Integrity 365

BUSINESS PROTECTION GUIDE

Protecting your business and the people who keep it running smoothly and efficiently.

BUSINESS PROTECTION: WHAT IS IT & HOW DOES IT WORK?

Much like individual protection policies, Business Protection is there should the worst case scenario occur, so it is important that you have the right type and amount of cover for your individual needs.

Small businesses form the backbone of the UK economy, with small and medium-sized enterprises (SMEs) accounting for 50% of the total revenues generated by UK businesses, and 44% of the country's labour force[1].

More than half of all small businesses in the UK do not have any type of business protection insurance in place. Some may have already looked at the risks they face, priced insurance products available and decided that, for some reason, this is not for them.

However, most small business owners either have not considered the potential risks of an owner or partner falling critically ill or dying, or have assumed there is little that they can do about it, and this could be a major oversight.

For most business owners, business protection should be a key consideration, shown through the unprecedented times we have witnessed in recent years. Planning is the key to success and sustainability.

How Business Protection Works

The majority of protection policies are based on:

- The length of time you need the insurance for
- Your age
- Your health
- The amount of cover
- The type of cover

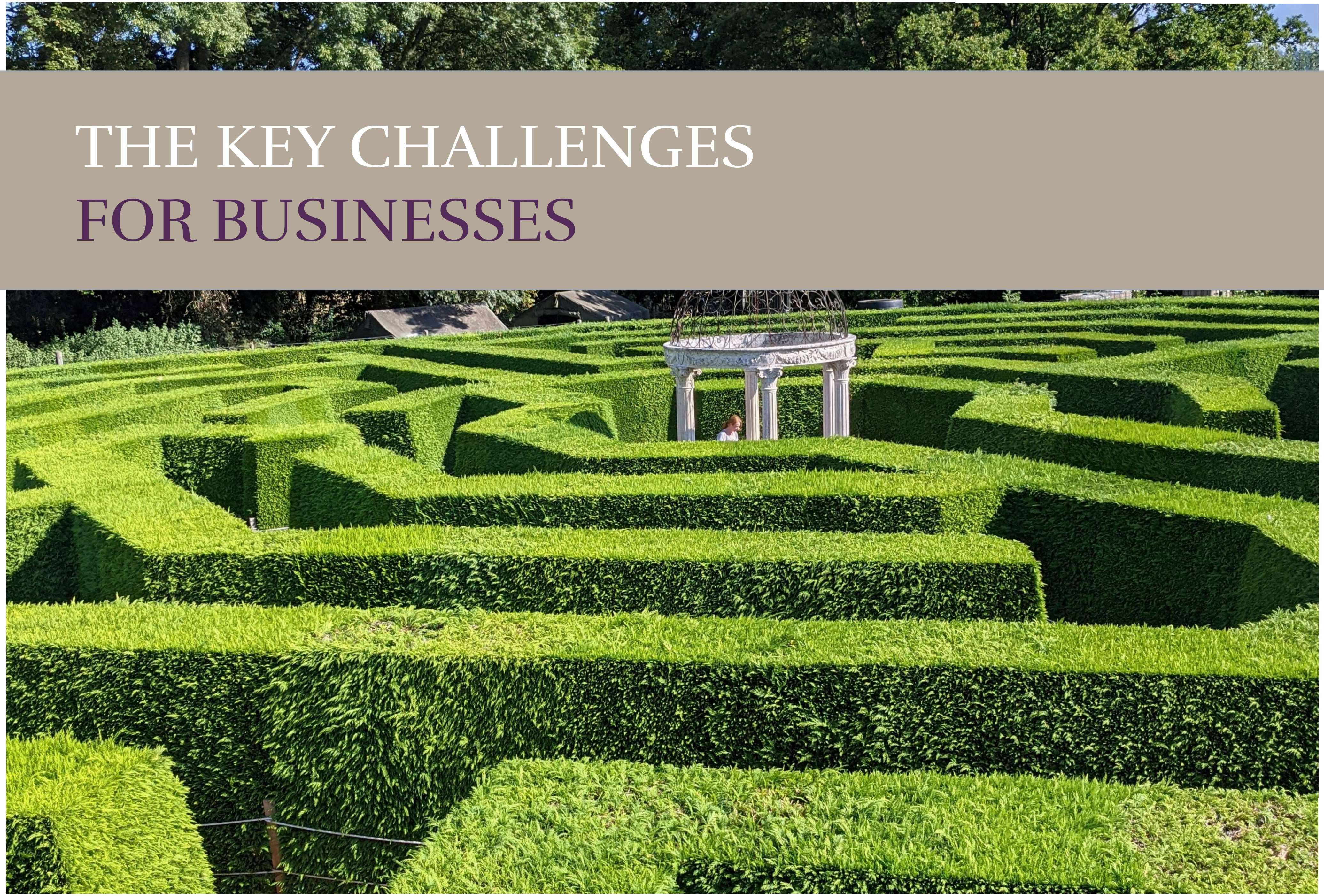
You can have life cover, critical illness cover or income protection, and these can be set up for a number of reasons, which is explored in more detail throughout this guide.

Business protection is a complex area often involving trust and taxation issues, so it is important to get impartial independent advice to receive the right cover for you and your business.

The cost of protection rises as the chances of dying or getting seriously ill increases (for example, if you are over a certain age, a smoker or have pre-existing health conditions), so it is wise to consider protection as early as possible in order to get the best solution and deal for you.

Sources:

1. UK Department for Business, Energy & Industrial Strategy, gov.uk, 2020



THE KEY CHALLENGES FOR BUSINESSES

Even if you have run a business for a number of years, you should still consider any potential hurdles you may face and create contingency plans if appropriate.

