Adviser guide

Business Protection

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Introduction

Business protection has an important part to play within a business enterprise and can be configured to meet a firm's specific business needs to provide a straightforward, cost-effective and, in some instances, tax-efficient way for businesses to protect their future.

This adviser guide has been written to help financial advisers assess their client's business protection needs, the business customer issues that need to be considered, and the information that needs to be gathered before a business protection application is submitted.

This guide, along with our online application process, supports and helps streamline the advice process. It is not intended to provide a definitive account of all business protection planning solutions or to be a substitute for professional or expert advice.

In relation to the tax implications of business protection, this guide can only outline the current practice for the more common situations. Tax treatment can vary depending on the structure of the business, the purposes for which insurance has been taken out, the legislation in force at the time of claim and the individual tax position of the policy owner(s). This guide is not intended to replace detailed advice from a tax expert.

This document provides guidance for professional financial advisers and should not be distributed to retail customers.

Why a business needs protecting

Your client may have already taken steps to protect their business against major catastrophes and put together a business continuity plan to ensure its future if things go wrong. However, research suggests some owners may have given little thought to insuring against the loss of their most important business assets – themselves and their key employees.*

The death or critical illness of a key employee or a co-owner can have a major impact on the business. It could lead to a fall in sales, the loss of a major contract and difficulty in repaying business loans. Without the cash to buy out a co-owner, the business could even end up in someone else's hands.

What is business protection?

Business protection is a type of insurance that helps protect a business against possible financial losses when illness or death affects the owners or their employees. By including business protection in a firm's business plans, owners can help the business to survive and continue trading under seriously challenging circumstances.

Business protection is different to personal protection because it reflects particular business needs.

For example, the insurance could cover the life of another person such as a key employee, to protect against significant loss of earnings should they die or while they recover from serious illness. Business protection can also be used to ensure the ability of business owners to repay a loan in similar circumstances.

Who can take out business protection?

There are protection solutions available for the specific needs of different types of business, be it a limited company, sole trader, partnership, or limited liability partnership (LLP).

Depending on the circumstances, it is possible to take out a 'life of another' or an 'own life' policy, which is then written into a business trust. This is covered in more detail later in this document.

Aviva provides four main solutions: **key person** cover, **business loan** protection, **shareholder** protection and **partnership** protection.

*Source: High Net Worth & Business Protection Adviser Research. Cicero Research, February 2019

How does business type affect who owns the policy?

The following table outlines the different business types and an overview of their legal structure:

Business type	Subsets	Definition
Limited company	Public limited company (Plc)	These business types constitute a legal entity, and can own insurance policies on the lives of their employees, including directors or the business owners.
	Private limited company (Ltd) and Partnerships in Scotland	
Partnership	Limited liability partnerships (LLP)	
	Partnerships (England and Wales)	These businesses do not constitute a separate legal entity from the partners/business owner. Although the partnership may have a name and a bank account, the business cannot own property or insurance policies in its own name. In a partnership, these assets may be held by one or more partners as nominee(s) for the partnership; these policies would not usually be owned personally if they are a partnership asset.
Sole trader	Business owner	

What risks do businesses face and what protection solutions are available?

Every business has protection needs, from covering liabilities to protecting profits. The table below lists some of the needs a business may have and the protection solutions that are available if it unexpectedly loses one of its owners or key employees as a result of death or serious illness:

A business may have:	Risk exposure	Protection solutions
Liabilities	Inability to repay a loan	Term assurance and/or critical illness cover on each of the lives of those responsible for repayment of the loan
Key people	Reduced profitability	Term assurance and/or critical illness cover on the lives of key persons
	Interruption to business activities or the inability to service its commitments	
	Costs of recruiting a replacement	
Shareholders/Partners	Their interest in the business if a co-owner dies or suffers a serious illness	Term assurance and/or critical illness cover on the lives of the co-owners
	Their family's financial security	

What is an insurable interest in relation to business protection?

When selecting business protection insurance, it is important that an insurable interest is identified and calculated. For a life assurance policy to be considered a valid contract, an insurable interest must exist when the plan is taken out. This requirement was introduced in the Life Assurance Act 1774 (also known as the Gambling Act).

