that the settlor/insured person could be a

potential beneficiary. Under the trust the benefit could automatically revert to the insured person if he/she leaves the LLP or retires – giving valuable flexibility.

You should also consider the IHT relevant property regime with the business trust. Under the relevant property regime, IHT charges can occur on the 10-yearly anniversaries of the creation of the trust and, when property leaves the trust. However, where the underlying investment is a term policy, this shouldn't normally cause a problem because the policy is only likely to have any value on critical illness, terminal illness or death.

Where a LLP owns the policies, there should be commerciality so long as the same kind of benefits are provided under each policy and the benefits are fixed at an appropriate level for each member.

On the death of an insured person the benefits would pass free of IHT to the LLP. The value of the deceased member's share of the policy would be an asset of their estate for IHT purposes where the LLP owns the policy.

Under the business protection trust, assuming it's fully discretionary or a post-2006 flexible trust, there would be no value in the deceased member's estate as they're only a discretionary beneficiary.

Income tax and capital gains tax (CGT)

While the only asset of the trust is a life insurance policy, there will be no income tax or CGT implications regardless of how the arrangement is structured.

LLPs – business succession

Business succession planning is one of the biggest issues that business partners (including LLP members) have to face. So, it's important that the owners sit down and discuss what they'd like to happen to their business interest and the management of the business when, or if, anything happens to one of them.

For example, the remaining members might not want a third party joining the LLP as a member. It may not even be possible. Similarly, if a member were to die, their family might simply prefer to receive the market value of their share in cash and not have anything more to do with the business.

Business succession planning, together with a suitable arrangement to provide the funds, allows the remaining members to keep control of the business, while helping to make sure that the outgoing member's family receive the value of their business interest should anything happen to them.

As mentioned earlier, a LLP is transparent like an ordinary partnership (in other words, is treated in the same way as an ordinary partnership, with each partner being assessed for tax on their share of partnership income and gains at their personal tax rates, except where the LLP is in liquidation). Therefore, the LLP members would have to make similar considerations to partners of a partnership when it comes to business succession planning. In other words, an LLP isn't treated like a corporate entity for these purposes.

Although a LLP is a corporate body, no separate shares exist (unlike limited companies), therefore the LLP wouldn't be able to take out life of another policies to address its business succession needs.

Therefore, for LLP members (in the same way as for partners in ordinary partnerships) there are two main options available to provide for business succession:

- share purchase by the co-members, or
- automatic accrual.

Choosing the most suitable succession and protection arrangement

There are various steps involved in setting up a business interest purchase or succession arrangement.

- Consider what the provisions of the Members' Agreement are in relation to business succession objectives.
- Determine the value of each member's share in the business.
- Put in place a legal agreement stating who is to, or who has the option to, buy the business share in the event of critical illness and/or death, and at what price.

The protection arrangement can be set up to provide the funds in the event of the critical illness or death of a member.

There are two ways of providing funds to facilitate business succession planning:

- own life policies held in trust, or
- life of another policies.

Different funding arrangements apply where the method of succession is automatic accrual.

In all cases, members should put a suitable option agreement for the share purchase in place. Our Business intestacy audit can help members match their aspirations with reality.

The Members' Agreement – why is it important?

Any form of business succession plan (whether an option agreement for business interest purchase or an automatic accrual) that the members put in place, must be consistent with the provisions detailed in their Members' Agreement (see the **About LLPs** section for more information). Otherwise, the members will have to arrange for a solicitor to amend the Agreement.

If there's no Members' Agreement, section seven of the Limited Liabilty Partnership Act 2000 states that where a member has died, their personal representatives may not interfere in the management of the business. However, they're still entitled to receive whatever the member would have been entitled to.

Also, if there's no Members' Agreement, the default provision in the Limited Liability Partnership Regulations 2001 is that all the members of a LLP are entitled to share equally in the capital and profits of the LLP.

Calculating the level of cover

The level of cover should be equal to the value of the member's interest, which will include:

- the capital value of the member's share in the business, including the member's capital account;
- the forecast value of undistributed profits (in other words profits made but not distributed), and
- the value of goodwill – if it appears in the accounts as an asset.

As the value of the LLP may rise or fall in the future, it's important to regularly check that the level of cover is enough for the surviving members to buy the deceased or critically ill member's interest.

If there's not enough cover, the surviving members would have to find an additional way of paying for the membership interest.

This is a highly subjective area because the value of any business is, in effect, the price that somebody else is willing to pay for it. The benefit amount should reflect the value of the business interest, based on a reasonable valuation method. We recommend getting an independent valuation from a qualified accountant.

There are several ways to value a business.

Net profit multiple

This will be averaged over the last three years.

- Businesses demonstrating good growth year on year – up to 10 times.
- Businesses with a fairly static but consistent trading position – 5 to 7 times.
- Businesses with an inconsistent trading position, or decreasing profits – up to 5 times.

Net profit new business

Net profit as detailed in business plan projections – up to 5 times.

Net asset value

Suitable for stable businesses with significant tangible assets. This is the value of assets as detailed in the accounts, less any liabilities.

Put simply, this is the cash you could expect to receive for a business if it were broken up and sold. However, it takes no account of intangible assets, such as the value of brand name, skilled or specialist employees, goodwill etc. Also, assets may be understated, being recorded at their historic cost rather than current market value.

Types of share purchase agreement

Double option agreement

This is also known as a cross option agreement. The surviving members have an option to buy the deceased's business interest and the personal representatives have the option to sell. If either party exercises their option within a specified timeframe, the other party must comply. As the option agreement isn't a binding contract for sale, it helps to preserve any IHT business property relief (BPR) that the business interests attract. We cover BPR later.

Our Sample double option agreement states that each member must take out and maintain a policy that provides the amount needed to buy their business interest, and how the business interests are to be valued when they die.

The members should speak to a solicitor to make sure that our sample double option agreement meets their needs. However, as we've previously mentioned, it's important to check that the option agreement is consistent with the Members' Agreement.

Single option agreement

Although a double option agreement is commonly used for life protection, it may not be appropriate for critical illness protection. This is because a double option agreement would mean that the other members could force the critically ill member to sell their business interest following a critical illness claim. However, they may not want to sell their interest for various reasons, such as they:

- may recover and want to return to work;
- may have to pay capital gains tax when they sell their interest, or
- will lose the benefit of business property relief (BPR) if they sell their interest as the cash proceeds will form part of their estate and be liable for IHT.

The solution may be to have a single option agreement, which lets the critically ill member sell their interest, but doesn't give the other members an option to insist that they sell. We have a Sample single option agreement for members who want critical illness protection.

However, a single option agreement for critical illness protection may not always be the best option as the member may assume they're going to recover but don't. To get around this, the members may prefer a double option agreement with different option periods.

The critically ill member could have an option to sell within a fairly short time, such as three or six months, following diagnosis of the illness. The other members could have an option to force a buyout, which they could use after a suitable period has passed. This will usually be longer than the option period of the critically ill member, such as one or two years. The longer option period should put the other members in a better position to decide whether they want to buy out the critically ill member or not.

Buy and sell agreements

HMRC considers there to be a binding contract for sale where the members enter into a buy and sell agreement. This means, if a member dies, their personal representatives must sell and the other members must buy their interest. When they die, the deceased's business interest is viewed as cash and therefore IHT BPR won't apply.

The loss of business property relief might not be an issue if the deceased's estate is to pass to a surviving husband, wife or registered civil partner, because that would be an exempt transfer. In this case, there wouldn't be any inheritance tax to pay on a member's death. However, this doesn't help if assets pass on death to someone other than a husband, wife or registered civil partner – for example, children or to a trust. If the deceased's business interest is to be sold to the surviving members, it's better to preserve the BPR, so the double option method would be the better option.

Choosing the most suitable business protection arrangement to meet your business succession plans

Let's now look at the two methods of share purchase protection in more detail.

Own life policy under a business trust

This type of arrangement makes sure the members have the funds available to buy the business interest from a critically ill member or a deceased member's personal representatives.

Setting up this arrangement

Each member applies for an own life policy, generally for a term up to their retirement date, for the value of their business interest. From the start, the policy is held in the business trust for the benefit of the other members. It's very important that an existing policy isn't assigned into the trust, as this could result in a capital gains tax charge in the event of a claim. Any capital gain is likely to be the difference between the claim proceeds and the premiums paid to date by the trustees.

Our Business trust is a flexible interest in possession trust. Flexible interest in possession trusts are trusts where the trustees must pass on all trust income to the default beneficiary(ies) as it arises (less any expenses). Where a business trust is created after 21 March 2006, it's taxed under the relevant property IHT regime, which we cover later.

If a member dies or becomes critically ill, the other members can use the funds from the trust to buy the LLP interest from the critically ill member or the deceased's personal representatives. For example, if there are four members, each with a 25% interest, the three surviving members could each buy one-third of the deceased's interest, so the survivors would each have an equal 33.3% interest. The claim proceeds would go to the trustees who would pay the funds to the surviving members. The surviving members would then buy the interest from the deceased's personal representatives so that whoever is named in the deceased's will, or

according to the rules of intestacy if they don't have a will, receives the cash.

