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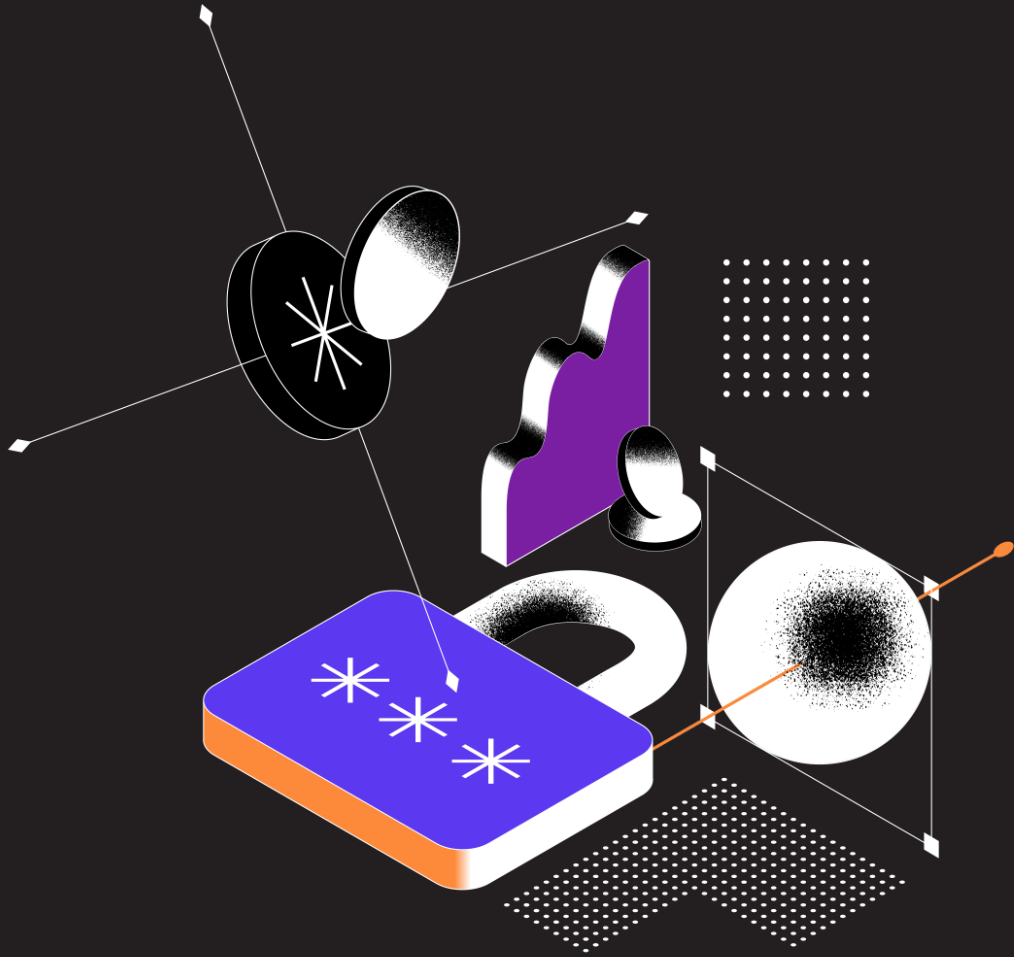
Your Guide To Shareholder Protection

Safeguarding Your Business And The Shareholder's Family



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What is Shareholder Protection?

Protection for your business and for the shareholder's family

Shareholder Protection Insurance protects a business and its shareholders.

It offers cash to buy an absent shareholder's shares should a shareholder die or become too seriously ill to continue working.

This allows the business to continue trading as normal should the worst happen to a shareholder. It also allows the remaining shareholders to keep control of the business.

Meanwhile, Shareholder Protection also allows the absent shareholder or their family to monetise their shares easily. This benefits both the business and the family - the business retains the shares and the family receive the financial support at a difficult time.

Shareholder Protection Isn't Simple - Get Advice

Setting up a Shareholder Protection policy requires carefully-structured advice from a variety of parties to ensure you get it right. You should only take out Shareholder Protection in consultation with an expert adviser and your accountant to ensure you're choosing the best option for your needs.

Your Broadbench financial adviser can help you to set up the correct type of policy and ensure that the valuation of the business is accurate and that all parties fully understand the agreement they are entering into.

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The Benefits

Losing a valuable shareholder, whether through illness or death, can have a destabilising effect on a company. Here are some advantages of taking out Share Protection to safeguard your business.