Unfortunately, the 1774 Act did not include a definition for the purposes of business protection. It simply said the applicant of an insurance policy should have an interest in the life assured and the sum assured must not be greater than that interest. It is generally necessary to demonstrate that there is a financial interest between the applicant and the life assured – an interest that is capable of being valued in financial terms – at the time the contract is taken out.

An insurable interest can arise where a commercial loan has been made to a business, or where the loss of an individual employee as a result of death or serious illness could impact the profits of a business. If you require further guidance on this area of the law, please seek legal advice.

Key person cover

What is key person cover?

Businesses will, in most cases, own various forms of insurance either because it is a legal requirement or to manage the risk of financial loss to the business. These typically include:

- professional indemnity insurance
- public liability insurance
- buildings and contents insurance
- commercial vehicle insurance, and
- employer's liability insurance.

However, none of the above covers the risk of losing a key employee. Key person cover can help insure against the financial losses that may arise if a 'key' employee (also referred to as a key person) dies, becomes terminally ill or suffers a critical illness. The problems associated with the loss of a key person can be summarised as follows:

- loss of profits
- costs of recruiting a replacement
- loss of loan facilities, or the inability to make repayments, and
- loss of income to sole traders and/or their families.

A key person may be the business owner (who may either insure their own life or the business can insure their life), or an employee, in which case the business owner would insure the life of another person.

The costs associated with losing such employees through serious illness or death can be compensated. The following sections explain key person cover in more detail as well as giving suggestions for appropriate insurance.

Who are the key persons in a business?

A key person is any individual in the business whose skill, knowledge, experience or leadership contributes significantly to the continued financial success of the business. Key persons might include:

- owners
- managing directors
- sales managers
- research development staff
- technical experts, or
- individuals with specialist skills.

What impact will the loss of a key person have on a business?

The risk of financial loss is a serious concern to any business should a key person die or fall seriously ill, and can mean:

- a fall in sales
- a delay to product launches
- delays in the completion of existing contracts (financial penalties)
- a lack of confidence in the business from a bank, suppliers, customers and other employees
- loans may be called in
- suppliers may demand payment upfront
- customers choose to go elsewhere, or
- further recruitment costs, 'head hunting' fees, or training costs for a replacement.

Some of the above will have a short-term or immediate impact, while others will have longer term implications.

How Aviva can help

A Business Protection policy can provide a range of flexible solutions to meet specific business needs.

Our key person cover offers:

- protection suitable for most business types
- a choice of life insurance or life and critical illness cover
- a choice about the amount of insurance needed and how much the business should pay within the maximum and minimum available
- the flexibility to change the insurance cover when the financial needs of the business change, subject to certain limits, and
- the option to write the policy for a specified term or on a 5 or 10 year renewable basis.

If a business takes out insurance on the life of a key person, the benefit will be paid directly to the business in the event of the key person dying or suffering a terminal or critical illness. The proceeds of a claim can then be used to meet the financial needs of the business while it recruits a replacement or undergoes reorganisation. If a critical illness claim is paid and the key person subsequently returns to work, the funds could be used to pay for a temporary replacement or to cover a profit shortfall.

How do I calculate the value of a key person?

Having established the need for key person cover, consideration needs to be given to the appropriate amount of cover required to meet any potential financial loss to the business.

There may be a number of ways in which a business may 'value' an employee. Each situation will need to be examined on its own merits. The value can typically be reflected in the salary and bonus a key employee is paid. However, that may not reflect the true value a key employee contributes to the overall profitability of the business. This could be done by calculating the value of profits attributable to the key person.

Insurers use various calculations when assessing business protection applications to help justify the level of cover applied for. The following are two of the more common calculations used for this type of protection, to help you identify the appropriate sum assured.

Loss of profit calculation

To calculate the potential loss of profits generated as a result of the death or serious illness of a key person, you should:

Take the average net profit* before tax for the last three years and multiply by five.

In order to establish the maximum cover available, the profit calculation will need to be split where there is more than one key person contributing to profit.

You may wish to compare the result with calculations using the salary multiple calculation.

*Definition: net profit is gross profit less salaries, administration and/or production costs, any other overheads and interest payments. Net profit is the total amount before tax deductions.