Each member is known as the 'settlor' of the trust they've created and is automatically a trustee. Each member should appoint additional trustees, which will usually include some or all of the other members in the arrangement. The other members will be the beneficiaries in their respective proportions. The settlor is also a beneficiary of the trust, so the trustees can assign the policy to the settlor before a claim arises, if they no longer own an interest in the LLP.

To help secure the IHT benefits of the arrangement, it's important that the only members who can benefit are those participating in the arrangement. In other words, each member should take out a policy on their own life and put it into trust for the others. If any members don't participate, they shouldn't be able to receive any benefit from the trust. We'll cover the IHT benefits in more detail later.

This arrangement will make sure the trustees receive the benefit amount if the settlor dies or becomes critically ill. This also provides the members with the funds to buy the LLP interest from the critically ill member or the deceased member's personal representatives in line with their option agreement.

What happens to the claim proceeds if the single option isn't exercised?

When a critical illness claim is made, the trustees, as the owners of the policy, receive the claim proceeds. The member may decide that they want to remain a member and not sell their interest. In that case, the trustees should think about keeping the claim proceeds within the trust in the short term until the succession issue has been resolved. However, this might result in a pre-owned assets tax (POAT) charge if the settlor is a beneficiary under the terms of the trust, and the trustees still hold the proceeds in trust on 6 April – see the **Pre-owned asset tax** section for more information on this.

The purpose of the cover is to buy the LLP interest from the member if they become critically ill. If the trustees pay some, or all, of the claim proceeds to the critically ill member, this could create a number of problems.

For example, the critically ill member could suffer a second critical illness. But, if some of the claim proceeds have already been spent, the remaining members won't have enough money to buy the interest from the critically ill member. If it's a life with critical illness policy, the members will, again, have to consider how they'll buy the deceased's interest in the future if the claim proceeds on the earlier critical illness have already been spent by the other members or distributed to the critically ill member.

What happens if a member has left the business and a new member joins?

Our business trust is flexible. Any new members joining the business are automatically included as beneficiaries of the existing business trusts, as long as the new members take out their own life policy in a business trust. The members will also need to draft a new option agreement.

The business trust also states that, if the settlor no longer holds an interest in the business for any reason other than their death, then the trustees hold the policy for the settlor. This means the settlor will be entitled to the claim proceeds. A member may sell their interest if they leave or retire from the business or if the whole business is sold or liquidated.

In the event that the settlor is no longer a member, the trustees could assign the policy to them. They could then continue the policy and use it for some other purpose, such as putting it into a flexible trust for the benefit of their family.

Tax implications – own life policy under a business trust

Tax treatment of the premiums

If the members pay the premiums, they won't receive any tax relief. Similarly, if the members pay the premiums from the LLP's business account and charge these back to the members, the premiums won't qualify for tax relief.

Tax treatment of the claim proceeds

The claim proceeds will be paid tax free to the trustees. The death of the insured person is a chargeable event. However, there won't be a chargeable event gain, as our protection policies have no investment content.

IHT treatment of the business trust

Maintaining the commerciality of the arrangement

In an own life in business trust arrangement using our business trust, each member is a potential beneficiary of the business trust they've created. This is because the policy can be assigned out of the trust to them if, for example, they're no longer a member. Usually, if someone gives an asset away but can still benefit from the gifted asset, it's treated as a gift with reservation of benefit. However, if the arrangement is commercial

without any element of gift, this will help to safeguard the IHT treatment of the arrangement making sure it doesn't trigger the gift with reservation of benefit provisions.

Also, as the members are all applying for an own life policy in a business trust at the same time, and they're beneficiaries under each others' trusts, the arrangement has to be commercial to avoid triggering the gift with reservation of benefit associated operation rules. The potential beneficiaries under the business trust are restricted to the other members only and don't include family members (unless they're also members).

There are various ways of helping to protect the commerciality of the arrangement, such as:

- restricting the beneficiaries under the trust to the members who have taken out cover in trust for the same purpose;
- making sure the members aren't over-insured, and
- equalising the premiums.

As previously mentioned, it's important that only members who take part in the protection arrangement can receive any claim proceeds.

If one of the members isn't able to get life cover, for example because of their age or bad health, they'll need to find an alternative way to buy the business interest if one of the members dies or becomes critically ill. Some options could include taking out a loan or ring-fencing savings.

Similarly, those taking part in the arrangement also need to consider how they'd buy the interest of the uninsured member. For example, they could borrow money to buy the interest or they may decide that they can only afford to do so by paying for the interest in instalments over a number of years. In this case, they need to get a solicitor to draw up a suitable agreement.

The level of cover should equate to the market value of the LLP interest if the option agreement gives the members the option to buy the interest at market value. The members should review their cover regularly. If there's a shortfall when a member dies or becomes critically ill, the other members will have to find the money elsewhere to make this up. If the level of cover is too high, then arguably there's an element of gift being made, so this could impact on the commerciality and IHT effectiveness of the arrangement.

Equalising the premiums

Each member takes out an own life policy. If the members are of different ages, the costs of their individual protection policies will vary. If the members each pay the premiums for their policy held in trust, this would mean that older members would generally pay more but be less likely to benefit because they're more likely to die before the younger members. This could affect the commerciality of the arrangement.

Equalising the premiums can address this inequality, with the members making cash payments between themselves. Alternatively, the firm's accountant can adjust the members' loan accounts or current accounts to correct this. This makes sure that each member contributes to the total cost of the arrangement in proportion to the benefit they're likely to receive, meaning there's no element of gift. Use our Premium equalisation calculator or read our Equalisation of policy payments factsheet for more information on how to maintain the commerciality of share purchase arrangements.

IHT entry charge

Normally the premiums won't have any IHT consequences because each member is putting their policy in trust for the other members as part of a commercial arrangement. Therefore, the premiums aren't gifts, so the gift with reservation provisions won't apply.

Ten-yearly charge (also known as the periodic charge)

On each tenth anniversary of the trust's creation, the trust is assessed for IHT. There will be a 10-yearly tax charge if the value of the trust fund immediately before each tenth anniversary is more than the applicable nil rate band. As a protection policy won't usually have a market value, in most cases there shouldn't be any tax to pay.

A 10-yearly charge could be payable if the claim proceeds were still held in trust, or the insured person dies or is critically or terminally ill, immediately before the tenth anniversary. In these cases, there would be value in the trust. However, tax will only be payable at up to 6% on any value above the applicable nil rate band.

If there's a tax charge but the trustees don't have the funds to pay it, HMRC may try to recover the tax from the trust's beneficiaries or settlor.

These charges will apply even if the arrangement is commercial and there was no entry charge.

Exit charge (also known as the proportionate charge)

An exit charge between 10-year anniversaries is unlikely. When the trustees distribute all or some of the trust fund to the beneficiaries, exit charges might be triggered. The maximum rate of tax is 6%, although this reduces depending on whether the exit charge occurs before the first 10-year anniversary or after the last 10-year anniversary.

If the claim proceeds are distributed to the remaining members before the first 10-year anniversary, this won't generally result in a tax charge. This is because the calculation of an exit charge takes into account the value of the trust fund at the start of the trust, which should be nil when the policy is issued to the trustees, and any additions to the trust before an exit charge is triggered. The premiums won't amount to transfers of value in a commercial arrangement.

If an exit charge occurs after the first 10-year anniversary, the rate of tax is based on the rate that applied at the last 10-year anniversary. However, in most cases, there won't be a 10-yearly charge at each tenth anniversary.

Pre-owned assets tax

Pre-owned assets tax (POAT) is a yearly income tax charge, which aims to counter certain IHT avoidance schemes, which don't meet the gift with reservation of benefit rules, but could still allow a member to benefit from assets given away.

As the settlor is included within the class of beneficiary under the business trust this doesn't amount to a gift with reservation of benefit because the arrangement is commercial, therefore, they'll be liable to a POAT charge while they're alive and resident in the UK. This is because there's no commerciality exemption for POAT purposes.

POAT is a separate income tax charge, which applies to the settlor whether they actually receive a benefit from the trust or not. It's calculated by applying a prescribed rate (equal to the official rate of interest as defined in section 181 Income Tax (Earnings and Pensions) Act 2003) to the value of the trust fund at 6 April each year. This is subject to the settlor's overall £5,000 de minimis limit. Below this, there's no income tax charge.

If it looks like there will be value in the trust on 6 April, the trustees could remove the settlor by Deed of removal of beneficiaries in order to avoid a POAT charge applying. This could be as a result of a critical illness or terminal illness claim being in progress, or the claim proceeds being held in a trustee bank account on 6 April.

Life of another – individual owned

This type of arrangement will generally be suitable where there are only two members in a LLP.

Setting up this arrangement

Member A would apply for a policy on the life of member B and member B would apply for a policy on the life of member A. The benefit amount should equal the value of the insured person's LLP interest. The members should also put an option agreement in place. This provides the member with the funds to buy the interest from the critically ill member or the deceased member's personal representatives in line with the terms of their agreement.

A double option agreement is the most attractive option agreement where the member dies. However, a single option agreement could be preferable where the member becomes critically ill. However, as the critically ill member doesn't have to use their option, under a single option agreement, this could cause problems. For example, member A has a life with critical illness policy on the life of member B.

- If member B suffers a critical illness, member A would receive the claim proceeds as policy owner.
- If member B sells their interest to member A, the claim proceeds paid to member A are outside member A's estate when they buy the interest.
- If member B has a single option agreement but decides not to exercise their option, member A would still have the claim proceeds in their estate, which would potentially become liable for IHT at 40%, if member A dies without buying member B's interest.