Loss of Key Individuals

Most businesses insure their premises and equipment, but all too often do not insure their people. It is important to think about how the business would cope in the event of losing a key employee due to death or serious illness.

For example, if your business partner suddenly died, would the business have to find the money to pay back loans? Unfortunately, these situations can be catastrophic for the business, but insurance can help lessen the financial impact of such events.

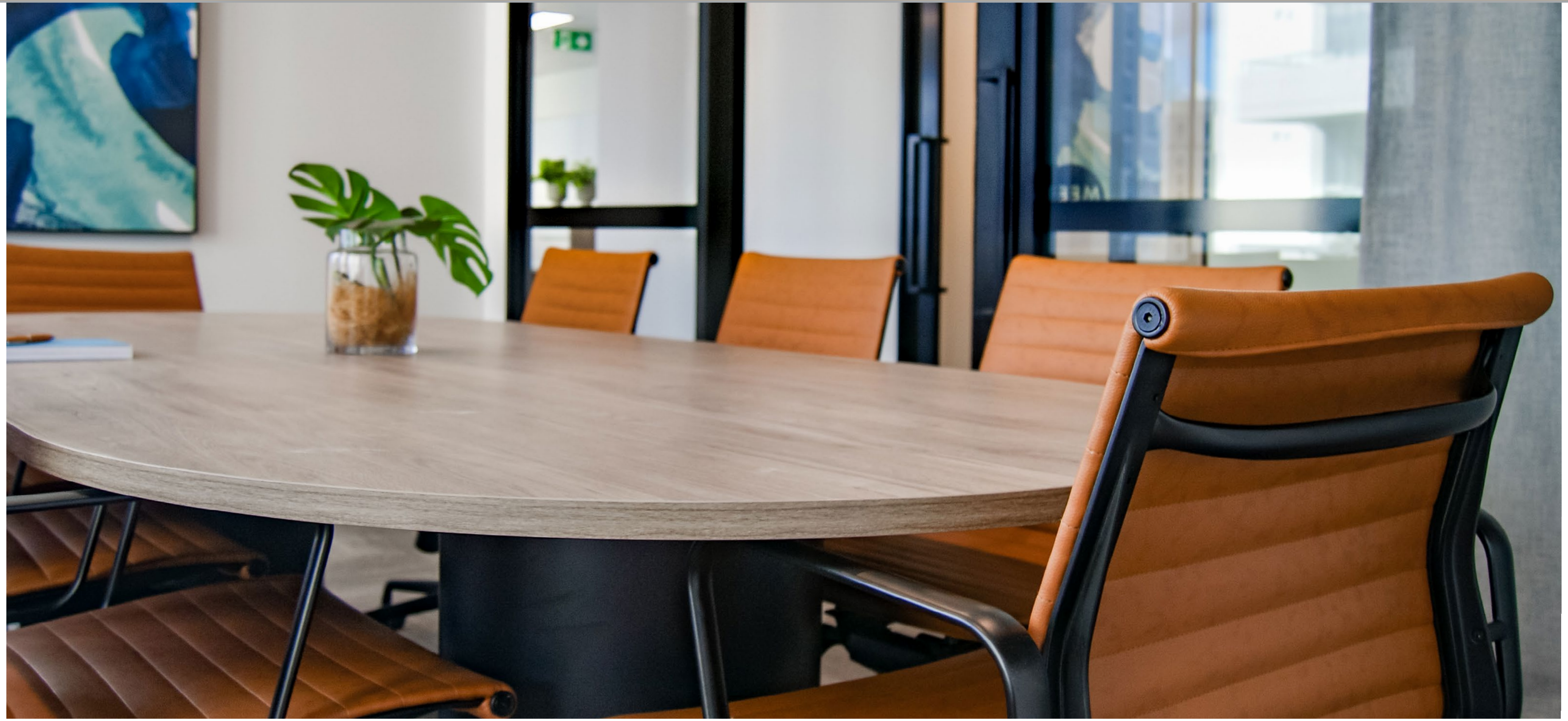
Business Disruption

Even robust plans can be undermined by events beyond your control. As well as having adequate business insurance, a business interruption plan should be drawn up, setting out how the business would continue to trade in difficult circumstances.

Did you know...

59% of businesses would cease trading in under a year if a key person died or became critically ill.

(Legal and General, 2022)



PROTECTING THE BUSINESS: KEY PERSON COVER

The loss of a key individual that has a direct impact on the success of the business can cause a variety of difficulties. Key Person Cover is there to help ease the process and keep the business on track.

Many business owners do not insure key individuals who are crucial to the future success and profitability of the business. This could leave them vulnerable should vital employees become critically ill or die.

Negative effects can include:

- Loss of profits or sales
- The cost of finding and training a replacement
- Potential loss of customers/suppliers