Salary multiple calculation

A popular approach to calculating the amount of key person cover required is to take a multiple of that person's remuneration.

For life cover this is their total remuneration multiplied by up to a maximum of 10, and for critical illness cover it is their total remuneration multiplied by the number of years until they reach age 68 - depending on the financial loss their absence from the business would represent.

This approach is straightforward and most suitable for companies whose main concern would be the costs of recruiting or training a replacement.

How do I arrange protection for key persons?

If the key person is the business owner, the business owner may either insure their own life, or the business may insure their life using a life of another plan.

If the key person is an employee, the business owner would insure the life of another person.

What are the underwriting requirements?

The amount and duration of cover calculated for business protection must be justifiable.

We will need to know who is initiating the cover, its intended purpose and the method used to calculate the sum assured. This is to ensure that the amount and type of cover is reasonable in relation to the specific needs of a business.

If your client wants to take out a large amount of insurance or the insurance is to protect 'start up' or loss-making companies, our underwriters may require more detailed information about why the cover is required.

A representative of the business will need to complete the application. The key persons must answer their own medical questions, while the business will need to provide any financial evidence requested by our underwriters. Our underwriting team will be able to provide pre-sales assistance and support on the required approach.

What are the tax implications arising from key person cover?

The tax treatment of key person premiums and claims payments received under key person policies may not be straightforward. What follows reflects our understanding of current HMRC practice as at February 2023, but this may change.

Although tax relief should not be a key driver to taking out key person cover, we suggest you encourage business owners to seek to clarify with their local Inspector of Taxes whether any premiums will be deductible. We have included a letter template for this purpose which can be found on page 24 of this guide.

In 1944, Sir John Anderson, the then Chancellor of the Exchequer, established the key tax principles when he made the following statement in answer to a Parliamentary question:

"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 is an annual or short-term insurance.**

Premiums paid by companies to insure the lives of directors are dealt with on similar lines."

Providing the above criteria are met, HMRC may treat premiums as allowable deductions from profits for tax purposes.

If premiums have been allowed as deductions from profits for tax purposes, the proceeds of a claim will usually be treated as a trading receipt of the business in the year of payment and could be liable to tax.

A business does not have the right to elect to give up tax relief on the premiums to ensure any claim proceeds are free of tax.

What if the key person is a shareholding director?

There may be instances where a key person is also a shareholding director, which generates a different taxation outcome. Where key person cover covers a shareholding director, HMRC may view the proceeds of an insurance policy as largely for the benefit of the life assured (if the director owns significant shareholdings in excess of 5% of the company) and therefore not eligible for tax relief on insurance premiums paid by the business.

Are there any inheritance tax implications?

Please note that the following section only applies to limited companies.

A cash injection generated by a term assurance claim will most likely boost the value of the shares in a business. If the key person who has died was also a shareholder, the value of their estate could rise through an increase in the value of their shareholding.

If shares pass to someone other than the spouse or registered civil partner, and Business Property Relief was not fully available, any Inheritance Tax liability will increase.

The tax treatment of each key person's cover is considered by HMRC on its own merits. In order to establish their tax position, the company should explain the purpose of the insurance policy to its local Inspector of Taxes ahead of buying business protection.

The business could write to their local Inspector of Taxes and detail how they expect the premiums and benefits to be treated for tax purposes, as described in our tax summary (see page 22). We have included a letter template for this purpose which can be found on page 26 of this guide.

If the life assured is a director or shareholder, it will be important to establish the percentage of shares held, and whether other members of the family own shares. This will influence the decision made by HMRC.

Business loan protection

What is business loan protection?

Many businesses take out loans to start up a company or to expand their operation. Their ability to repay will often rest with a few key people. Businesses need to make sure they have enough insurance in place to pay an outstanding loan if something happens to those people.

If the business has outstanding borrowings such as a loan, commercial mortgage or a director's loan, business loan protection can help repay these should one of the business owners die or suffer a critical illness.

Under the terms of a business loan, shareholders may be jointly liable, or severally liable, or jointly and severally liable for the repayment of the loan. It is important to understand each individual's liability under the terms of the loan before arranging cover for each shareholder. This information should be available in the original loan agreement.