The policy shouldn't be written in trust. Each member will own the policy on the life of the other member and will pay the premiums for it. It isn't necessary to equalise the premiums, as the members aren't paying premiums that reflect their personal circumstances.

If an insured person dies, the member who has taken out the policy would receive the claim proceeds. The policy owned by the deceased member would form part of their estate, with the value being the market value on the date they died.

There are some disadvantages with this arrangement. If there's a wide gap in the ages of the members, the younger member will pay higher premiums for the policy

they own on the life of the older member.

If there are several members, many policies will be needed making this an unattractive option. For example, three members would need six policies, while four members would need 12.

This type of arrangement is also inflexible, as it doesn't provide a revolving door facility when new members join or leave the business.

Tax implications – life of another individual owned

Tax treatment of premiums

If the members pay premiums, they won't receive any tax relief. Similarly, if the LLP pays the premiums from the business account and charges these back to the members, the premiums won't qualify for tax relief.

Tax treatment of the claim proceeds

The claim proceeds will be paid tax free to the policyholder. A claim on the death of the insured person is a chargeable event. However, there won't be a chargeable event gain, as this is a policy with no investment content.

IHT

Each member will own a policy on the life of the other member. The value of this policy will form part of their IHT estate. As there's no trust involved there will be no other IHT implications.

Automatic accrual

What is an automatic accrual?

Automatic accrual is an arrangement generally used in ordinary partnerships that lets a deceased partner's business interest (or, sometimes, only the value of the goodwill in the business) pass automatically to the surviving partners. The beneficiaries of the deceased partner's estate will receive the value of the deceased partner's business interest in cash from a separate life policy.

Given the similarity of a LLP to an ordinary partnership, in terms of asset ownership and the fact that no separate shares exist, the automatic accrual method of business protection is also available to LLPs. It can't be used for shareholder protection.

Setting up an automatic accrual agreement

The LLP members should complete an automatic accrual agreement drawn up by their solicitors in line with their Members' Agreement. As part of the arrangement, each member should set up an own life policy for the value of their business interest, and place it in trust for the benefit of their family.

This method doesn't involve actually buying a deceased member's business interest. Under the terms of the agreement, a deceased member's business interest would pass automatically to the surviving members when they die. The beneficiaries of the deceased member's estate will receive the claim proceeds of the life protection policy from the trustees.

The trusts used with an automatic accrual arrangement will be personal flexible or discretionary trusts. Business trusts and partnership/LLP trusts aren't suitable.

If any members have loan accounts or current accounts with undrawn profits, these would be excluded from automatic accrual, so the surviving members would still need cash to repay these.

Life policies under automatic accrual

The automatic accrual agreement will normally require each member to take out a life policy written in trust for their family.

The deceased member (their family after their death) receives the benefit amount payable under their own policy to compensate for their LLP interest automatically passing to the surviving members.

Each member takes out and owns their own policy and can use it for any purpose. A member will normally place the policy in a flexible trust or another type of personal trust, so the policy proceeds don't form part of their estate. However, for the trust to be effective for IHT purposes, the other members shouldn't be beneficiaries of the trust.

As a settlor can't benefit from our flexible trust, there aren't any pre-owned assets tax implications.

Premiums under all the members' policies will normally be paid by the LLP and treated as a first charge on the firm's profits and then be rateably apportioned among the members according to age and cover provided. This way it will be certain that each policy is maintained. If there's some inequality of cost between the members, the premiums should be equalised, for example by treating the premiums as an expense of the LLP in the distribution of profits. The premiums won't be deductible for income tax purposes.

If the policy is held in our Flexible trust, you should be aware of the IHT treatment of these trusts. The premiums should not generally be gifts, particularly where the premiums are equalised. The trustees will be subject to 10-year charges and exit charges.

If the value of the claim proceeds is less than the value of the deceased's business interest in the LLP when they die, the surviving members will have to make up the difference to compensate the deceased member's estate for the shortfall.

Need more help?

If you need more help and support with putting protection in place for limited liability partnerships, speak to your usual Aegon sales contact or email us.

Important information

The following information is based on our understanding of current taxation law and HM Revenue & Customs (HMRC) practice, as at May 2021, which may change.

The tax treatment depends on the individual circumstances of each client and may be subject to change in future. The value of any tax relief depends on the individual circumstances of your client.

Trusts establish legal rights and entitlements and might have material financial and tax implications for the settlor, trustees and beneficiaries. Aegon UK isn't authorised to provide legal advice, so you should take your own legal advice before setting up a trust, to make sure that it meets your clients' requirements. Our trusts have been drafted for use by UK domiciled individuals.

Sole traders

What's a sole trader?

A 'sole trader' or 'sole proprietor' generally means a business that's owned and controlled by one person who makes all the decisions, has all the responsibility and profits from the business that they run. Although most sole traders will be relatively small businesses, many will have employees who, in some cases, can also be 'key'.

Sole traders can trade as self-employed individuals or as a single member limited company.

About sole traders and single member companies

Types of sole trader business

As mentioned previously, there are two types of sole trader business:

- a self-employed individual, or
- a single member limited company.

When a sole trader runs their business as a self-employed individual there are no special legal requirements to set up the business.

However, if a sole trader chooses to run their business as a limited company, they have to comply with all the legislative requirements that apply to private **limited companies**.

What are single member companies?

Since the introduction of the Companies (Single Member Private Limited Companies) Regulations 1992, it's been possible for a private limited company to have just one shareholder – referred to as 'a single member company'. This provision is confirmed in the Companies Act 2006 which also allows private companies to have just one director. The only other statutory requirement is that a director must be at least 16 years old.

Since April 2008 there's no requirement for a private company to have a company secretary, although one can still be appointed. Individuals who prefer to run their business on their own can set up a limited company and register with Companies House to receive a certificate of incorporation (where they want to limit their liability or for tax reasons), without involving other people.

Practical problems for single member companies

One potential problem of operating as a single member company is, should anything happen to the single shareholder director, issues can arise around who has control of the company in the short term.

Companies which have adopted the default Model Articles under the Companies Act 2006, have the necessary provisions to allow personal representatives to appoint directors. However, if the old Table A Articles apply (for companies incorporated before 1 October 2009) these don't allow personal representatives to make decisions or take action on behalf of the company, for example appointing a new director to run the company. In this scenario, if the Table A Articles aren't amended, the personal representatives will need to apply to the Court to correct the register of shareholders by removing the deceased's name and replacing it with the names of the personal representatives.

Key business protection considerations for sole traders

For individuals trading as sole traders, or through single member companies, a key consideration is whether the business will carry on following their death or serious illness or whether it will, effectively, die with the owner.

When dealing with business continuity or succession planning for sole traders, this should always be the first question to be considered – regardless of whether the business is run as a sole trader or a single member company.

Sole traders – business continuity

Who are the key people?

A key person is someone whose death, critical illness, disability or prolonged illness would have a serious effect on a business's future turnover and profits. The sole trader themselves will generally be a key person. In addition, a business can have one or more employees who make a vital contribution to its revenue and profitability. Who is key will depend on the business and the relevant individuals contributing to it. A person may be key to the business because they:

- have valuable sales contacts, which might be lost if they died;
- are a key sales person who contributes a significant amount of profit;
- are the founder, and still the main driving force behind the business;
- are the owner who has personally guaranteed loans made to the business by a bank – the bank may insist on life protection as a condition of the loan;
- are heavily involved in the development of a new product because of their knowledge and expertise. Without their input, the product launch might not go ahead, or
- are at the top in their line of work and have been time-consuming and expensive to recruit. It might be difficult and expensive to recruit their replacement.

These are just some possible examples. Who's key in a sole trader business will depend on its individual circumstances.

It's important to remember that the key question to consider for all sole trader businesses is whether or not the business will carry on following the death or serious illness of the owner.

If the business is to continue after the death or serious illness of the sole owner, but is likely to suffer immediate problems as a result, there may be a need for key person cover on the owner's life.

Depending on who will need the funds, protection cover should be taken out by the owner and put in trust either for those who will inherit the business or for those who will run the business.

Reasons to cover key people

Loan cover

If the business already has outstanding loans, the loss of a key individual could affect its ability to repay them. Financial institutions will often lend money to businesses based on one or two key people in that business. If something happens to either of these key people, the financial institution would probably want the business to repay the loan immediately. For sole traders, it's important to remember that repaying the loan would fall on the sole owner's family to repay if they died as opposed to the business.

As a result, it's becoming more common for financial institutions to ask for some form of protection to be in place to make sure any loans can be repaid.

Loss of profits

Most sole trader businesses rely on the expertise of the owner, although employees of the business can also be considered key. If they die, become seriously ill or disabled or suffer a prolonged illness, this could cause trading problems for the business, for example loss of experienced management skills, decline in customer orders and/or loss of goodwill, and result in a financial loss.

Having business continuity plans in place, including protection cover for key people, can help the business continue trading and mitigate the potential reduction in profits due to the death or illness of a key person.

One-off expenses

If the key person is an employee, there may be a need, even if it's only on a short-term basis, to recruit someone to replace them. The recruitment costs may include advertising, agency fees and training costs.