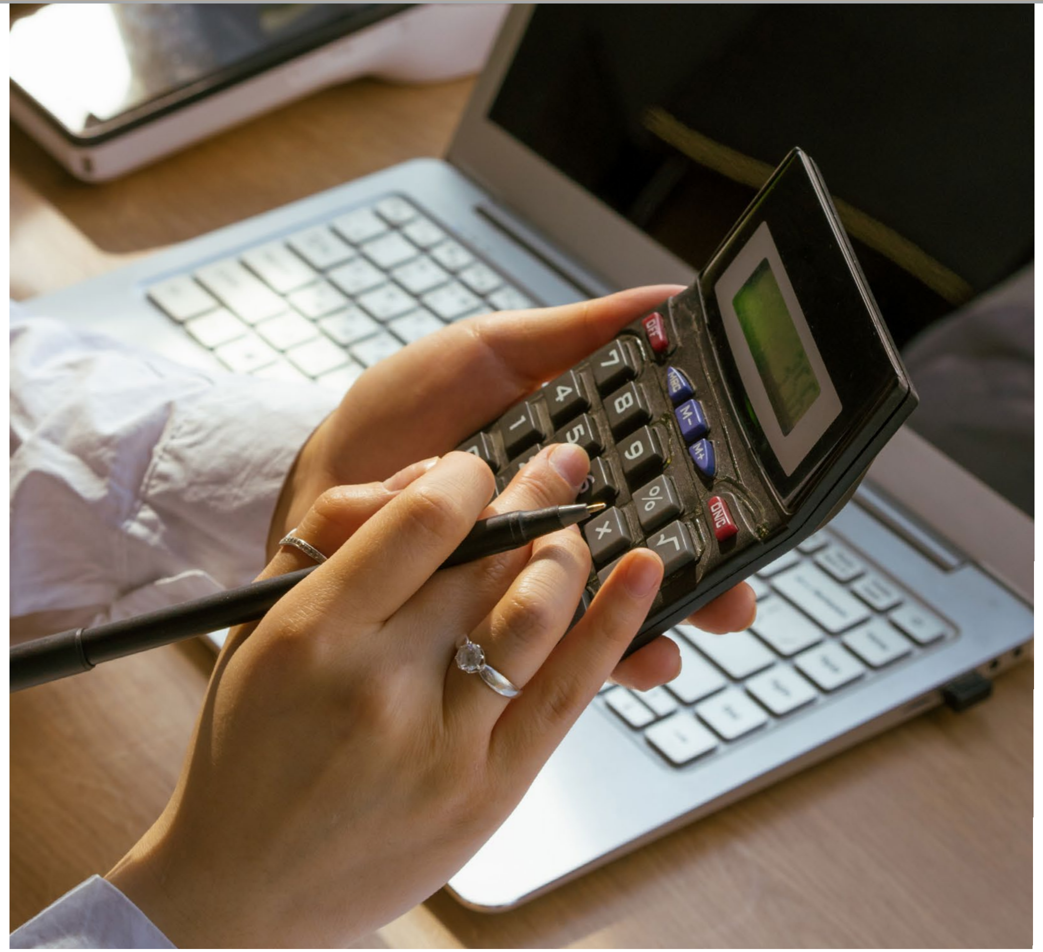
Key person protection is a life cover policy (with a critical illness option if chosen) or an income protection policy which the business takes out, where the employee is the life assured.

The business pays the premiums, and if the insured person dies or becomes seriously ill during the policy term, the policy will pay the agreed lump sum or income to the business, helping them to protect their profits or to continue trading as normally as possible.

A key person is anyone within the business who has a direct impact on the Company's profits, such as the business owner, director, salesperson or any employee with specialist skills, knowledge or expertise. Their absence for any significant period of time would have a serious impact on the business.

PROTECTING THE BUSINESS: KEY PERSON COVER CONT...

It is important to not only consider the type of protection that is best suited to your needs, but also the level of cover you may require should the worst case scenario occur.



Calculating Cover

Business owners should consider how long it might take to replace an individual, any potential loss to the business and any costs associated with finding/training a suitable replacement. The most common methods of calculating cover are:

1. Based on earnings: Typically a multiple of annual earnings plus any additional costs of training and recruitment costs, if appropriate.

2. Replacing profits: This method looks at an individual's contribution to business profits. Typically, firms may choose to insure twice the gross annual profit they generate or five times the net profit directly attributable to that person. It may help to look at an average profit over a number of years.

Tax Considerations

It may be possible to offset the cost of key person protection against your Corporation Tax bill, as it can be treated as an allowable business expense if certain criteria conditions are met:

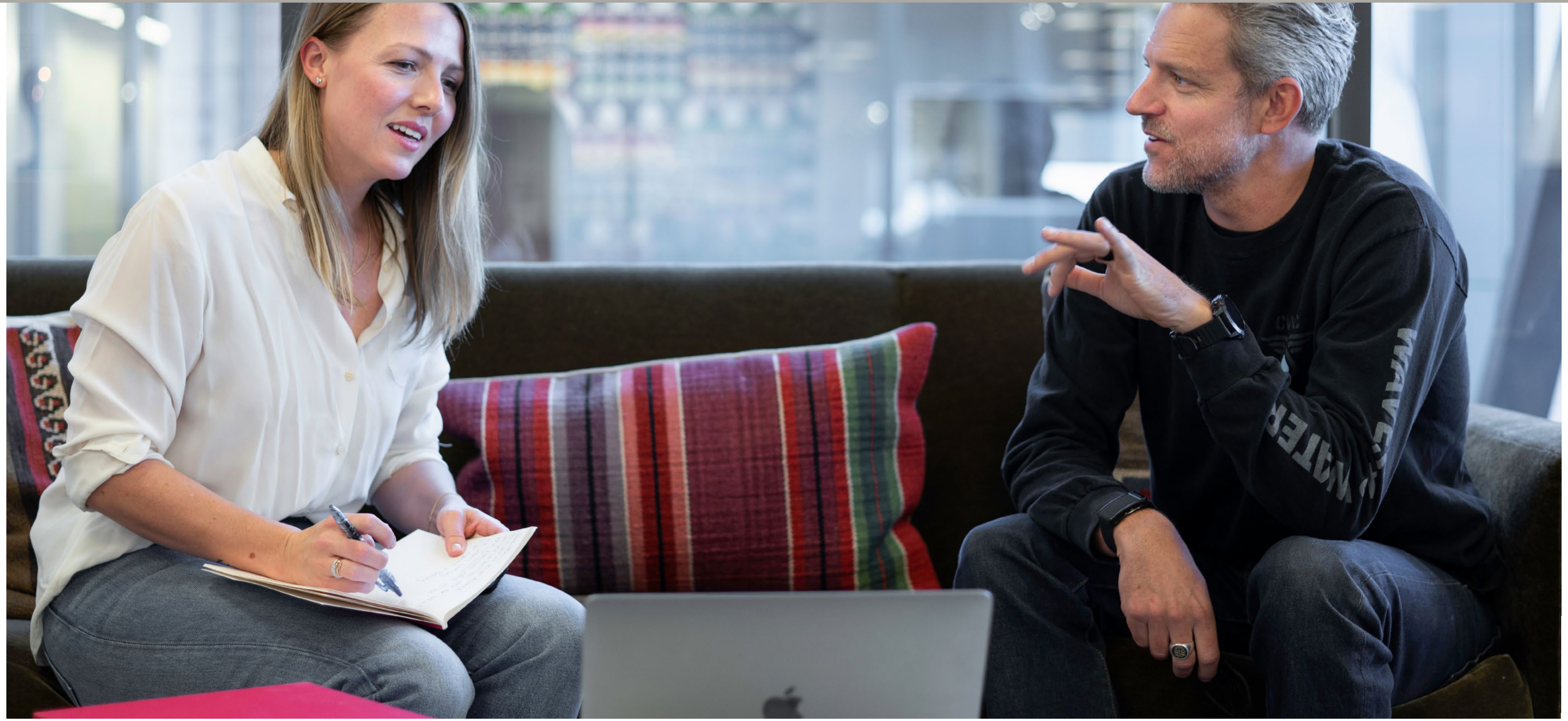
1. The policy must be short-term - although, there is no clear definition of short term, generally five years would be acceptable (although it is possible to add a renewal option to extend).