Business loan protection is similar to personal life insurance taken out to cover a mortgage. In the majority of cases, your client can protect the full amount with life cover, or life and critical illness cover. When they make a claim, the sum insured is paid to either the business or directly to the lender if the cover has been assigned to them.

What are the types of loans that a business can protect?

Most loans can be protected, including:

- commercial loans and mortgages
- venture capital loans
- directors' loans, and
- personal guarantees.

A lender may make business loan protection a condition of the loan before they are prepared to release any funds, and the owners of the business may be asked to sign a personal guarantee for the loan. A lender will consider life insurance, critical illness cover or a combination of both as suitable insurance for key people in the business to mitigate any risk to repayments.

How does business loan protection differ from key person cover?

The underlying insurance is the same but differences arise in the purpose for which the cover is purchased:

- the sum insured for loan protection should match the amount of the outstanding loan and the term of the policy should match the remaining term of the loan. The sum insured for key person cover is calculated against the loss of profits or replacement costs and can therefore vary
- there are differences in the taxation treatment of premiums and claim proceeds between loan cover and key person cover.

How Aviva can help

Business loan protection offers:

- loan protection for most business types
- a choice between life insurance or life and critical illness cover
- a 'reducing benefit' version, which allows you to structure loan protection in an efficient manner
- the flexibility to change insurance cover to complement any changes made to the loan, subject to certain limits and conditions, and
- the option to write the policy for a specified term or on a 5 or 10 year renewable basis.

How do I arrange protection for business loans?

Typically, the business will take out cover on the persons responsible for repaying the loan on a life of another basis. The terms and conditions of a business loan can vary, and those responsible for paying it back may be liable in different ways (e.g. jointly and/or severally) and for different amounts. Business loan protection is a flexible solution that can be tailored to suit the specific circumstances of the business.

For example, the amount of insurance doesn't have to be the same for each person, the policies can be assigned to the lender if required, a decreasing sum assured can be selected so that the sum assured decreases in line with the outstanding loan, or a fixed value sum assured can be selected if the business has taken out an interest-only loan.

Should the person covered die or suffer a critical illness during the term of the cover, the proceeds of a claim will be payable to the business.

The business can then decide if they wish to pay off the loan immediately or continue repayments according to the initial agreement. If the policy has been assigned to a lender, We will pay the proceeds of a claim directly to the lender.

What are the underwriting requirements?

You may be asked to provide a copy of the loan agreement and confirmation that the loan has been drawn down before the cover commences.

What are the tax implications for business loan protection?

The tax treatment of policies set up for loan protection differs from key person cover and is clearly defined. Where insurance is initiated as collateral security for a loan, premiums paid will not be treated as a deductible expense from profits for corporation tax purposes. They will be regarded as part of the cost of raising capital. Benefits will be treated as a capital receipt and not taxed.

Shareholder protection

What is shareholder protection?

Shareholder protection is taken out to allow remaining business owners to buy the insured partner's or the shareholder's interest in the firm should one of the business owners die or become either terminally or critically ill.

What is the impact of losing a business owner?

The loss of a business owner can destabilise a business and result in financial difficulties for other shareholders. Shareholder protection ensures the surviving shareholders have the opportunity to stay in control of their business by providing the cash to buy out another shareholder if they die, or suffer a terminal or critical illness.

How Aviva can help

Shareholder protection offers:

- share protection for most limited companies
- a choice of life or life and critical illness cover
- the flexibility to change the cover when the financial needs of the business change, subject to certain limits and conditions, and
- the option to write the policy for a specified term or on a 5 or 10 year renewable basis.

How do I calculate the value of a business?

Having established a need to protect a business against the loss or illness of a major shareholder, the value of their share of the business will determine how much cover is needed.

Business share owners may have a clear understanding of the value of their business. If this is not the case, the calculation outlined in this section could help you work out the amount of cover your clients need to apply for. The amount of cover needs to be established and justified for financial underwriting purposes and you will need to demonstrate how the figure has been reached.

Our underwriting team is on-hand to provide assistance and support in calculating levels of cover.