Compensation for family/dependants of the sole trader

If the sole trader decides the business won't continue after their death, the family and/or dependants of the sole trader will need to be compensated for their loss of income.

Our Business protection liability audit can help you highlight your client's business continuity needs to make sure their business can continue to run smoothly.

Calculating the level of cover

When considering the level of cover a business needs, the starting point is to estimate the impact on the business's future profits if a key person dies, becomes critically ill or disabled or suffers a prolonged illness.

The business will need protection in place so it can continue to trade and to provide funds to replace the key person.

There's no hard and fast rule to assessing a key person's financial contribution to the business, although insurable interest must be shown or the contract will be void.

Underwriters will look at each case to determine whether the level of cover makes sense and will assess each case on its own merit. The amount of evidence our underwriters need depends on how much cover your clients need. You can find full details in our Underwriting limits guide.

Our Business protection liability audit can help you arrive at an appropriate benefit amount and makes the risk impact real.

Levels of key person cover

Key person cover for a sole trader business falls into two areas:

- cover required on the life of an employee of the sole trader, or
- cover required on the life of the sole trader.

There are various ways of arriving at a suitable level of key person cover – we cover some of them below.

Levels of key person cover for employees

Method	Formula	Life/critical illness	Income protection
Salary-based approach	Salary x multiple	Yes	No
This method is based on the assumption that a salary reflects an employee's contribution to the business. The cover is estimated by basing it on a multiple of the key person's total salary, including any benefits. This can be up to 10 times salary for life protection and up to five times salary for critical illness protection. This method may not be suitable if a key person's salary doesn't reflect their contribution to the firm's profits. If they aren't being paid their 'true worth', the estimate of the cover required may be too low. Equally, the cover may be too high if they're close to retirement. As the cover is to replace loss of profits, it may be more appropriate to link the cover level to the firm's profits.			

Method	Formula	Life/critical illness	Income protection
Payroll-based approach	(key person's salary ÷ total payroll) x gross profit x expected years to recover	Yes	No
This method estimates the key person's contribution to the firm's profits by dividing their salary by the firm's total wage bill and then multiplying by the gross profit times expected years to recovery. This method may not be suitable for a new or unprofitable business.			

Method	Formula	Life/critical illness	Income protection
Profits-based approach	Gross profits x multiple (for example, two)	Yes	No
	Net profits x multiple (for example, five)	Yes	No
This method estimates the required cover by multiplying either the gross profits or the net profits. The usual multiples are two times gross profits or five times net profits. This method may not be suitable where several key people are covered, as it may be difficult to determine the contribution each individual makes to profits, although a higher multiple may be justified for a rapidly expanding business.			

Levels of key person cover for the sole trader

Even where the sole trader receives a salary from the business, it's unlikely to reflect their contribution to the business. Therefore the salary-based approach and the payroll-based approach described on the previous page won't be appropriate.

The profits-based approach is the most suitable to calculate the level of cover on the life of the sole trader.

If the business will stop trading after the death of the sole trader, the income and capital needs of the family and dependants should be considered when determining a suitable level of key person cover. Use our Personal liability audit with your clients to help them identify their personal protection needs.

How to set up an arrangement

There are two ways to set up the arrangement.

Employees as key people

The usual way for a business to apply for cover on the life of an employee would be for the business to apply for a policy on the life of the employee on a life of another basis. The employer/employee relationship, combined with a potential financial loss, should be sufficient to establish the necessary insurable interest at outset.

Sole traders who are self-employed could take out the policy on the life of the key employee. No trust is needed.

If the sole trader runs their business as a limited company, the company could take out the policy on the life of the employee.

Sole traders as key people

Typically, where businesses are set up as a limited company, the life policy providing the key person cover would be owned by the company.

However, if the sole trader is running their business as a single member company, this wouldn't be suitable where the sole trader is the key person.

Depending on who needs the funds, cover should be taken out by the sole trader and put in trust either for those who will inherit the business or for those who will run the business.

For those who will inherit the business, the policy would usually be held under a personal discretionary or flexible trust. The beneficiaries of this trust would be the family/dependants of the insured person, in other words the sole trader.

If the funds are needed by the continuing employees/managers, the sole trader could take out a policy on their own life in trust for the employees/managers.

Tax implications of key person policies

Policy on the life of a sole trader

Tax treatment of premiums

There will be no deduction for the business.

Tax treatment of the claim proceeds

The claim proceeds will be paid tax free. If the policy is written in trust for the family or for the employees, the proceeds will be paid to the trustees. The death of the insured person is a chargeable event. However, there won't be a chargeable event gain, as our protection policies have no investment content.

Policy on the life of an employee

Tax treatment of premiums

Unfortunately, there's no direct legislation covering the taxation of key person policies, but the principles that apply were set out in 1944 by the then Chancellor of the Exchequer, Sir John Anderson. These principles are known as 'the Anderson Rules'.

Following a parliamentary question, he said the 'treatment for taxation purposes would depend upon the facts of the particular case and it rests with the assessing authorities and the Commissioners on appeal if necessary to determine the liability by reference to these facts. I am, however, advised that the general practice in dealing with insurances by employers on the lives of employees is to treat the premiums as admissible deductions, and any sums received under a policy as trading receipts, if:

- the sole relationship is that of employer and employee;
- the insurance is intended to meet loss of profit resulting from the loss of services of the employee, and
- it's an annual or short-term insurance.

Cases of premiums paid by companies to insure the lives of directors are dealt with on similar lines.'

Although the rules were designed for dealing with life policies on the lives of employees and directors of limited companies, the same principles apply regardless of whether the employer is a limited company, a partnership or a sole trader.

The tax treatment of premiums and proceeds can never be guaranteed. The local Inspector of Taxes will look at each case on its own merits.

It's commonly believed that if an employer doesn't receive tax relief on the premiums it will receive the claim payment tax free and vice versa. Whether or not tax relief is available on the premiums depends on whether they're allowable as a business expense. To be an allowable business expense, the premiums must be paid 'wholly and exclusively for the purposes of the business'.

So, it's important to look at the Anderson Rules in detail to determine the tax consequences. Read our Taxation of key person policies technical factsheet for more information.

Tax treatment of the claim proceeds

Where key person cover is designed to meet the loss of profits, the employer (for tax purposes the sole trader or the sole trader's company) will pay tax on the claim proceeds at its marginal rate(s) for that tax or financial year. This is because the policy was to replace loss of profits and those profits would have been taxable.

If the policy was taken out for a capital purpose, the claim proceeds should be tax free. Capital purposes include buying new premises or repaying a bank loan.

Assigning a life of another key person policy to a former employee

The key person, as the insured person, doesn't have any rights to the policy, either in terms of its ownership or the claim proceeds. If the employee leaves or retires from the business before the end of the policy term the policy will no longer be needed.

Alternatively, instead of cancelling the policy, it could be assigned to the departing key person. In this case, a solicitor would have to draft a suitable Deed of Assignment. If the key person leaves the business and the policy is transferred to them in the same tax year, they'll be taxed at their marginal rate on the total premiums paid at the date of transfer, under the benefit-in-kind legislation.

If the policy is transferred to the key person in the tax year following their departure, the benefit-in-kind legislation won't apply. However, the termination of employment legislation will apply, so the tax liability will be calculated on the market value of the policy.

As the protection policy has no investment content, there won't usually be a market value, unless the insured person is critically or terminally ill. Once the policy is transferred to the key person, it becomes second hand and the capital gain (which is the claim proceeds less the premiums paid to date by the key person) could be subject to capital gains tax.

Inheritance tax (IHT)

This is only relevant where a sole trader takes out a policy in trust for the benefit of their family/dependants or for the employees. The trust will usually be a personal flexible or discretionary trust. Therefore, the inheritance tax relevant property regime will be relevant but any premiums paid under these types of trusts will normally be covered by the normal expenditure out of income exemption.

Income tax and capital gains tax

As the only asset of the trust is a life insurance policy, there will be no income tax or capital gains tax implications regardless of how the arrangement is structured.

Sole traders – business succession

When thinking about business succession planning, a sole trader needs to consider whether the business will carry on following their death or serious illness or whether it will, effectively, die with them.

What happens when the sole owner dies – business stops trading

When the profitability of a sole trader's business relies entirely on the owner continuing to be involved in the running of the business, if they die or have to stop working due to a serious or critical illness, their business won't be able to continue.

If the business is run on a sole trader basis, and has no separate identity from that of its owner, any business assets, including any property used in the business, will simply pass to those who inherit the estate of the deceased. Apart from any tangible assets, for example property, there will be no value attached to the business.

If the business is run as a limited company, the shares will pass to the estate of the deceased. If the business stops trading, the shares won't be worth anything, except for any assets held in the company's name.

In the scenarios above, there's no need for any business protection or business succession planning. However, this doesn't mean there's no need for protection cover at all. Sole traders are likely to have personal protection needs that should be addressed including protecting their family against the financial risks resulting from their death.

What happens when the sole owner dies – business continues to trade

When the profitability of a sole trader's business doesn't depend entirely on the owner continuing to be involved in the running of the business, the business is likely to continue.

Where this is the case, the owner needs to think about what plans need to be put in place to allow business succession as well as making sure there are funds available to provide compensation, for example for family members who may not inherit the business or a husband, wife or registered civil partner who doesn't want to be dependent on new owners.