2. The policy must cover an expected loss of profits.

3. The policy must be for an employee (with a shareholding of less than 5% if a shareholder).

However, if Corporation Tax relief has been applied on the premiums, any pay-out after your claim is likely to be treated as a trading receipt and potentially subject to Corporation Tax.

PROTECTING THE BUSINESS: KEY PERSON CASE STUDY



Some of your employees may have more of an integral role to the day to day running of your business than others. How would your business be affected if they were suddenly no longer there?

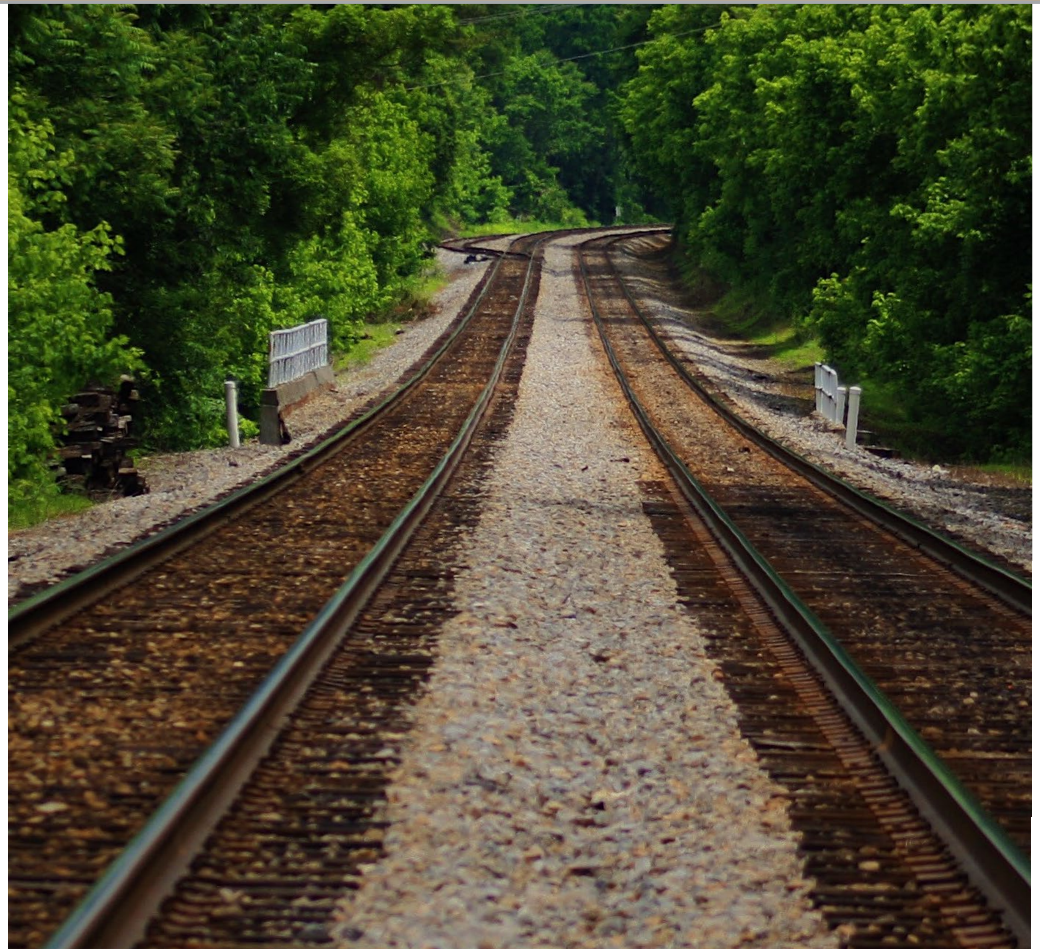
Karen is the sole owner of a profitable sales business where her long-term employee, Pete, makes substantial contributions towards the company's success. Pete has worked at the company for 16 years and so knows the business very well. He generates over £1.5 million for the business each year on average, and plays a vital role in leading and training others.