Business value calculation

There are many ways to value a company, and determining the value of a business is somewhat subjective. When professionally valued, the factors influencing the company can include profit growth, market position, and net asset value. Valuation methods could range from allowing the company's auditors or an expert valuer to fix the price of the business or put a fixed price on the transfer of any shareholding, for example £1 per share.

Aviva, for example, would consider a multiple of seven times net profit before tax (based on the average of the last three years' audited accounts) to be reasonable when calculating the value of a company. With justification, we could consider multiples above this and the inclusion of the net asset value.

The sum assured should be the equivalent of the individual's percentage shareholding.

Whenever you are looking to value a business, it is important you refer to the company's Articles of Association and any shareholders' agreement to see if there are any restrictions on the transfer of shares. The amount of conditions relating to the transfer of the shares will affect their value. Many Articles simply allow the directors the discretion to refuse to register the transfer to any person for any reason. Larger companies may have more complicated restrictions.

How do I arrange protection for shareholders?

Any protection solution must be aligned to the Articles of Association and the shareholders' agreement. A trust and/or buyback deed may also need to be put into place for this solution to be effective.

Own life applications

To set up shareholder protection, each shareholder takes out an own life cover with a sum assured equivalent to the value of their shares. This policy must be put into trust, with their co-shareholders as beneficiaries. All shareholders enter into an agreement whereby if one of the shareholders suffers a critical illness or dies, the others would use the proceeds of claim on their policy to purchase their shares from their personal representatives if they die, or directly from the shareholder should they suffer a critical illness.

The sum assured for each shareholder reflects the value of their shareholding in the business

£150,000 life & critical illness cover under a business trust for GREEN and RED

£250,000 life & critical illness cover under a business trust for BLUE and RED

£50,000 life & critical illness cover under a business trust for GREEN and BLUE

On the death of GREEN

GREEN dies. £250,000 is payable to the business trust – trustees pay the surviving shareholders

The surviving shareholders purchase shares for £250,000 from GREEN's estate

RED and BLUE remain as joint owners

On receipt of the proceeds of the sale, the deceased's personal representatives would be able to distribute the proceeds in accordance with the deceased's will or with the rules of intestacy.

Are business trusts required?

A flexible approach to shareholder protection is to arrange for business protection to be written into trust from the outset. Trusts are often seen as complex, so we have included notes within our trust documentation to assist with their completion. Further information can be found at **protection.aviva.com/advisers/literature/trusts**. However, Aviva cannot provide advice in relation to trusts and professional legal advice should be sought.

Writing business covers under a flexible business trust allows new shareholders to benefit from the trust without revising the complete shareholder arrangement. It also allows shareholders who leave the business to be removed from the shareholder arrangement with a minimal amount of legal administration.

Aviva requires that, once completed, the trust document is sent directly to us.

What is a double option agreement?

To complete the trust planning, an agreement is required between the shareholders to ensure that, should one of them die, their personal representatives will agree to sell their share. This can be done using a double option agreement.

A double option agreement creates a 'buy' and 'sell' option. If the remaining shareholders want to buy, the deceased's personal representatives must agree to sell. If the personal representatives want to sell, the remaining shareholders must agree to buy.

If neither party wishes to exercise their option, the shares will pass to the beneficiaries of the deceased's estate. They become the new owners of the shares and can choose to sell them on the open market (subject to any restrictions in the Articles of Association or any shareholders' agreement).

A double option agreement is not a binding sales agreement, so Business Property Relief from Inheritance Tax will be available.

A specimen double option agreement is available at **protection.aviva.com/advisers/literature/trusts**. Please note that double option and single option agreements are in one document.

What is a single option agreement?

If critical illness cover is included, each shareholder will also want to ensure their co-shareholders will agree to buy their shares if they suffer a critical illness and want to sell their stake in the business. This can be done using a single option agreement.

If a shareholder suffers a critical illness, a single option agreement creates a 'sell' option for the affected shareholder only. Unlike a double option agreement, it does not give the remaining shareholder(s) the right to exercise a 'buy' option. This ensures the other shareholders cannot ask the affected shareholder to sell their share against their will, allowing them to continue working if they wish to.

If the affected shareholder does not want to sell, the proceeds of a claim can be retained in the trust in case they decide to sell their share later on.