- **Financial stability** for both the business and the family.
- **Businesses won't need to use capital** or dip into savings to purchase the additional shares.
- **The business owners retain control** of their company.
- It negates the risk that **a stake in your business could be inherited by an unwelcome beneciary,** whose priorities may not align with yours.
- It mitigates the risk of **the business having to be sold.**
- **A seamless process** for shares to change hands that keeps disruption to a minimum at a challenging time.
- When a shareholder passes away, their shares become part of the estate which usually goes to the family. This means the family now owns the shares. With **Shareholder Protection the other shareholders can buy back the shares from the family.**
- **The family/beneficiaries will have a clear understanding** of the amount they will receive when selling the shares back to the remaining shareholders.
- **You have the flexibility** of coming to different agreements on how to manage the shares; for example, owners could buy shares back from a shareholder who's diagnosed with a critical or terminal illness.

Important Considerations

The loss, or incapacity, of a shareholder can disrupt a company but by having shareholder protection in place the interruption to your business will be minimised by enabling:

- **What would happen if Shareholder suffered a critical Illness?**
- **Business Continuity.**
- **Calculating the value of the company.**
- **Use of Trusts.**
- **Funds being made available to the individuals who wish to buy the shares.**
- **An improved tax position on the death of a shareholder.**
- **The deceased's estate to receive funds in a timely manner.**
- **Creation of a 'market' for private company shares.**

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Company Share Purchase

The company takes out a policy on the life of each individual shareholder.

In the event of death or serious illness of a shareholder, the insurer pays the benefit to the business. The company then has the necessary funds to purchase the absent shareholder's shares. The result is that the remaining shareholders will increase their shareholdings.

Who Pays?

The company pays the premiums, owns the policy and is the ultimate beneficiary.

Taxation

HMRC typically treats the payout as free from corporation tax as a capital receipt, but this depends on your accountant, your local inspectorate of taxes and your legal representatives.

Premiums are not generally classed as a deductible expense for corporation tax purposes. There is also typically no need for a trust.

As the company both owns and pays for the policy and is the beneficiary, HMRC does not typically class this method as a benefit in kind for the shareholders.

Cross Option Agreement

The company share purchase route requires the shareholders and the company to enter a cross option agreement. This lays out the terms of the share purchase, such as options to buy and sell the shares and how the shares will be valued.

For tax reasons, at the time you establish the cross option agreement there will be no guarantee that the company will be in a position to purchase the shares.

The agreement is generally drafted to resolve this by allowing the company to purchase the shares from the shareholder (or their estate) or the option to sell the shares. This will generally preserves business property relief for inheritance tax purposes on the shares.

Company Share Purchase

The Pros

- It's less complicated to set up because trusts and equalisation of premiums are not necessary.
- It's not usually a P11D or benefit in kind for the shareholders.
- You can add new shareholders to the arrangement simply by taking out a new plan on them and setting up a new cross option agreement.

The Cons

- It's not necessarily suitable for new companies
- In order to secure favourable capital gains tax treatment on the proceeds from selling the shares, one stipulation is that the seller needs to have held the shares for at least 5 years (or 3 years if the personal representatives administering the estate are selling).
- The company's articles of association must authorise the company to buy its own shares
- Older companies' articles, especially those set up before 1982, may not permit this. The articles would therefore need amending before a share buyback could happen.
- Any changes to the articles as a result of the above may then increase the value of each individual's shareholding, potentially therefore requiring more cover
- There may also be capital gains tax implications
- Should the surviving shareholders eventually dispose of their shareholdings, the value of which has increased thanks to the company share purchase.
- There is less flexibility here where a shareholder leaves.
- Any share buyback scheme may be prevented in the future if the company fails to meet the necessary requirements under the Companies Act 2006 in relation to the buyback.

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Own Life Under Business Trust

Each shareholder takes out an individual insurance policy on their own life. The policy is then written in trust for the benefit of the business.

On the death of a shareholder, the policy pays out into a business-owned trust. The remaining shareholders will then use the funds to buy the deceased or seriously ill shareholder's shares.

Who Pays?

There are two ways to pay for own life under business trust Shareholder Protection: Each shareholder can pay for it personally or the business can pay for it.

Taxation

HMRC taxes Shareholder Insurance differently depending on how you take it out.