Family succession

If the business is to pass to a family member, for example to a son or daughter, there may be a need to compensate one of the children should they not wish to be involved, or inherit the business. A husband, wife or registered civil partner may also need compensated if they don't want to be dependent on the new owners.

To provide the funds for this, the sole trader should take out a life protection policy written in trust for the benefit of the person(s) to be compensated. Inheritance tax will rarely be a problem as the business is likely to qualify for 100% business property relief, but you should verify this in all cases.

Management buy-out

What is a management buy-out?

If the sole trader's family doesn't want to own and run the business, it could pass to the employees instead. The employees (who will usually be the individuals or managers involved in running the business) could buy the business from the deceased's estate on death – usually referred to as a 'management buy-out'. Capital gains tax on the sale should be nil or minimal following the death of the owner, as the business will have been revalued on death.

Management buy-out agreement

The employees/managers' 'right to buy' should be documented by the sole trader and the managers entering into an agreement for purchase. In most cases, for tax reasons, the agreement for purchase would be in the form of an option agreement between the owner and the employees/managers and not a binding agreement for sale. Using an option rather than a binding agreement is particularly relevant for agreements that cover the purchase on death, as any available business property relief for inheritance tax purposes wouldn't be affected.

The owner and employees/managers should speak to a solicitor to make sure any option agreement meets their needs.

Funding a management buy-out

Whenever the sale takes place, having access to funds is important for the employees/managers. To make sure the funds are available, the employees/managers should take out a life policy on the life of the sole trader.

The level of cover should reflect the value of the business and should be split between all the employees/managers participating in the arrangement. The employees/managers will pay the premiums, which may be covered by an increase in their salaries.

Granting an option to sell may have capital gains tax implications for the business owner. This will depend on the age and state of health of the business owner and is particularly important if the price for the purchase is fixed. Therefore, for any succession arrangement involving a transfer of a business to employees/managers, it's important all parties involved get professional advice.

Need more help?

If you need more help and support with putting protection in place for sole traders, speak to your usual Aegon sales contact or email us.

Employee benefits for small and medium sized businesses

By their very nature, small businesses don't have the scale to qualify for group risk schemes. But without offering a competitive employee benefits package, will they be able to attract and retain the right employees to help them grow?

We have a solution. By combining relevant life and executive income protection, your clients can create a competitive benefits package for their employees in a tax-efficient way. Let's take a look in more detail.

The following information is based on our understanding of current taxation law and HM Revenue & Customs (HMRC) practice, which may change.

The tax treatment depends on the individual circumstances of each client and may be subject to change in future. The value of any tax relief depends on the individual circumstances of your client.

Group benefits versus relevant life

We'll discuss **Relevant Life** in more detail in **Part six** of this guide. The table below highlights the differences between relevant life, death-in-service and group life schemes.

	Relevant life	Death-in-service registered scheme	Excepted group life
Company pays	✓	✓	✓
No P11D charges or National Insurance contributions	✓	✓	✓
Normally corporation tax relief	✓	✓	✓
Generally tax-free benefits under trust	✓	✓	✓
Available for small companies	✓	✗	✓
Available on a single life	✓	✗	✗
No annual allowance or lifetime allowance trap	✓	✗	✓
Not subject to pension scheme rules	✓	✗	✓
Flexible	✓	✗	✗

Things to consider

- Businesses may choose a registered death-in-service scheme, however these types of schemes aren't suitable for all. For example, for:
  - small businesses who don't have the scale to qualify for group life schemes, or
  - employees who have high registered death-in-service scheme benefits (a lifetime allowance issue) and would prefer to receive their life insurance benefits outside a registered scheme.
- Under excepted group life schemes, the benefit is worked out the same for everyone included in the scheme – normally a multiple of earnings, but can be a flat amount. The definition of earnings and the frequency allowed for change is also the same for everyone under the policy.
- Lifetime allowance doesn't apply to excepted group life schemes or relevant life policies. We'll take a look at this in more detail on the next page.
- Group schemes will offer less underwriting compared with relevant life policies but won't be able to offer similar levels of cover – potentially leaving your clients without suitable cover.
- Death-in-service and excepted group life schemes don't offer the same flexibility as relevant life policies.

On leaving employment there's no continuation option under group life arrangements, so cover stops when the employee leaves employment. This could actually be at a time when the employee needs it most, for example, leaving due to ill health. With relevant life, if your client leaves employment, their relevant life policy can continue.

Lifetime allowance – a closer look

The lifetime allowance is a limit on the amount of pension benefit that can be drawn or taken from pension schemes – whether lump sums or retirement income – without triggering an extra tax charge.

In this example, we show how the lifetime allowance can impact death-in-service benefits and the tax payable by personal representatives.

Dan was a company director. He had a yearly salary of £120,000, a pension value of £850,000 and his death-in-service scheme was four-times salary.

Unfortunately, Dan died in May 2021, aged 39. When the claim proceeds from his death-in-service scheme were paid to his personal representatives, this triggered the lifetime allowance benefit crystallisation event 7 to check against his available lifetime allowance.

Dan hadn't opted for any protection of the lifetime allowance. The lifetime allowance available was £1,073,100. Dan's personal representatives were liable for a tax charge of 55% on the amount taken as a lump sum over the value of £1,073,100 (2021/22 tax year). In this case:

Dan's pension value	£850,000
+	
Dan's death-in-service benefit of	£480,000
=	£1,330,000
Minus lifetime allowance	£1,073,100
=	£256,900
55% tax charge =	£141,295

If Dan's company, as his employer, had used a Relevant Life policy instead of providing a death-in-service scheme, the personal representatives would have saved £141,295 as the lifetime allowance wouldn't have been exceeded.

This is a fictional example. It doesn't represent a real customer.

Executive income protection

However, as it's more likely that an employee will be unable to work due to an illness or injury as opposed to dying, you can add more value by recommending executive income protection to your clients – helping them to attract and retain the talent they need to develop and grow their business.

Employers paying their employees via the Pay As You Earn (PAYE) system can choose an executive income protection policy to sit alongside their employees' relevant life policy. This will allow them to continue paying a salary to their ill or injured employees who are unable to work, which will help them during their recovery.

As well as helping to protect your client's pre-retirement income, executive income protection can also help them, and their employer, to maintain regular pension contributions. This can be beneficial if your clients become unable to work during their working life, as it's likely that they'd also be unable to continue building up their income for retirement – which could have a devastating impact on their retirement plans.

When the executive income protection claim is paid to the business, it can then pay this out via PAYE, so the employee receives relevant UK earnings letting the employee continue making pension contributions.

Read our Executive income protection – financial security for your clients case study for more information.

Our solutions

A good business protection offering should include:

- A comprehensive range of protection products.
- Capacity for large sum assured risk.
- The ability to understand and underwrite complex cases.
- Competitive financial underwriting limits.
- Access to underwriters.
- Technical resource.
- Access to experienced Sales consultants.
- Good support materials.
- Strong claims payment record.

We offer a range of business protection solutions designed to help protect your clients' businesses.

Our Business Protection menu offers one of the most comprehensive solutions in the market. We offer both Relevant Life and executive income protection – letting you offer your clients a comprehensive employee benefits solution, with only one online application to be underwritten.

Our solutions can protect your clients' families and businesses from the financial consequences of them – or someone in their business – dying or becoming seriously ill or disabled.

Products

In our Business Protection menu, you can choose the following main benefits:

- Life protection
- Reducing life protection
- Critical illness protection
- Life with critical illness protection
- Reducing life with critical illness protection
- Executive income protection with a choice of benefit payment periods – either two years or full term to the benefit end date
- Key person income protection

A number of additional benefits are available, including:

- Waiver of premium
- Renewal option
- Indexation option
- Instalment option
- Total permanent disability

Download our at-a-glance guide for a summary of our Business Protection menu.

We also offer **Relevant Life** on a level and reducing basis.

The following additional benefits are available for both Business Protection and Relevant Life:

- Guaranteed insurability options
- Access to Policy Plus

You can apply for a Relevant Life policy online using our signature-free Relevant Life trust or by completing our Relevant Life application form and our Declaration of trust for a Relevant Life policy.

Download our at-a-glance guide for a summary of our Relevant Life policy.

Underwriting and claims

It's important to us that we provide affordable cover for as many of our customers as possible. That's why we strive to get the best decision for your clients.

We offer an underwriting service with your clients' individual needs in mind. Our experience allows us to offer a flexible approach to risk assessment – if we can't offer the terms your clients ask for, we'll offer alternatives.

We can also help lighten the load by offering:

Immediate cover – we can put 60 days' cover in place immediately while we request any routine medical information for up to £3.5 million life protection and £1.5 million critical illness protection. Read our Immediate cover facility factsheet for more information.

Accidental death benefit – we'll automatically include up to 90 days' accidental death benefit with all benefits except key person income protection or executive income protection, when our immediate cover facility isn't in use.

Competitive financial and medical limits – find out more in our Underwriting limits guide.

We'll discuss these points in more detail throughout this section of the guide.

Pre-sale support

Pre-submission underwriting helpline

We're committed to providing an efficient and professional service.

Our dedicated pre-submission underwriting helpline can give you support or practical advice on any pre-submission technical, medical, financial or occupation underwriting issue. If you need to speak to a member of our underwriting team, call our helpline on 03457 83 54 73 (call charges will vary).