A specimen single option agreement is also available at **protection.aviva.com/advisers/literature/trusts**. Please note that double option and single option agreements are in one document.

What is an equitable premium calculation?

Where each of the shareholders has taken out trust arrangements for shareholder protection, it is possible to make an equitable arrangement to 'even out' any differences in premiums. This is important to maintain the commerciality of the shareholder protection arrangement.

Adjustment of premiums removes the potential inequality between older shareholders and those with larger shareholdings (who may have to pay more for cover) and those with smaller shareholdings, who may gain less benefit. Adjustment brings about an equitable distribution of costs.

What happens if a new shareholder joins the business?

Any shareholder joining the business should enter into the shareholder protection plan. The insurance, trust documentation and option agreement should be set up to match any existing shareholder protection arrangements.

This would be an ideal opportunity for existing shareholders to review their protection arrangements and, where appropriate, make the relevant adjustment to life and critical illness covers, as well as ensure all trust documentation and option agreements are up-to-date.

What happens if a shareholder leaves the business?

Shareholder protection will no longer be needed by a shareholder if they leave the business.

The life insurance cover on their own life would 'revert' under the terms of the business trust into a personal insurance policy for the benefit of the departing shareholder and their business trust will cease. The cover could then be put into a new personal trust to help the leaving shareholder's dependants mitigate against possible Inheritance Tax.

What are the tax implications of shareholder protection?

If the company pays the premium on behalf of the shareholder, it can deduct this payment as a business expense for corporation tax purposes. The company may also incur a liability for National Insurance contributions paid on behalf of the shareholder, but this may also be a deductible expense.

If the company pays the premium on behalf of the shareholder (even where the shareholder is both owner of the cover and life assured), the premium payments will be assessed as a benefit to the shareholder for Income Tax and National Insurance purposes. If the individual shareholder pays the premiums, this will be deducted from their taxed income. Please see page 20 for further information.

Tax liability on the proceeds of a claim

There is no Income Tax liability on the payment of death or critical illness benefit under Aviva Business Protection.

Provided arrangements are regarded as a commercial transaction with no element of gift, there would normally be no Inheritance Tax charge applied to premiums paid by a business or a shareholder.

The proceeds of a claim from an Aviva Business Protection policy, when effected as part of a commercial share protection arrangement written under a business trust, would be payable to the Trustees free from Inheritance Tax. Funds from the trust are intended for the purchase of shares in the deceased's estate.

Limited companies issue 'unquoted' or 'quoted' shares that qualify for Business Property Relief (BPR). This varies depending on the type of shares as follows:

- 50% BPR for quoted shares, or
- 100% BPR for unquoted shares.

In order to qualify for Business Property Relief the shareholding must have been owned for at least two years and must be in a trading business (not dealing in securities, land and buildings or investments).

Trustees should be aware that a business trust fund will be treated as 'relevant property' for Inheritance Tax purposes. There could be an Inheritance Tax charge at each 10-year anniversary of the trust (also known as a 'periodic charge'), based on the value of the property then held in trust. This is despite the fact that no gifts are made to the trust in a commercial arrangement between the owners. In the case of a term assurance policy held under Aviva Business Protection, the value of the property will be the market value of the cover. However, the plan is not usually considered to have a market value unless the life assured is in ill health at that time.

In the unlikely event of a tax charge arising, the 'effective rate' will not exceed 6% of the value of the trust property. When any property leaves the trust, it could be subject to a proportionate charge (also known as an 'exit charge') based on an appropriate fraction of the 'effective rate'. Again, the charge will not exceed 6% (the proportionate charge is based on the previous periodic charge). If there is no periodic charge, there will also be no exit charge.

If the business is a family business, Inheritance Tax and Business Property Relief are unlikely to be affected as long as the arrangement is solely to protect the business and is arranged to protect only those with direct shareholdings.

Liability for Capital Gains Tax (CGT)

There is no CGT liability on the proceeds of a claim from a life or critical illness plan. However, there could be a liability on death for the beneficiaries of the deceased's estate, on any increase in value of the shares between the date of death and the sale of shares.

A CGT liability may arise if a director's shares are sold as a result of a critical illness.

What is company share purchase?