For own life under business trust, the most common route is to have the company pay for it. In this instance, the company is typically able to deduct premiums as a business expense against corporation tax. However, the shareholders would generally have to pay tax on the premiums, as these would be a P11D or benefit in kind.

If each shareholder pays individually, which is much less common, then they'll pay the premiums from their post-tax income. This generally means that there aren't any further tax obligations for the individual shareholders.

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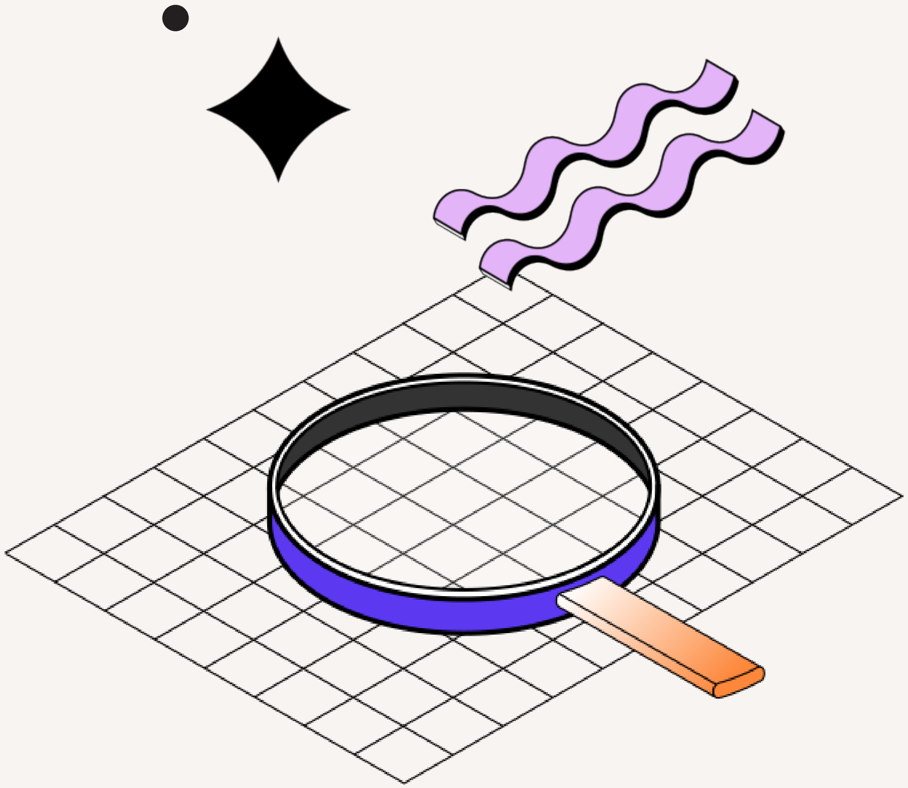
Own Life Under Business Trust



The Pros

- There are unlikely to be complications with regards to company law and the company buying back its own shares because this sees shareholders buying out another shareholder.
- You can add new shareholders and remove old ones relatively easily.

The Cons

- You may need to equalise premiums, which can be a complex calculation. However, premium equalisation ensures the deal remains ‘commercial’. This means you can usually buy and sell the shares free from inheritance tax concerns, so it’s an important step.
- There may be greater tax efficiencies with the company share purchase option.

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Companies Act 2006

You must meet the following criteria to allow a shareholder buyback to continue

- The company's articles of association must permit share buyback or an ordinary resolution requiring more than 50% votes in favour, but excluding the shareholder who is selling the shares. This ordinary resolution must approve the purchase.

- Rather than funding the share purchase from capital, the company must first attempt to use distributable profits instead. Proceeds from Shareholder Protection could be classed in a number of different ways depending on your accountant, legal representatives and financial adviser. For example, tax authorities could potentially class a payout as a receipt in the profit and loss account or perhaps as capital.

- If the company intends to fund the buyback from capital, which may include the payout from Shareholder Protection depending on how HMRC and / or your local inspectorate of taxes classes it, you'll have to meet additional requirements:
  - The directors must make a statement that the purchase will not prejudice creditors. This should be accompanied by an auditor's report, which you'll need to deliver to the Registrar of Companies.
  - You must place notices to creditors in the Gazette and a national newspaper. If the company has substantial debts, creditors may make a court application to prevent the share purchase going ahead.

Shareholder Protection Isn't Simple - Get Advice

Your Broadbench financial adviser can help you to set up the correct type of policy and ensure that the valuation of the business is accurate and that all parties fully understand the agreement they are entering into.