Karen was concerned that if Pete were unable to work due to accident, ill health or even death, it would not only be a massive shock to his colleagues, friends and family, but could also have a significant negative impact on the company's future prosperity. Pete, age 50, currently earns an annual salary of £70,000 plus bonuses based on the company's performance. Karen and her adviser determined that the loss of earnings and the additional cost of hiring a qualified replacement for Pete would amount to £500,000, which is likely to remain the case for 10 years, until Pete intends to retire.

Therefore, it was appropriate to put in place key person cover for a 10 year term to compensate the business in the event of Pete suffering a critical illness or a meeting an untimely death.

The company owns and pays the premiums on the policy and is named as the beneficiary. If a successful claim is made, a lump sum is paid to the business, that can be used towards replacing lost profits; protecting their credit position; providing a financial cushion; recruiting a qualified replacement; and offset lost business value.

PROTECTING THE BUSINESS:
BUSINESS LOAN PROTECTION



Having the right protection in plans can ensure the business keeps moving forward and stays on track, even when tragedy strikes and key employees are absent.

Directors' Loans

Due to the fact that some small businesses struggle to secure finance, many people end up investing their own money into the company, often by taking out a mortgage on their own home. Individual directors can safeguard their own investments by setting up a director's loan account.

This is a loan to the business that has to be declared via the company's accounts. Almost one in three business owners are unaware that these loans have to be repaid in the event of the directors death. This could leave companies with severe financial difficulties at an already difficult time.

Business Loan Protection

As well as director's loans, most small businesses have some sort of debt, be it overdrafts, loans, or commercial mortgages.

A significant proportion of small businesses do not have any form of insurance backing this debt. Therefore, if an owner died, or was diagnosed with a critical illness, these liabilities could become a serious issue.

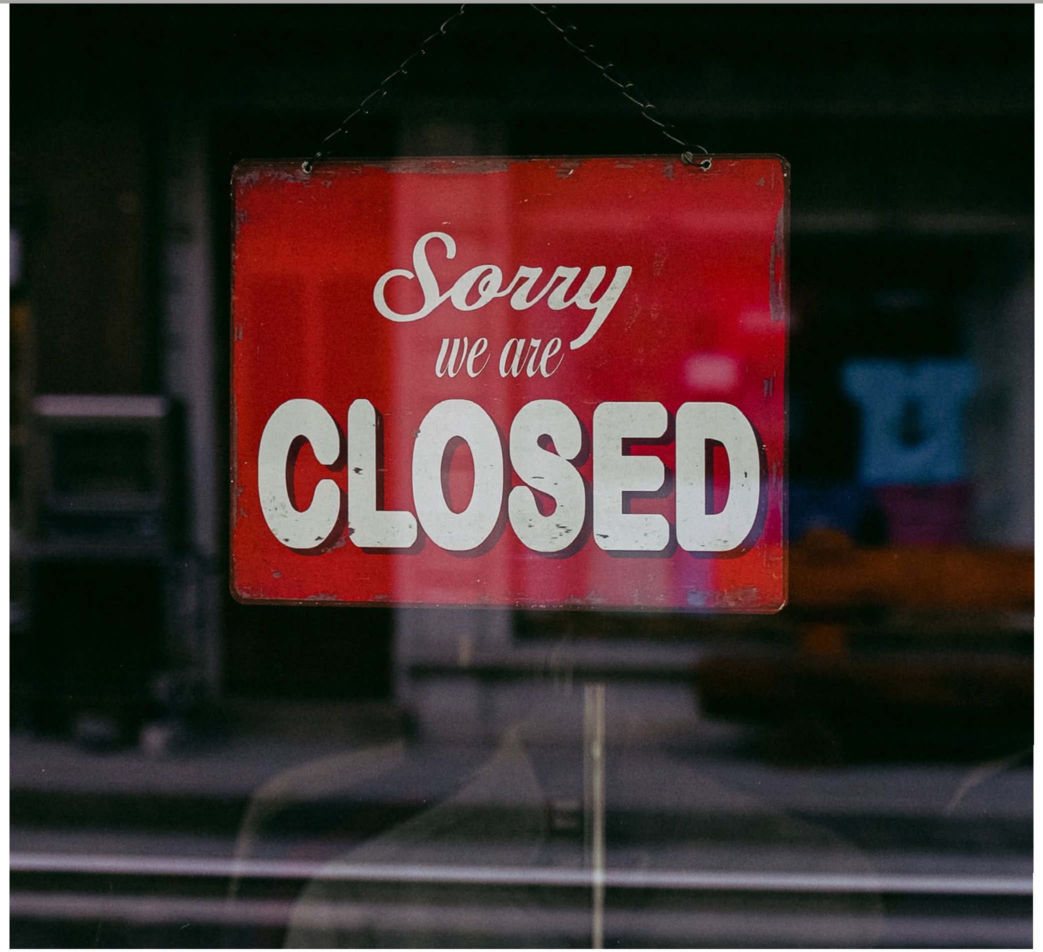
Business loan protection policies can be set up to ensure the debt is paid off in these scenarios, taking some of the pressure off the business financially.

Also, where a business has acquired debt, it is likely that the ability to service this debt is reliant on certain people within the business to ensure it is profitable and well run. Personal guarantees are often provided too.

Either a Life Assurance Policy or Life Insurance Policy with Critical Illness Cover included can be used to protect the value of the debt. A policy is taken out on the life of the key individual or individuals, so that any money due from a claim can be used to help towards paying any outstanding debt or loan.

