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The business case for business protection

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This is intended as a guide only. You should ensure that your clients seek appropriate legal, tax and financial advice to fully assess their individual circumstances.

Introduction

Ask most people who run a business and they'll tell you that insurance is one of their basic running costs.

They have insurance for buildings and contents, public liability, key equipment, stock and vehicles to name but a handful of examples.

Yet despite putting insurance and contingency plans in place for all of their physical business assets, many companies often haven't even considered protecting their real key asset:

People

People are at the heart of any business, and are responsible for its success.

Without business protection, the death or serious illness of a key member of staff could have a significant impact.

In some cases, it could mean the business has to stop trading, affecting people's livelihoods.

And in the case of shareholder/partnership protection, it could mean a shareholder's family is forced to take control of a business they don't know anything about.



What is Business Life Insurance Options?

Our Business Life Insurance Options policy can help to financially protect your client's business. It lets them choose life cover or life and critical illness cover:

- Life cover pays out if the life covered dies during the policy term.
- Life and critical illness cover pays out if, during the policy term, the life covered dies or is diagnosed with, or undergoes surgery for, a critical illness that meets our policy definition and then survives for at least 10 days. We only cover the critical illnesses we define in our policy and no others.

Both types of cover include terminal illness cover. This pays out if, during the policy term, the life covered is diagnosed with a terminal illness that meets our policy definition.

We only pay the cover amount once, so when we've accepted a claim for the death benefit, terminal illness benefit or full critical illness cover the plan will end. The policy has no cash in value at any time.

You can use Business Life Insurance Options to cover one person (single policy) or two people (joint policy). For joint policies, you can choose a combination of life cover and/or life and critical illness cover. We'll only pay out once. So when we've accepted a claim for one life covered, the policy will end.

Business Life Insurance Options could help make sure that a company can:

- pay its debts
- replace key employees
- protect its profits
- let partners/shareholders keep control of the business
- provide support to a partner's/shareholder's family.

It can be used for:

Key person protection

Shareholder/partnership protection

Business loan protection

The policyholder can choose to have the cover amount paid as a lump sum or, where level cover is selected, as annual payments.

Business Life Insurance Options is designed to be flexible so it can meet the changing needs of a business.

Available as life of another

Cover amount available in annual instalments when level cover is selected

Types of business protection

Key person protection

Helps a business keep trading.

Losing a key person – through death or serious illness – could have a damaging effect on your client's business.

If the key person died, the business might:

- have to continue without a key person whose reputation, personality or vision is critical to its success
- lose existing contracts, goodwill or contacts
- become vulnerable to competitors
- run into problems raising money for new ventures or expansion
- have difficulty meeting loan repayments.

If the key person became critically ill, the business may have to:

- provide an income to the key person, even though they aren't contributing to the profits
- pay two salaries for the same role as it recruits and trains an interim replacement for the key person.

In the blink of an eye, a business could lose key skills, experience and contacts if a key person dies or becomes seriously ill. And trying to find a suitable replacement can be expensive and time-consuming.

A key person could be:

- the business founder
- a senior manager
- the top sales person
- a technical specialist.

Examples of how business protection might work

The following examples aren't real, but they show how business protection can work. In practice, this will depend on the particular circumstances of the business – for example; a trust might not be suitable in all instances. Clients should seek their own advice in this regard.

For partnerships:

If the key person is a partner,

they take out a policy on their own life.
The policy can be written under a trust for the benefit of the other partners

▼
The key person dies or becomes seriously ill

▼
A claim is made

▼
Where the policy is written under trust, we pay the cover amount to the trustees for the benefit of the other partners

▼
The other partners could use the money to help cover, for example, loss of profits and recruitment costs

If the key person is an employee,

the partners take out a policy on the key person's life.

▼
The key person dies or becomes seriously ill

▼
The partners make a claim

▼
We pay the cover amount to the partners

▼
The partners could use the money to help cover, for example, loss of profits and recruitment costs

For companies and Limited Liability Partnerships (LLPs)

The business takes out the policy on the life of the key person

▼
The key person dies or becomes seriously ill

▼
The business makes a claim

▼
We pay the cover amount to the business

▼
The business could use the money to help cover, for example, loss of profits and recruitment costs

For sole traders:

The sole trader takes out a policy on their own life.

▼
The policy can be written under trust for the benefit of their family or dependants (or themselves if they suffer a critical illness)

▼
The sole trader dies or becomes seriously ill

▼
A claim is made

▼
Where the policy is written under trust, we pay the cover amount to the trustees who then pass the money to the beneficiaries

▼
The beneficiaries could use the money, for example, to try and keep the business going or to help cover their loss of income

Shareholder/partnership protection

Helps stakeholders look after each other and their families.