We also have a Pre-submission underwriting questionnaire to help you gather detailed information from your clients before you call our helpline.

Any pre-submission decision we give is based purely on the details you give us. We can't guarantee the decision as it's subject to full underwriting.

Point-of-sale questionnaires

If we need more information about a pursuit or medical disclosure, we may ask your clients to complete a point-of-sale questionnaire. For medical disclosures, this can help reduce the need for us to request general practitioner's reports (GPRs) and saves time – giving you and your clients a quicker turnaround.

Get in touch

If you need to get in touch, you can:

call us – 03457 83 54 73 (call charges will vary)

email us, or

get in touch with your Aegon sales contact.

If you're not sure who your Aegon sales contact is, email us with your name, email address, firm name and postcode, and we'll get back to you.

If you're contacting us by email please remember not to send any personal, financial or banking information because email is not a secure method of communication.

Illustrations

You can get illustrations online or from us directly. We aim to reply to all new illustration requests within 24 hours if these are submitted via email or phone.

If you know that your client will need special underwriting requirements, for example medical, pursuits or travel, we can offer rated illustrations which can help you manage their expectations.

Price Pledge and price matching

We want to make sure your clients get comprehensive business protection at a competitive price. Our Price Pledge offers to beat the standard monthly or yearly premiums offered by our competitors, and is available on both life protection and reducing life protection.

If a case isn't covered by our Price Pledge we may be able to offer price matching. You should speak to your usual Aegon sales contact to find out if individual cases qualify.

Medical underwriting

Underwriting doesn't have to be complicated. We've designed our online application journey to collect the relevant information we need from your clients upfront, reducing the need to contact them again during the underwriting process. Our dedicated team of underwriters are experts at what they do.

Competitive medical limits

Our routine medical evidence limits are competitive. For example, up to age 35 we don't automatically need to see a GPR until the benefit amount for life protection goes over £1 million.

We know how important flexibility is for you and your clients. In certain circumstances we can offer a range of medical examination options, including the client's own GP, third-party medical provider (surgery based), mobile nurse or a mobile doctor. Read our Underwriting limits guide for more information.

Financial underwriting

Financial underwriting is often seen as a barrier to writing protection business, but that doesn't need to be the case. We're committed to providing an efficient and professional service – the underwriting process can be simple, even for large cases.

Competitive financial limits

We only ask for financial evidence in the form of a Business protection financial questionnaire where the benefit amount is over:

- £2 million for life protection, and
- £850,000 for critical illness protection.

And, we only ask for reports and accounts where the benefit amount is over:

- £3.5 million for life protection, and
- £2 million for critical illness protection.

Read our Underwriting limits guide for more information.

Field underwriting

Certain commercial deals are highly confidential. So, in certain circumstances our underwriters can speak to a client directly, with the aim of financially underwriting the case there and then. This saves time waiting for evidence.

Specialist large sum assured underwriting team

Underwriting large sum assured cases is often seen as being extremely time consuming and complex, particularly the financial underwriting – but that's not really the case. Providers need to be flexible and practical to make the process a little easier and help cater for the specific needs that a larger case might need.

Our dedicated team is made up of underwriters and administrative support. Their experience allows them to take a practical approach to large sum assured cases.

- We recognise each case will have its own very specific needs and requirements.
- We have significant in-house underwriting capabilities and access to the reinsurance market for very large cases.
- We're committed to offering you and your clients the best service possible.

Our specialist large sum assured underwriting team deal with the more complex cases – those cases over:

- £1.5 million life protection;
- £750,000 critical illness protection and total permanent disability, and
- £40,000 a year income protection policies.

Immediate cover facility (ICF)

Immediate cover is available on both Business Protection and Relevant Life.

If your client's application and financial evidence is satisfactory, we'll put 60 days' cover in place immediately while we request any necessary medical information. This is available up to:

- £3.5 million life protection, and
- £1.5 million critical illness protection.

Cover is for 60 days and is full cover, not accident cover only. We'll also pay commission as soon as the ICF is accepted.

If the application is being written under trust and your client needs ICF, we'll need a fully completed trust form in addition to any financial evidence.

Read our Immediate cover facility factsheet for more information.

Dedicated support

At a time when some providers are cutting back their support in this area, we're fully committed to giving you the best level of support we can.

- We have a dedicated specialist business protection sales team, so they'll have the answers to any questions you may have.

If you're not sure who your Aegon sales contact is, email us with your name, email address, firm name and postcode, and we'll get back to you.

- If you need to call us, you'll always be able to speak directly to the people who are dealing with your application.
- We have a number of dedicated underwriting teams – specialist and large sum assured – that are experts within their individual fields.
- Our philosophy is to provide a professional and fair claims service by paying all valid claims as soon as possible. Our expert claims assessors recognise that all claims are different and need personal attention. They understand what's important when making a claim. Their priority is to pay valid claims quickly and with as little hassle as possible. They'll also look for ways to help your clients get back into work – providing support where they can, making sure your clients get the best and most appropriate advice and treatment.
- We have tax and trusts specialists to help with any queries about more complex tax or trust issues.
- We're proud to have won Best Business Protection at the Cover Excellence Awards 2020 and Insurer of the Year at the British Claims Awards 2020. We're also delighted to have won the Best Protection Service award for the fourth-year running at this years Investment, Life and Pensions Moneyfacts awards.

WINNER FOUR TIMES Investment Life & Pensions Moneyfacts Awards 2017-2020 Best Protection Service

COVER EXCELLENCE AWARDS 2020 WINNER Best Business Protection Aegon

BRITISH CLAIMS AWARDS 2020 WINNER Insurer of the Year #BCAwards

Visit our **Contacts** section for contact details.

Submitting a case

Application

You can apply for Business Protection and Relevant Life either online or by completing a paper application form.

Instalment option

If your clients are looking to future proof against changes to corporation tax rates, they could use our instalment option. This option is available if the company wants life protection, critical illness protection, or life with critical illness protection. You can only apply for this using our paper Business protection application form and your clients must select this when setting up their policy.

Trusts

Business trust

Own-life policies in business trusts are still one of the most useful arrangements for partnership and shareholder protection. If the policy is to be written under a Business trust, your clients must complete the trust

document and return it to us before their policy start date. We've added margin notes to our Business trust form to help your clients complete the form easily and quickly.

Relevant Life trust

Relevant life policies must be held in trust to mitigate the risk of the benefit amount forming part of the employee's inheritance tax estate when they die. Similar to the business trust, the trust must be completed before the policy start date. You can apply for a Relevant Life policy online using our signature-free Relevant Life trust or by completing our Relevant Life application form and our Declaration of trust for a Relevant Life policy. Our Relevant Life trust is a discretionary trust specifically designed to be used in conjunction with our Relevant Life policy.

Our Relevant Life policy, when held in our Relevant Life trust, is fully portable, so the insured person can take it with them if they move jobs. We also offer trustee flexibility. We don't insist on the employer being a corporate trustee, giving the employer the option of opting out. We'll explain more about relevant life policies later in the **Relevant Life** section.

Protection document service

Our protection document service lets us send you important servicing documents electronically as soon as they're available – so you can get your clients' protection cover in place quicker. Read our Using the protection document service guide for more information.

How flexible are our business protection products?

Tailoring a policy

We understand that your clients' circumstances can change. From restructuring their organisation to taking out a business loan, our Business Protection menu is flexible so they can change their policy as their needs change. For example, they could:

- add or remove an insured person;
- complete a Deed of Assignment to transfer the policy ownership;
- change from smoker to non-smoker status if the insured person hasn't used nicotine products within the last 12 months;
- add or remove benefits;
- reduce or extend the benefit term;
- increase or decrease the amount of cover, and
- use guaranteed insurability options to increase the amount of cover without the need for further medical evidence (certain limits apply).

You'll find full details of the guaranteed insurability options in our Business Protection policy conditions.

Our Relevant Life policy is also flexible and can be changed as your clients' circumstances change. For example, the policyholder (the trustees where the Relevant Life policy is in the Relevant Life trust) could:

- transfer ownership of the policy to the insured person if they move jobs or allow the policy to continue in the Relevant Life trust with the employee or a new employer paying the premiums;
- reduce or extend the benefit term. However, the policy can't continue past the insured person's 75th birthday;
- change from smoker to non-smoker status if the insured person hasn't used nicotine products within the last 12 months;
- increase or decrease the amount of cover, and
- use guaranteed insurability options to increase the amount of cover without the need for further medical evidence (certain limits apply).

You'll find full details of the guaranteed insurability options in our Relevant Life policy conditions.

Income protection

We offer two versions of business income protection – executive and key person. Each one protects in a slightly different way:

- **Key person income protection** – protects your clients' business from the loss of a key person and potential loss of profits.
- **Executive income protection** – allows your clients to protect the earnings of valued employees when illness or accident strikes.

Let's look at each in more detail.

Key person income protection

We'll pay a regular payment to the employer if the insured person is unable to work because they suffer a long-term incapacity as a result of accident or sickness. This benefit can then be used:

- for loan repayments;
- to help pay for a replacement employee, or
- to cover loss of profits/income.

For all key person income protection applications we need a completed Key person income protection financial questionnaire.

Ten reasons to choose our key person income protection

Not many providers offer key person income protection, however we understand the importance of offering this and are committed to providing bespoke business protection solutions that meet your clients' needs.