PROTECTING YOUR PEOPLE: BUSINESS LOAN CASE STUDY

Your immediate needs may draw your focus in the moment, but planning for the future, including unexpected life events, is key to protect those you leave behind - both within the business and in your personal life.



Brian was made redundant from his long-term job as an electrician in 2008. He decided to use some of his redundancy funds to start his own business, and invested £150,000 as a director's loan to buy a vehicle and the necessary equipment. As the business grew, he took on an apprentice, Josh, who eventually took on more responsibility over time, even though it was still Brian's business.

Sadly and suddenly, Brian died of a heart attack at 62 years old, leaving behind not only a devastated family, but also his employee, Josh, to run the business on his own. Josh was more than capable of running the business, however, he was unaware of the initial £150,000 director's loan that Brian invested into the business. The news was shared via Brian's solicitor, stating that £150,000 must be returned to Brian's estate, as it is repayable on death.

The business account held approximately £62,000 in cash reserves, however, Josh had no way of funding the rest. The bank would not lend the funds to Josh as they were not convinced he could run the business without Brian. This then led to Josh having to close down the business and sell the assets to pay back the remaining loan.

In this scenario, if Brian had a business loan protection policy in place, it would have paid a lump sum to the business which could then be used to repay the debt upon death. This would have not only saved Josh a lot of hardship and allowed him to continue working in the business, but his family would have had the money that was rightfully Brian's right away rather than dealing with a long, drawn out process.

Clearly, this type of protection not only protects your funds and your family, but can also make things easier on the people within the business that you leave behind to deal with these financial arrangements and can make things much easier on them too.

PROTECTING THE BUSINESS: SHAREHOLDER/PARTNERSHIP

Similar to a will, you should not only ensure that you have a shareholder agreement in place, but you should also ensure it is up to date and reflects your current wishes and circumstances.

Why Shareholder/Partnership Protection?

Shareholder and Partnership Protection can help business owners keep control of their company if one of them dies or is diagnosed with a critical illness and ensures the deceased's family are fairly treated. This cover would sit alongside a shareholder or partnership agreement to ensure the right cover and the right documentation is in place should the worst happen.

The loss of an owner or partner can cause numerous problems, and can create a devastating knock-on effect to the business. When an owner or partner dies, their share of the business will generally pass to their family, which could leave the remaining owners or partners in a difficult situation.

Some family members may be happy to act as a silent partner, some may prefer to take more of an active role, and some may just prefer to have the monetary value of the share of the business. The question is, will they be able to raise the funds to do this?

This is how the shareholder/partnership agreement, and shareholder/ partnership protection can help.

How does it work?

The most common form of agreement is a cross option (or double option) agreement. This gives the surviving owners the option of buying the deceased owners share of the business, and the relatives the option to sell.

As this is a choice, and does not happen automatically, it is the most efficient method from an inheritance tax perspective.

Each owner takes out a life cover policy (with a critical illness option if appropriate) equal to the value of their shares in the business, and written in trust for the benefit of the other business owners. The owners can choose to pay for their own premiums, or the business can pay on their behalf (subject to a benefit in kind tax implication).

It is advisable to equalise the payments of these premiums in order to ensure the transaction is commercial in the eyes of HMRC.

Valuing the Business

It is important to try and get an accurate valuation of the business to ensure that cover is set at an appropriate level. An accountant may be able to help with an estimate of the businesses value, or a professional valuation can be sought. The most important thing to do is to review your insurance regularly as business values can change, and the cover may need to be altered as a result.

PROTECTING THE BUSINESS: SHAREHOLDER CASE STUDY

Who do you want your shares to pass to when you die? It is important to legally document your wishes to ensure a smooth transition for your family, colleagues and the business itself.

A Bristol-based Limited company with three directors who are also the only shareholders was seeking financial advice. The value of the company is approximately £3,000,000 and each director owned 33.3% of the business.

In an initial meeting, their adviser asked a question that none of them could answer; "What would happen to the company if one of you dies unexpectedly?" The reason for this is due to not having a shareholder agreement in place which would outline what would happen in this exact scenario.

They did, however, discuss their wishes and decided that they would want the shares to pass to the on-going shareholders, as neither of them wants the executors or beneficiaries of their estates to have ownership of the company.