Losing a stakeholder (a partner or shareholder) – through death or serious illness – could have a serious impact on your client’s business and their family as they face the question of what happens to the business:

- The stakeholder’s family may want a quick sale; if the remaining stakeholders can’t raise the funds, the share of the business may be sold to an unsuitable buyer.
- The stakeholder’s family members could become involved in running the business, even if they don’t have the relevant expertise.
- Banks and creditors may want to renegotiate terms or call in debts if the ownership changes.

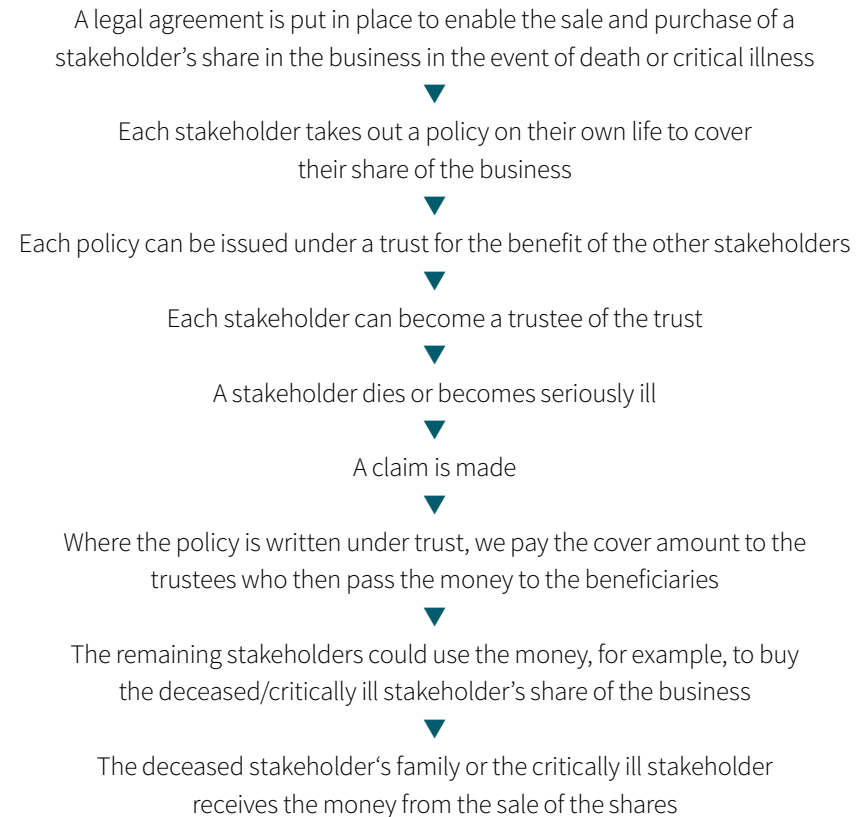
You can use Business Life Insurance Options to avoid these kinds of problems, giving the remaining stakeholders the funds to buy back the share of the company or the partnership.

What’s more, it could also provide extra money to help cover any loss of profits which results from the death or illness of a stakeholder.

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Example of how business protection might work

For companies, partnerships and LLPs:



Why a legal agreement?

To make sure any sale/purchase of the shares can go ahead as planned

Why a policy each?

To provide the money to buy the shares

Why a trust?

To make sure the money goes to the right people

Setting up shareholder/partnership protection

A partnership will automatically dissolve if any of the business partners die unless an agreement exists to the contrary. Your client can set up a legal agreement to protect all stakeholders. There are various different ways to do this, which could include buy and sell agreements, option/cross option agreements - or automatic accrual. Your clients should seek their own advice around which particular type of agreement would be most suitable for them.

By way of illustration – and using just one example from those detailed above – your client could choose to set up a cross-option agreement. These give the surviving stakeholders the option to buy the interest in the business for a set period of time. You can use our Business Protection Specimen Option Agreement with your clients. This can be tailored to meet their needs, but they should obtain their own advice.

The type of arrangement that suits a company's needs will be based on individual circumstances.

For sole traders

As sole traders are the business owners, there are no other shareholders or partners. So this kind of business protection isn't necessary. However, if the sole trader dies or becomes seriously ill, it leaves a family without a breadwinner. So you could talk about other ways to put financial protection in place to cover any loss of income.



Business loan protection

This could be used to help a business clear its debts.

If your client has a business loan, overdraft, commercial mortgage or director loan account, being able to make the repayments is crucial to their continued success – and survival.

Business Life Insurance Options could provide a lump sum which could help to pay off the loan. Without it, the remaining partners or directors – or even your client's family – could be held responsible for any outstanding financial commitments. In some instances the insurance could be a condition of the loan and the bank may also require any life insurance proceeds to be paid directly to it, rather than the business.

The following examples are fictitious, but they show how business protection can work. In practice, this will be dependent on the particular circumstances of the business - for example; a trust might not be suitable in all instances. Clients should seek their own advice in this regard.