- **Choice of maximum benefit calculation** – your clients have the choice of either:
  - 2.5 times the insured person's gross salary, averaged over the last three years;
  - 75% of the company's average gross profits that can be attributed to the insured person over the last three years, or
  - loan repayment that can be attributed to the insured person.

  Both options are subject to an overall maximum benefit amount of £250,000 a year.
- **Choice of payment period** – at the start, your clients can choose how long they want the benefit to be paid for – one, two, three, four or five years. Limiting the benefit payment period keeps the cost down for your clients.
- **Choice of deferred period** – 13, 26 or 52 weeks, or a selection of these via split deferred to help manage costs.
- **Rehabilitation benefit** – if the insured person can't do their normal job or the hours they're contracted to do and have to go back with fewer duties or working less hours, we'd support them by continuing to pay a monthly benefit amount at a reduced level.
- **Protection against inflation** – to help maintain the real value of your clients' benefits, they can choose our indexation option.
- **Guaranteed insurability option** – if we accept the key person on standard terms and the business needs to increase the benefit amount because circumstances have changed, it can do so without having to provide us with evidence of the key person's continued good health, up until age 55.
- **Claims** – we won't reduce the benefit amount when your clients have to make a claim.
- **Key person replacement service** – providing help and guidance on how to find replacement 'key' personnel – whether temporary or permanent. It also offers advice, guidance and support on all aspects of employment law.
- **Health and wellbeing service** – giving customers, and those closest to them, access to confidential support and guidance on a wide range of issues, including loss of a family member or friend, marital and relationship concerns, consumer rights, legal and debt issues.
- **Second medical opinion service** – giving customers, and their family members, a face-to-face consultation with a UK-based specialist to review a recent medical diagnosis.

Executive income protection

We'll pay a regular payment to the employer if the insured person is unable to work because they suffer a long-term incapacity as a result of accident or sickness. This allows the employer to insure the income of valued employees. Our executive income protection comes with a choice of 2-year or full term benefit payment period. This benefit must be used to help pay a salary to the employee while they're off work and will be paid through the Pay As You Earn (PAYE) system.

Executive income protection is paid for and owned by the employer and works well when considered alongside relevant life in terms of tax treatment of premiums, as neither are treated as P11D benefits.

Most people understand the need for, and benefits of, pension saving to provide an income in retirement. But, have your clients considered what would happen should they be unable to work? Not only would their immediate income needs not be met, without protection in place they also wouldn't be able to continue building up their income for retirement.

As well as helping to protect your client's pre-retirement income, executive income protection can also help them, and their employer, to maintain regular pension contributions.

When we pay the executive income protection claim to the business, it can then pay this out via PAYE. This means the employee receives relevant UK earnings, allowing the employee to continue making a pension contribution. Read our case study for more information.

Ten reasons to choose our executive income protection

- **Common sense approach to maximum benefit calculation** – 80% of employee's pre-incapacity taxable earned income (up to a maximum of £150,000 a year) plus:
  - the yearly contribution towards the insured person's pension made in the previous 12 months by the company, plus
  - employer National Insurance (NI) contributions (which can also be protected by the employer up to the amount paid for the insured person in the last 12 months).

  The combined overall limit for pension contributions and NI contributions is £30,000. The total executive income protection cover available is £160,000 a year.
- **Choice of benefit payment period** – at the start, your clients can choose how long they want the benefit to be paid for – either two years or full term to the benefit end date. Limiting the benefit payment period keeps the cost down for your clients.
- **Maintain retirement savings** – as the executive income protection claim benefits are paid to the company, the company pays the employee via PAYE and these payments count as relevant UK earnings. This means the insured person can continue to make personal pension contributions if they can afford them. The employer pension contributions can be covered and continue to be paid by the company, as they can be included within the benefit.
- **What we're prepared to accept as income**:
  - salary, bonuses and the value of P11D benefits, and
  - for a shareholder director, dividends paid by their company.
- **Choice of deferred period** – four, eight, 13, 26 or 52 weeks, or a selection of these via split deferred to help manage costs.
- **Proportionate and rehabilitation benefit** – if the insured person is no longer able to carry out their normal occupation, but takes up work on a lower income with the same company or can't do their normal job on the hours they're contracted to do and have to go back with fewer duties or working less hours, we'd support them by continuing to pay a monthly benefit amount.
- **Protection against inflation** – to help maintain the real value of your clients' benefits, they can choose our indexation option.
- **Key person replacement service** – providing help and guidance on how to find replacement 'key' personnel – whether temporary or permanent. It also provides advice, guidance and support on all aspects of employment law.
- **Health and wellbeing service provided** – giving customers, and those closest to them, access to confidential support and guidance on a wide range of issues, including loss of a family member or friend, marital and relationship concerns, consumer rights, legal and debt issues.
- **Second medical opinion service** – giving customers, and their family members, a face-to-face consultation with a UK-based specialist to review a recent medical diagnosis.

(!) As we mentioned previously, executive income protection works well when considered alongside relevant life in terms of the tax treatment of premiums as neither are treated as P11D benefits.

Relevant Life

Relevant life is a life insurance policy available to employers to provide an individual death-in-service benefit for an employee. You can't use a relevant life policy for business loan cover, business continuity or business succession planning.

- It can help smaller businesses attract and retain high-calibre staff by offering them attractive benefit packages in a tax-efficient way.
- It can also be a tax-efficient way for directors to make provision for their family and have their life insurance paid for by the company.
- It allows employees, who are members of group life schemes, to top up their life cover without counting towards their annual and lifetime allowances.

A relevant life policy is defined in section 393B(4) of the Income Tax (Earnings and Pensions) Act 2003.

Who can apply for a relevant life policy?

An employer takes out a relevant life policy on the life of an employee. The following could apply for a relevant life policy, as an employer:

- a limited company (directors will often be employees);
- a partnership;
- a limited liability partnership;
- a sole trader, or
- a charity.

However, as the following aren't employees, they can't be covered by a relevant life policy:

- an equity partner in a partnership;
- a member of a limited liability partnership, or
- a sole trader (in their personal capacity as business owner).

Conditions of a relevant life policy

There are a number of conditions that must be met for a policy to qualify as a relevant life policy. These are:

- The policy must only provide a lump sum death benefit which is payable before age 75.
- The death benefit must be payable when the insured person dies, unless the circumstances surrounding the death are excluded in the policy conditions.
- The policy doesn't have, and mustn't be capable of having, a surrender value.
- The benefits must only be payable to an individual or a charity, although they can be payable to a trustee(s) for them to pay the funds to an individual or a charity.
- The claim proceeds must be capital in nature and shouldn't constitute income.
- The main purpose of the policy mustn't be tax avoidance.
- Where terminal illness benefit is included, this benefit must only be payable while the employee is in the employment of the employer who's paying the premiums. The terminal illness should also lead to the employee's retirement.

Tax benefits

It can attract beneficial tax treatment when compared to a non-relevant life policy, as long as it meets certain legislative criteria (see **Conditions of a relevant life policy** opposite) and is written under trust. If the policy doesn't meet these criteria, it would fall outside the relevant life rules. The tax treatment depends on the individual circumstances of each employee and may be subject to change in the future.

There can be tax benefits for both the employer and employee.

Employer benefits:

- Corporation tax relief (so long as the premiums are wholly and exclusively for the purposes of the business).
- Normally no National Insurance contributions to pay on the premiums paid to fund the relevant life policy.

Employee benefits:

- Normally no National Insurance contributions to pay on the premiums paid to fund the relevant life policy.
- The premiums won't be taxed as a benefit in kind, where they're not paid under a salary sacrifice or flexible benefits arrangement.
- Premiums and benefits don't count towards annual or lifetime pension allowances.

Use our Relevant Life calculator to see the potential tax savings that can be made using a relevant life policy compared to a non-relevant life policy.

Importantly, there's no guarantee that a favourable tax position will apply in all cases. A tax adviser should be able to provide confirmation on the tax treatment of the policy for both the business and employee. If not, they may be able to get clarification from HM Revenue & Customs.

Trustee flexibility

The employer should arrange for the Relevant Life policy to be written in trust for the benefit of the employee's family. This will help to fulfill the legislative requirements for a relevant life policy and also, in most cases, it should help to mitigate inheritance tax.

There are two ways you can declare a trust – using our signature-free Relevant Life trust or completing our paper Declaration of trust for a Relevant Life policy.

Our Relevant Life trust is a discretionary trust with a wide class of discretionary beneficiaries, including the employee. Our trust is flexible and gives the employer the choice to act as a corporate trustee or not.

Being a trustee – if the worst should happen the employer can help to make sure that the employee's wishes are carried out as they'd intended. It's a small, easy step for employers to take, but it could make a real difference to the employee's family and help them to retain loyal staff.

Choosing not to be a trustee – if your client is the sole director with 100% shareholding in the business and the business is the sole trustee, the trust will be locked if they die until another director is appointed to act on behalf of the company. To help avoid this scenario, we don't insist on a corporate trustee, giving the company the choice of opting out.

Our Relevant life – should the company be a corporate trustee? sales aid gives you more information.

Portability

Our Relevant Life policy can continue if the insured person moves jobs. They can then either continue paying the premiums themselves, or ask their new employer to take over this payment as part of their benefits package.