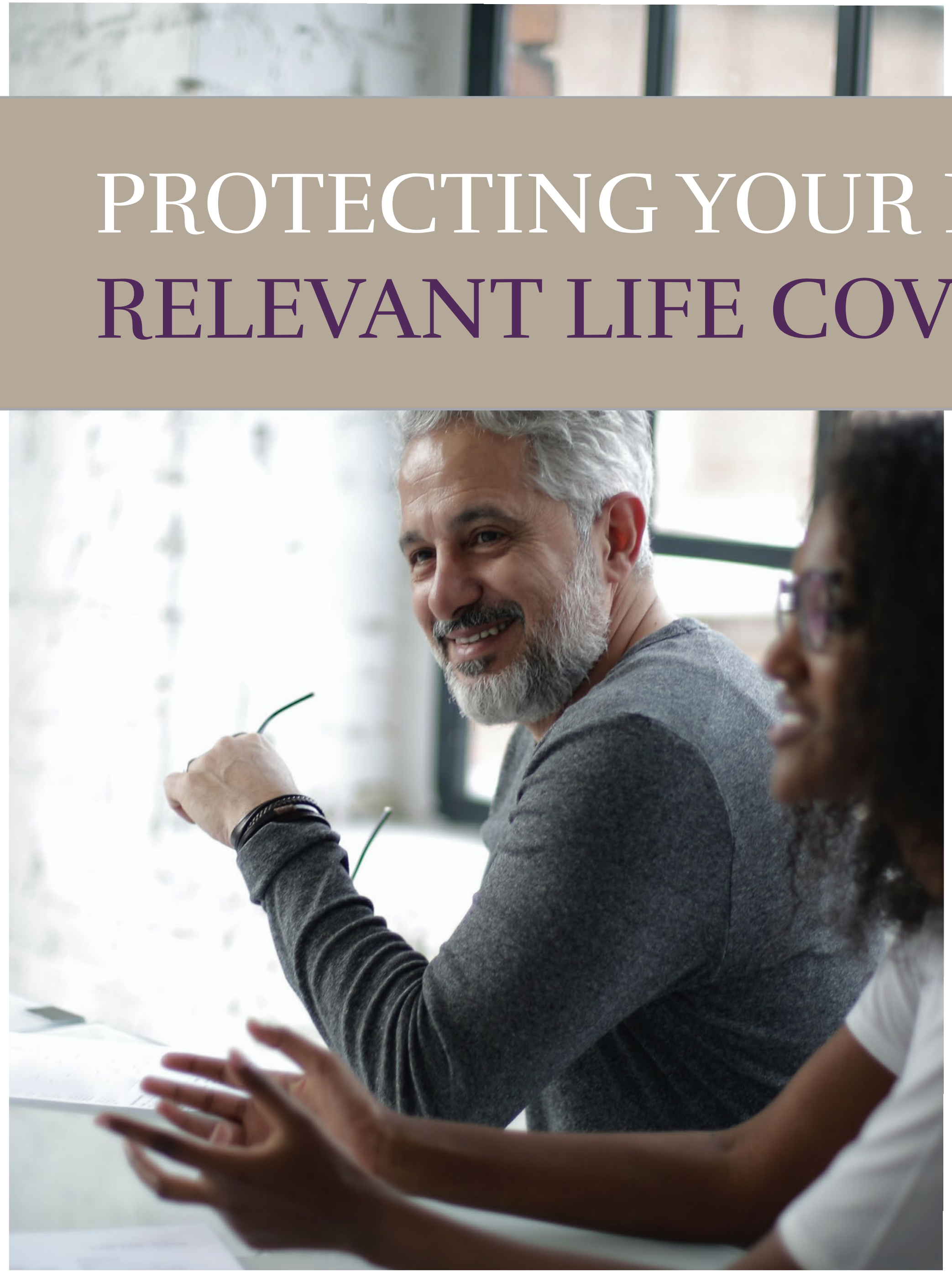
Without this documentation, however, if one of them were to pass away then their shares would instead pass to their beneficiaries – for example, their family.

This would add the burden of not knowing what to do with the shares during a challenging time, and the shareholders would need to find the capital to purchase them from the beneficiaries. In the event of a director dying, the bank is unlikely to want to lend the company anything as they have no idea if the business will be able to continue without them.

It was then decided that a shareholder agreement should be drawn up, with the help of a solicitor or legal professional. This would normally take the form of a cross option (or double option) agreement - however, this depends on the company structure. To sit alongside this agreement, a life insurance policy for all of the shareholders should be put in place, to provide the capital to buy the shares.

These policies are written in trust so that the transfer of shares and capital is tax free. The cross-option agreement is the legal framework to ensure that the shares are transferred to the on-going shareholder and the beneficiaries receive the agreed value of the shares without being liable to Inheritance Tax.

This arrangement ensures that the company can continue to function with minimum disruption, and the family will inherit what the shares are worth without the worry of what to do with the shares at an already difficult and emotional time.



PROTECTING YOUR PEOPLE: RELEVANT LIFE COVER

Some businesses offer death-in-service benefits to their employees, which would pay out to their family or dependants that rely on them financially should the worst case scenario occur.

A Relevant Life plan is a tax-efficient life insurance policy, set up by the employer and pays out a tax-free lump sum on the death of the person insured. The proceeds go to the employee's family or financial dependants, free of Inheritance Tax (IHT) and any potential Lifetime Allowance charge.

Traditionally businesses have offered a 'death in service' benefit to employees to provide financial protection, peace of mind, and to attract the best talent.

This type of cover can also offer a more cost-effective solution for smaller companies where there are too few employees to set up a group arrangement, a tailored level of cover is required for key people, or simply where a high level of cover is required.