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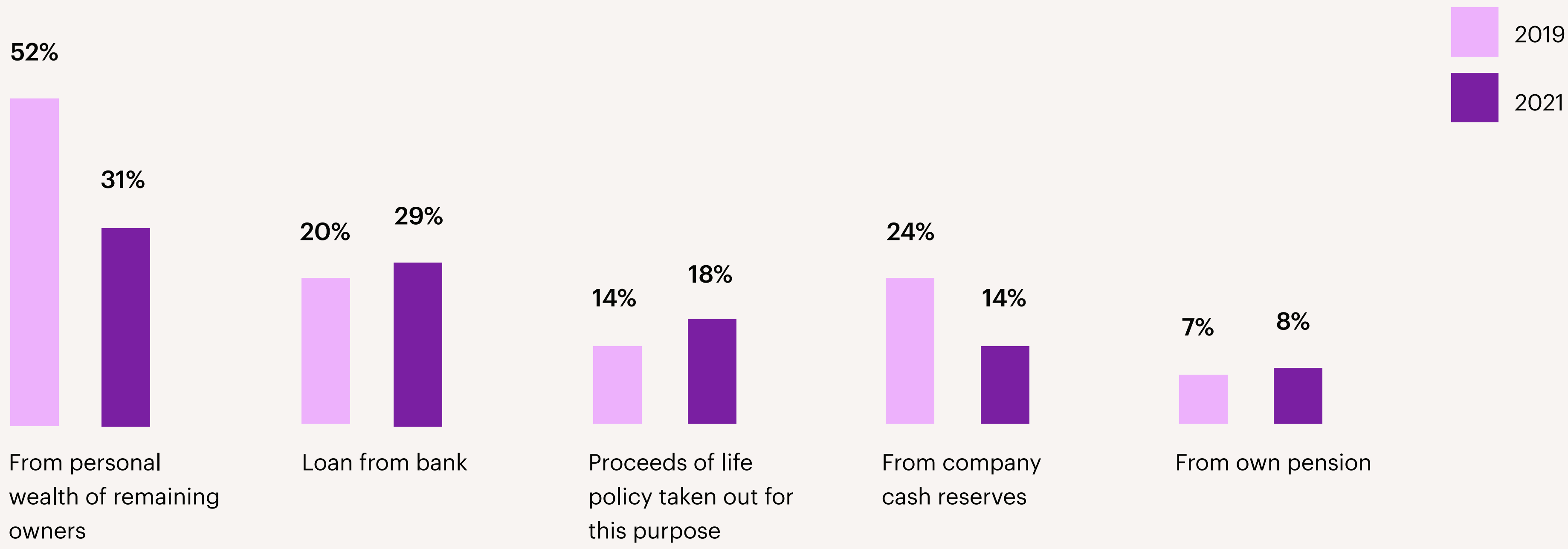
What Would Happen To The Shares?

If A Shareholder Were To Die How Would The Purchase Of The Shares Be Funded?



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FAQ's

How is shareholder protection structured?

There are three main ways to set up shareholder protection:

1. **Own life plans under business trusts** – Each shareholder takes out a policy on their own life, written in trust for the benefit of other shareholders.
2. **Life of another plans** – Each shareholder owns policies on the lives of other shareholders.
3. **Company-owned plans** – The company takes out policies on shareholders to fund the buyback of shares.

Speak to your Broadbench financial adviser to determine the best option for your business.

Does a cross-option agreement affect IHT business property relief?

No. If a shareholder passes away while owning shares in an unquoted trading company, 100% Business Property Relief (BPR) may apply for inheritance tax (IHT) purposes, as long as the shares were held for at least two years.

Even if the estate receives cash for shares under a cross-option agreement, BPR is preserved because:

- The option is only exercisable after death.
- There is no binding contract to sell at the time of death.

What happens if the single option is not exercised?

If a shareholder receives a critical illness payout but chooses not to sell their shares, we recommend keeping the proceeds within the trust until the succession issue is resolved.

Although the funds might be available, they were intended for share buyout purposes. Distributing them to the critically ill shareholder could lead to tax complications.

What is a cross-option agreement?

Also known as a double-option agreement, this gives surviving shareholders the option to buy shares from the deceased shareholder's personal representatives.

- If either party wishes to exercise their option, the other must comply.
- The option can only be exercised after death, within a specific timeframe.