(!) If their new employer is taking over the payment of premiums, many providers will place a time limit on when they can activate this option. We don't – providing even more flexibility.

Any employer who makes the payments on their employee's behalf may be eligible for corporation tax relief on the payments.

Alternatively, the employee can continue to pay the premiums themselves to maintain the policy. If the employee wants to pay the premiums and keep the policy in the existing trust, the trustees would need to remove the employee as a beneficiary by completing a Deed of removal of beneficiary to maintain the IHT benefits of using a trust. This option is really important if the employee has had to leave their job due to ill health, as they'll have cover at the time when they need it most.

Levels of cover

There are no limits to the level of cover set out in legislation. Usually the benefit level will be calculated as a multiple of the employee's income. The table below gives an indication of the maximum levels of cover we'll offer.

Up to and including age 35	30 times income
Ages 36-50	25 times income
Ages 51-60	20 times income
Ages 61 and over	15 times income

While we offer these maximum levels of cover, the employer should consider whether the premiums to maintain such a level of cover, will meet the wholly and exclusively for the purpose of the business test for tax purposes.

Immediate cover facility

Imagine you have a client with a healthy employee. They want cover in place as soon as possible and are happy with the premium, but underwriting is required due to the level of cover. What can you do to get the cover in place quickly?

Our immediate cover facility is designed for just this reason. We can provide immediate cover for the first 60 days while we request any necessary medical information. If you're applying for relevant life using our Relevant Life application form, we must also have a completed Declaration of trust for a Relevant Life policy.

Accidental death benefit

We automatically include accidental death benefit for up to 90 days when our immediate cover facility isn't in use. If the insured person dies as a result of an accident while we're assessing their application, we'll pay out a lump sum. Read our Key features of the Relevant Life policy for full details.

Ten reasons to choose our Relevant Life

- **Trustee flexibility** – if your client is the sole director with 100% shareholding in the business, and the business is the sole trustee, the trust will be locked if they die until another director is appointed to act on behalf of the company. To avoid this, we don't insist on a corporate trustee, giving the company the choice of opting out.
- **Portability** – unlike group life schemes, the Relevant Life policy can continue if the insured person moves jobs. They can ask their new employer to take over this payment as part of their benefits package. Any employer who makes the payments on their employee's behalf may be eligible for corporation tax relief on the payments. Alternatively, the employee can continue to pay the premiums themselves to maintain the policy. This is important if they've had to leave their job due to ill health, as it allows their cover to continue at a time when they need it most.
- **Immediate cover facility (ICF)** – for benefit amounts of up to £3.5 million life protection, we can provide immediate cover for the first 60 days while we request any necessary medical information. Cover is full cover, not accident cover only. We'll also pay commission as soon as the ICF has completed.
- **National Insurance (NI) savings** – in comparison to a protection policy taken out on a personal basis and paid for by the employer, there will be NI savings for both the employer and the employee. Use our **Relevant Life calculator** to help work out the potential tax savings that can be made using a relevant life policy compared to a non-relevant life policy.
- **Employee benefit solutions** – unlike death-in-service schemes, premiums and benefits don't count towards the employee's annual or lifetime pension allowances. Premiums won't generally be taxed as a benefit in kind.
- **Guaranteed insurability options** – if we accept the insured person on standard terms and their salary increases, they can increase their cover (within limits) without having to provide us with evidence of their continued good health, up until age 55.
- **Claim proceeds** – won't be subject to income tax or corporation tax. And, as the policy is held in trust, the claim proceeds shouldn't form part of the employee's inheritance tax estate.
- **Key person replacement service** – providing help and guidance on how to find replacement 'key' personnel – whether temporary or permanent. It also provides advice, guidance and support on all aspects of employment law.
- **Health and wellbeing service** – giving customers, and those closest to them, access to confidential support and guidance on a wide range of issues, including loss of a family member or friend, marital and relationship concerns, consumer rights, legal and debt issues.
- **Second medical opinion service** – giving customers, and their family members, a face-to-face consultation with a UK-based specialist to review a recent medical diagnosis.

Remember, there can be tax benefits for both the employer and employee.

Employer benefits:

- Corporation tax relief (so long as the premiums are wholly and exclusively for the purposes of the business).
- Normally no National Insurance contributions to pay on the premiums paid to fund the relevant life policy.

Employee benefits:

- Normally no National Insurance contributions to pay on the premiums paid to fund the relevant life policy.
- The premiums won't be taxed as a benefit in kind, where they're not paid under a salary sacrifice or flexible benefits arrangement.
- Premiums and benefits don't count towards annual or lifetime pension allowances.

Policy Plus

Your clients get more than just financial support with our protection products. All our Business Protection and Relevant Life customers have access to our Policy Plus services. These services offer your clients support and guidance, at no extra cost, whenever they need it. And, they don't need to make a claim to use theses services – they can access them from the day their policy starts.

Key person replacement service

Identify HR & Resourcing Solutions can provide Business Protection and Relevant Life customers with help and support should they need to replace key people within their business – either temporarily or on a permanent basis. They can also provide advice and guidance on all aspects of employment law. Watch our video to find out more.

Health and wellbeing service

All protection customers have access to our health and wellbeing service, provided by Health Assured. This gives customers, and those closest to them, access to confidential support and guidance on a wide range of issues whenever they need it. They also have access to an online hub where they'll find lots of help and support. Customers can speak to Health Assured's qualified and experienced counsellors over the phone in confidence 24 hours a day, 365 days a year. Watch our video to find out more.

Second medical opinion service

All protection customers have access to our second medical opinion service, provided by RedArc. Our second medical opinion service gives customers confidence in their, or their family member's, diagnosis and treatment options. It allows them to get a confidential face-to-face consultation with a UK-based specialist, who's local to them. Watch our video to find out more.

Funeral payment pledge

The loss of a loved one can leave families facing financial hardship. Even if it's for a short time while waiting for their estate to be distributed, it can be a real burden when you're already dealing with a loss.

Our funeral payment pledge helps bereaved families meet the funeral costs of their loved one.

Claims

We know that before you choose a protection provider, you want to know about its claims payment history. But you also need to know about a provider's claims process and service.

Our philosophy is to provide a professional and fair claims service by paying all valid claims as soon as possible.

When your clients make a claim, we aim to:

- provide a personalised, professional, supportive and sympathetic service, right from the start;
- get the information we need from their medical attendants as quickly as we can, without inconveniencing them;
- make sure all payments are made accurately and on time;
- look for ways to help them get back into work – we'll support them as much as we can, and
- make sure they get the best and most appropriate advice and treatment.

We realise that making a claim can seem a bit complicated. So we've created an Illness and disability claims guide to explain the whole process and hopefully answer any questions you or your clients might have should they need to make a claim.

Awards

Here are just a few of the awards we've won recently. We're delighted with each and every one of them, as they show we're getting things right for the people who matter – our customers.

COVER Excellence Awards 2020
Best Business Protection

British Claims Awards 2020
Insurer of the Year

Investment Life & Pensions Moneyfacts Awards 2017 – 2020
Four times winner – Best Protection Service

Previous awards

British Claims Awards
Underwriter of the Year 2019
Life Insurer of the Year 2018

COVER Customer Care Awards
Best Claims Management/Claims Team 2019
Best Intermediary Support Team 2018

Protection Review Awards
Underwriter of the Year 2017
Life and Health Claims award 2017, 2018

Cover Excellence Awards
Best life insurance provider 2017
Best service provider 2016

More about Aegon UK

Aegon UK is a leading savings, protection and investment service provider in the UK. Our mission is to help people achieve a lifetime of financial security and make financial planning simple, easy and rewarding.

We have a long heritage that we're proud of – helping people take responsibility for their financial futures since 1831 when Scottish Equitable was founded in Edinburgh. We're part of the Aegon Group – an international provider of life insurance, pensions and asset management.

With experience in the wealth planning and group pensions markets, along with in-depth knowledge of protection, we're well-positioned to help you build comprehensive solutions to meet your clients' individual needs.

Contacts

If you have any questions about this guide or our Business Protection solutions, please contact your usual Aegon sales contact. If you're unsure who this is, please email your contact details to **businessprotection@aegon.co.uk**

Pre-submission underwriting helpline

Call 03457 83 54 73 (call charges will vary)
protect_underwriting@aegon-service.co.uk

Large sum assured team

Call 03456 00 14 02 (call charges will vary) or email
LSAunderwriting@aegon-service.co.uk

Ongoing applications

Call 03456 00 14 02 (call charges will vary) or email
protect_support@aegon-service.co.uk

Claims

Call 03456 00 04 93 (call charges will vary) or email
claims@aegon-service.co.uk

Tax and trusts

Email businessprotection@aegon.co.uk

Or you can write to us at:
Aegon, Edinburgh Park, Edinburgh EH12 9SE

If you're contacting us by email please remember not to send any personal, financial or banking information because email is not a secure method of communication.

Other useful contacts

Companies House
companieshouse.gov.uk

Financial Conduct Authority
fca.org.uk

Prudential Regulation Authority
bankofengland.co.uk

LinkedIn
linkedin.com

Federation of Small Businesses
fsb.org.uk

Department for Business, Energy & Industrial Strategy
bis.gov.uk

Bytestart.co.uk, the small business portal
bytestart.co.uk

Aegon – your business protection specialists
and number one choice for
business protection.

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