For companies and LLPs:

The business takes out the policy on the life of the person who is significantly linked to the loan



The person covered dies or becomes seriously ill



A claim is made



We pay the cover amount to the business



The business could use the money, for example, to help clear outstanding debts

For sole traders:

The sole trader takes out the policy on their own life



The policy can be issued under trust for the benefit of their family/dependants (or themselves if they suffer a critical illness)



The sole trader dies or becomes seriously ill



A claim is made



Where the policy is written under trust, we pay the cover amount to the trustees



The trustees use the money, to pay the beneficiaries who could use it, for example, towards clearing outstanding debts

For partnerships:

The partners take out a policy on their own life



The policy can be written under a trust for the benefit of the other partners



A claim is made



Where the policy is written under trust, we pay the cover amount to the trustees



The trustees use the money, to pay the other partners, who could use it, for example, to help clear outstanding debts

Tax advantages of Business Life Insurance Options

Using Business Life Insurance Options for key person protection

Tax relief on premiums

Premiums on life policies taken out by employers for key person protection will be allowable deductions and get tax relief if:

- the sole purpose of taking out the policy is to cover any potential loss of trading income (not capital loss or as security for a loan) from the loss of the key employee
- the term of the policy does not go beyond the period of the employee's usefulness to the company
- there's an employee/employer sole relationship between the person covered and the company that will benefit from the policy
- It's a term/pure protection policy i.e. there is no investment element.

With an own life policy, a sole trader may not qualify for tax relief on the premiums as HMRC may see it as a personal benefit for them and their family.

Tax on claim proceeds

If HMRC **gives** tax relief on the premiums, it will normally tax any money from the policy as a trading receipt.

If HMRC **doesn't give** tax relief, it will decide how to tax any money from the policy, but won't generally tax it as a trading receipt.

If premiums are tax deductible and your client decides not to claim, the policy benefits would still be taxable as a trading receipt.

If you're using Business Life Insurance Options to set up key person protection for your client, we recommend they obtain tax advice to identify the appropriate tax treatment.

Inheritance tax

Getting a sum of money from a key person protection policy can increase the value of a business and consequently the value of shares held by an individual. This may increase both the value of the estate and the inheritance tax liability of a shareholder or person owning the business.

Your client may be able to use business property relief to help reduce any inheritance tax that may be due. You can find out more about this on the HMRC website.

Using Business Life Insurance Options for shareholder/partnership protection

Tax on premiums

Each partner/shareholder usually pays the premiums for policies they take out for shareholder/partnership protection on their own life. This means they don't benefit from tax relief.

If the premiums are paid by the business on behalf of a partner/shareholder, they will be classed as a deductible expense for the business.

A company will also be liable to pay National Insurance on behalf of the director.

The partner/shareholder will be liable for income tax and National Insurance on the value of the premiums.

Tax on claim proceeds

There is no income tax liability on the policy proceeds in the event of a life and/or critical illness claim.

Life policies are usually exempt from capital gains tax in the hands of the original owner.

Inheritance tax

The money from a claim won't be part of the policyholder's estate if it's placed in an appropriate trust.

Relevant property inheritance tax rules will apply if you use a flexible Partner's or Director's Trust. The gift of a policy into our Partner or Director Trust is a chargeable lifetime transfer. However, you'll create the trust at the start of the policy, so the policy will have no initial value. This means there won't be an inheritance tax charge at that time.

There may be an inheritance tax charge if the value of the trust property is greater than the available nil rate band on any 10 year anniversary of the creation of the trust. However, the policy will have little or no value if the key person covered is in good health and likely to survive the policy term.

Premiums paid for a policy in trust would normally count as gifts for inheritance tax purposes. However, HMRC may accept there is no gifting where there is a reciprocal commercial arrangement requiring all partners/shareholders to enter into a share protection agreement.

If your client has any doubt over tax, they should obtain tax advice before setting up a business protection policy.

Using Business Life Insurance Options for business loan protection

Tax on premiums

The premiums are not deductible as a business expense because the policy is set up for a capital purpose (i.e. to repay a loan).

Tax on claim proceeds

The policy proceeds are not taxable as they are treated as a capital receipt.

Any references to tax treatment are based on Aviva's understanding of legislation and HM Revenue & Customs practice at the time of publication. Both of these are likely to change in the future, and a liability to tax may arise under an existing arrangement. Every care has been taken as to accuracy, but it must be appreciated that neither Aviva nor its representatives can accept responsibility for loss, however caused, suffered by any person who has acted or refrained from acting as a result of material published.

Find out more

For more information, please read our guides:

- Business Life Insurance Options In focus AL15008
- Why choose us for your business protection clients AL98015

Or you can speak to your account manager for more information.

Need this in a different format?

Please get in touch with your usual Aviva contact if you would prefer this brochure (**AL15009**) in large font, braille, or as audio.



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