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FAQ's

What happens if shareholders enter into a buy/sell agreement?

A buy/sell agreement would deny Business Property Relief.

Shareholders agree that, upon the death of one, the remaining shareholders must buy their shares, and the estate must sell. Life insurance is taken out to fund the purchase.

Since this creates a binding contract at the time of death, HMRC treats the shares as already converted into cash, making them fully subject to IHT.

How does critical illness affect shareholder protection?

A critically ill shareholder may be unable to contribute to the business and may want to exit. Their co-shareholders will need funds to buy their shares.

- If a business trust is used, a policy with critical illness cover can be written under the trust.
- Instead of a cross-option agreement, a single-option agreement is recommended. This ensures that a critically ill shareholder is not forced to sell against their wishes.

A forced sale could trigger capital gains tax (CGT) and future IHT liabilities, as the shareholder would receive cash instead of retaining shares that may qualify for IHT Business Property Relief.

Are there disadvantages to leaving proceeds in trust?

Yes, there is a potential Pre-Owned Asset Tax (POAT) charge.

POAT is an income tax charge applied when someone benefits from an asset they previously owned. While Business Trusts used for shareholder protection fall under POAT, in most cases, the annual benefit remains below the £5,000 tax-free limit.

- The charge is 2% of the open market value of the life plan (subject to official rate changes).
- While the insured person is healthy, the market value is low, meaning no charge applies.
- If they become critically ill and the funds remain in trust, the value increases, potentially triggering POAT.

To avoid this, the settlor (original policyholder) can be removed as a beneficiary of the trust. However, this may have IHT implications, which should be reviewed with a Broadbench adviser.

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Why Broadbench?

Many of us decide on what insurance to go for (whether it's for your car, your house or your life) that fits the monthly premium we want to pay. Of course, you could go to a price comparison site and very quickly find the cheapest quote on the market, but would it be the best solution for you and your family?

Our advisers have the skills and knowledge to offer you bespoke and impartial advice, taking in a holistic understanding of your circumstances and combining it with a deep knowledge of what different providers offer. Not only that, but they know how to quickly navigate the insurance minefield and set up exactly what you require, taking the hassle out of your hands.

The Benefits Of Using Broadbench:

- Bespoke and impartial advice.
- You deal with a human, not a computer.
- The hassle is taken out of your hands.
- Access to expert market knowledge.

4 Simple Steps

How We Make Your Life More Manageable

1. We Listen To You

Getting to know you, your requirements and how you work enables us to find the perfect products for your needs.

2. We Study The Market

Leveraging our network of lenders and insurers, we scour the intermediary market to find the best options and dig into the detail to make sure they're the right fit for you.

3. We Do The Boring Bits

You just want to sign up with the right provider, not be buried in forms and red tape. That's why we run you through the details and fill out all the paperwork ahead of your final approval.

4. We Stay In Touch

We don't just recommend and walk away. We'll regularly check whether your product is right for your current circumstances and, if not, find a new one that is.

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- Relevant Life Insurance
- Key Person Iinsurance
- Executive Income Protection
- Business Healthcare
- Shareholder Protection
- Business Loan Protection
- Professional Indemnity

Personal Protection

- Life Insurance
- Whole Of Life
- Critical Illness Insurance
- Private Healthcare
- Personal Income Protection
- Buildings & Contents

Mortgages

- First Time Buyer
- Home Mover
- Remortgages
- Buy to Let

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What Our Customers Say

We are passionate about our customers and providing the very best service. Take a look at our latest reviews on Trustpilot.

"Great service! – I've been using these guys for years for my mortgage options as a contractor. Great service and knoledge. I've also got a few other products with them. Looking forward to many more years of great service. "

by Alexander Delaney

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"Brilliant, as always – I'm a returning client of Broadbench, and I'm always impressed by their professionalism. Mike was incredibly helpful, and knowledgeable, and made the entire process smooth and stress-free. He took the time to …

by Ali

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"Highly reccommend! Extremely helpful and took the time to explain and give all options for life insurance and income protection. Made the whole process very quick and smooth."

by George Gordon

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"Extremely helpful organised and knowledgeable. All the information required was conveyed concisely in a personable manner. "

by Liam

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by MJ

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"Exceptional service and advice from Broadbench. I really appreciate the fantastic independent advise given and effort to get the positive outcomes in setting up the right Insurance policies for me and my business. Would recommend Broadbench …

by Steve

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