

What you need to know about...

SHAREHOLDER PROTECTION

A key risk to almost every business is the loss of partners or director/shareholders. Each of these people is a key stakeholder in the business, and it important to consider the future continuity of the business, should one of the shareholders or partners dies, or is unable to continue in the business. The purpose of this type of protection is to ensure that the business can continue, while providing for the families.

Why should you consider shareholder protection?

The main problem arises when a partner or shareholder in a business dies. His shares will pass into his estate, usually to his spouse.

Often this spouse will have played little or no technical role in the business, and will have no desire to continue working in the business. As such, the spouse will probably prefer to have a cash sum, representing the value of the shares.

By the same token, the remaining partners or shareholders will probably want to run the business without interference from 'the outside', but may not be in a position to buy out the share of the deceased owner.

Shareholder protection seeks to provide a lump sum to allow the remaining partners or directors to buy out the deceased or incapacitated owner's shares.

How does this work in practice?

The business owners will first attempt to place an equitable value on the business, and then take out insurance policies to provide a lump sum in the event of death or disability.

This money can then be used if one of the owners becomes too sick to continue in the business, or dies. The business can then decide to use the proceeds of the policy to buy out the family of the person affected.

What are the advantages of this approach?

This allows maximum flexibility. The affected family can have a lump sum, which represents their share of the business, while the business can have continuity without undue financial stress.

Factors to consider

The business will probably have a partnership agreement, or articles of association, and these should be referred to in advance of any planning, as they may make provision for these circumstances. In many cases legal advice should be taken in this area.

Also, reviews of the cover should be regularly undertaken as the value of the business will change over time.

Continued overleaf...

Call today for independent financial advice on this, or any other issue on

01206 266882 or email advice@woodruff-fp.co.uk

Agreements to buy/sell

- **Cross option agreements**
A separate agreement can be set up alongside the insurance, to give the business and the family both the option to buy/sell the shares. Therefore, if either side opts to enforce the agreement, the other must sell, or buy the shares, using the proceeds of the policy. This approach allows maximum flexibility.
- **Single option agreements**
This allows one side, the person unable to continue in the business can force the business to buy the shares, using the policy.
- **Buy and sell agreements**
This agreement forces the sale on both sides, without any option. This is not effective for inheritance tax purposes.
- **Automatic accrual**
Under this method, the deceased's share automatically passes to the surviving business owners, but they take out a separate policy, written in trust for the deceased's family.

Taxation

Each method has its own inheritance tax consequences and advice should be taken on this area (this area is beyond the scope of this factsheet). We can help if you have queries in this area.

Company payment of premiums

If a company pays the premiums of a policy on behalf of a director, this will attract corporation tax relief as a qualifying business expense.

However, for the individual, this will be treated as extra remuneration, and attract income tax and national insurance contributions.

For partnerships, the premiums are not deductible when calculating income tax.

Conclusion

Shareholder or partnership protection has obvious benefits to many small and medium-sized businesses. Proper consideration of these issues can help to resolve any possible hardship or conflict that succession can bring to a business or family.

Why use us?

1. **Free** initial consultation
2. **Guaranteed** satisfaction with our advice
3. **Fee based** - no commission hungry salesmen
4. **Fully independent** from insurance companies
5. State of the art **research tools**
6. Regular contact and **services to suit you**

Call today for independent financial advice on this, or any other issue on
01206 266882 or email **advice@woodruff-fp.co.uk**



© Woodruff Financial Planning July 2007.

This leaflet is for general information purposes and should not be relied upon as financial advice. Legislation is subject to change at any time.

The Colchester Centre
Hawkins Road
Colchester
CO2 8JX

www.woodruff-fp.co.uk

Woodruff Financial Planning is regulated through Julian Harris Financial Consultants who are independent financial advisers regulated and authorised by the Financial Services Authority - 153566.