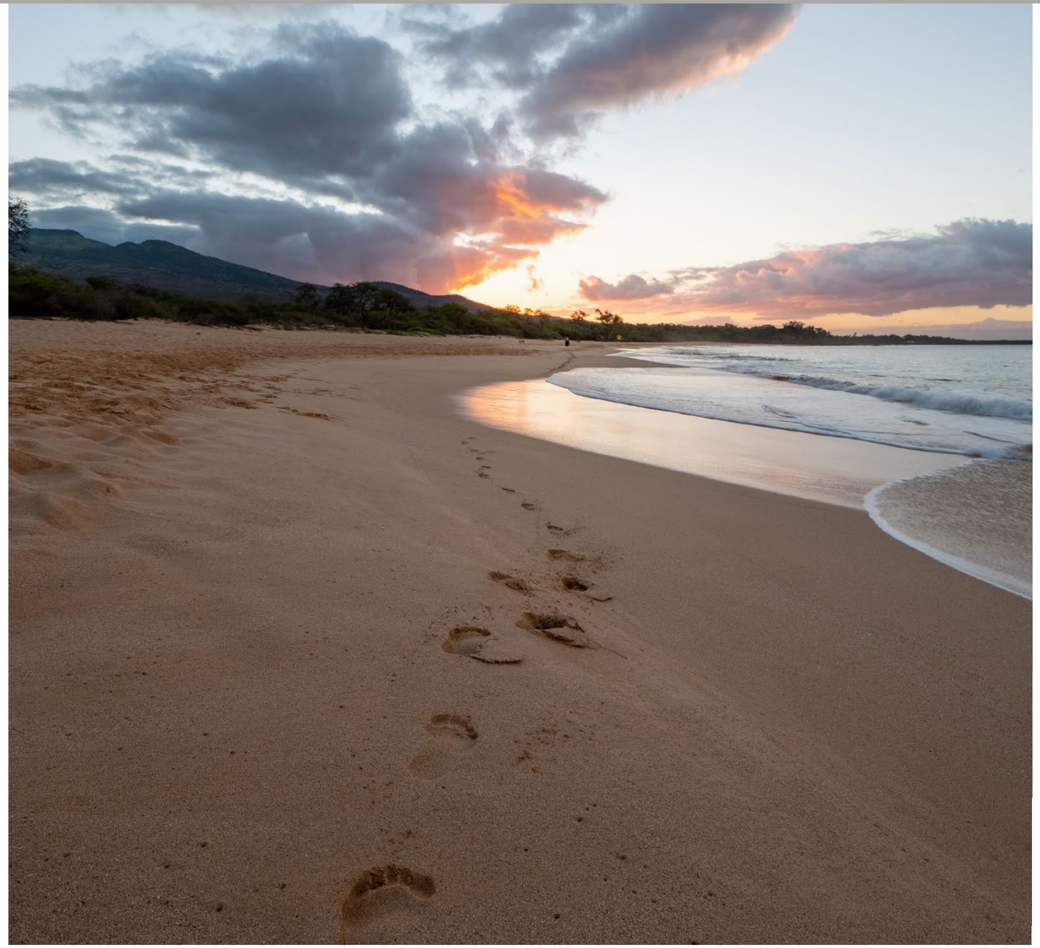
These plans may also be suitable for those with large accrued pension benefits and/or existing workplace life cover that is caught by the Pension Lifetime Allowance rules.

Relevant Life cover is one of the most tax efficient ways of providing personal cover through your company:

- The premiums are paid for by the company and they are usually classed as an allowable business expense, so can be offset against Corporation Tax.
- The policy is in trust so there are no IHT implications on pay-out.
- There is no benefit in kind tax implications for the employee.
- The policy is separate from pension contributions, so could offer significant benefits to those who are worried about exceeding their Lifetime Allowance and paying additional tax charges.

PROTECTING YOUR PEOPLE: RELEVANT LIFE CASE STUDY

Did you know that some protection policies can be paid directly by your company instead of yourself? Relevant Life cover could provide for your family whilst also being more cost effective for your business.



Our client, Lou, is the Managing Director of a manufacturing business and was worried that someday he may not be around to support his wife, Barbara. His wife volunteers at a local charity, and they have two adult children together who have their own young families and mortgages.

If Lou were to pass away, he would be leaving his wife to deal with and find a way to pay the household bills, mortgage and living costs. This could cause stress, disruption to her lifestyle, and force her to find a job that provides enough income to support her, all at an already difficult time following the loss of her husband.

Lou addressed his concerns both with a financial adviser and his company to review his options. The company was able to take out a Relevant Life plan at £1 million and Lou could name Barbara as the beneficiary.

Now, if Lou were to pass away during the term of the policy, the Relevant Life plan trustees would receive £1 million. This could then be paid - tax free - to Barbara, giving her enough money to pay off the mortgage on the family home and hopefully live comfortably for years to come.

In the meantime, Lou can rest assured with the peace of mind that his wife will be taken care of when he is no longer there to do so.

To help ensure that the policy proceeds are paid to those who you want to receive the money and without unnecessary delays, it is important that ***all Relevant Life Plans must be written in Trust.***

By doing so, this means that your beneficiaries can receive the money at the right time in a tax efficient manner, there is no need to go through probate or deal with intestacy laws, and an Inheritance Tax liability can be reduced, if not avoided completely.

PROTECTING YOUR PEOPLE: OTHER TYPES OF COVER

Too many people seek off the shelf protection products that are not suited to their needs and,as a result, may not pay out when they need it most. An adviser can help you find the right type and level of cover for you.

Executive Income Protection

If a key person within the business is absent for a period of time beyond normal sick leave, there will likely be significant impact on their income and thus the financial security of their family.

An Executive Income Protection plan provides an ongoing income to a key employee if they are unable to work due to illness or injury, and is implemented via the company where it can be tailored to the needs of the business and the individual.

Directors' Pensions

Often senior employees have pension planning requirements that are more nuanced than what a generic workplace pension scheme can provide, as their financial arrangements are inextricably linked to the affairs of the business.

A specialist pension allows for a tax-efficient pension scheme for directors, executives and key employees, offering greater control and investment flexibility than other workplace arrangements.

Corporate Advice

Did you know we also offer financial advice for businesses? Our corporate specialists can assist with areas such as:

- Pension Governance
- Employer/Employee Pension Guidance
- Pension Scheme Reviews
- Auto-Enrolment Advice
- Employee Benefits & Financial Education

Please do not hesitate to get in touch to discuss how we can help your business further.

HOW DO I CHOOSE THE RIGHT COVER FOR MY BUSINESS?

An Independent Financial Adviser can help you understand your options based on your current plans and requirements. We will then search the whole of the market for a solution tailored to your individual needs.

It is never too early to plan for the future, including death and illness which can occur at any time. Perhaps now is the time to take a moment away from your day-to-day tasks and consider some of the longer-term challenges that you may face.

The first step is to speak to a qualified financial adviser who will be able to provide you with tailored information, appropriate to your individual circumstances. Once you have all the facts you then will be able to decide whether you require any additional insurance policies in order to safeguard the future of your business, your employees and your family.

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