A company share purchase (or 'buy back') arrangement is designed to allow a firm to buy shares from a shareholder on his or her death. Such an arrangement can provide a deceased shareholder's estate with a buyer for the shares where a market for them might not normally exist.

A company share purchase arrangement does not remove the need for business protection as it requires the business to effect policies on the lives of each shareholder matching the value of each shareholding. Any benefit paid by Aviva on the death of the shareholder is paid to the business so it has the necessary funds to buy out and cancel the deceased's shares - effectively increasing the proportionate shareholding of the remaining shareholders.

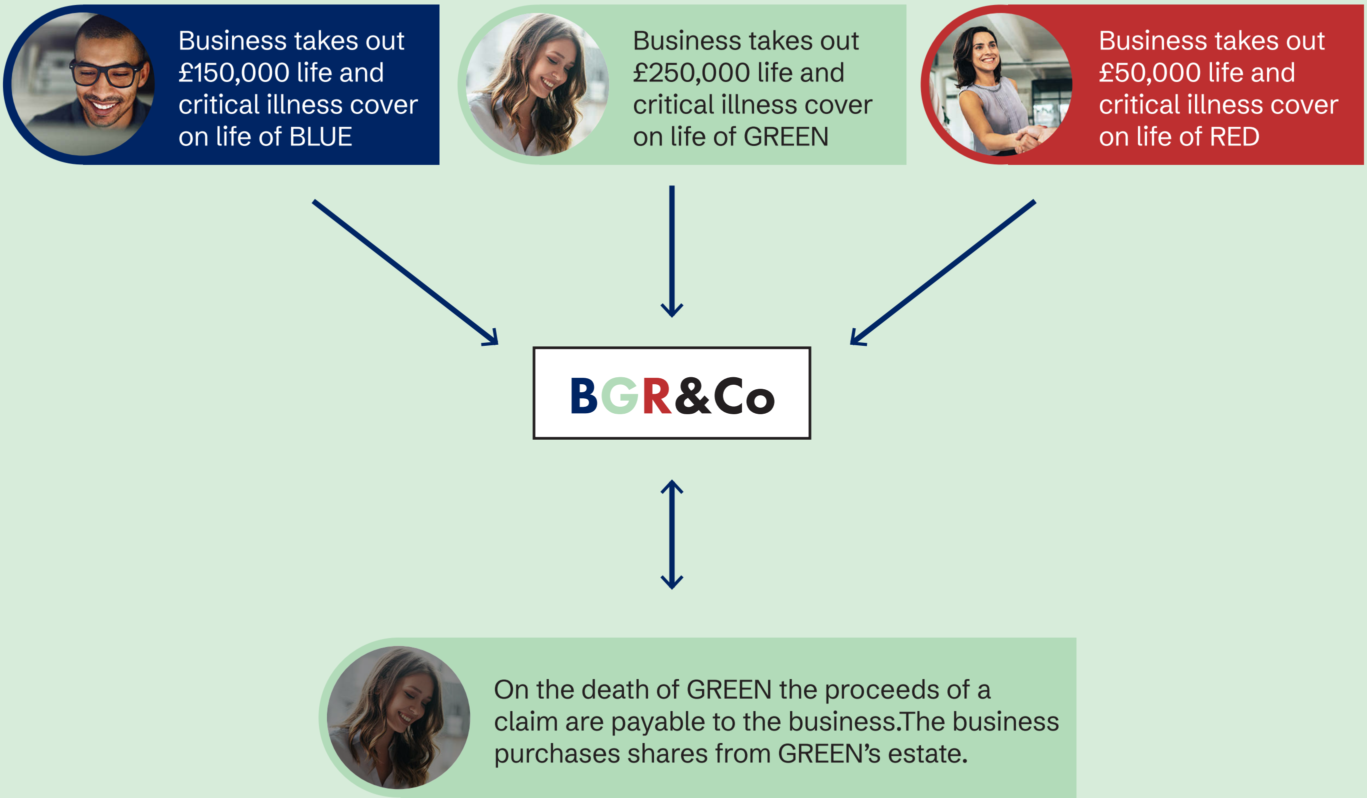
This type of arrangement achieves the same effect as the surviving shareholders purchasing a deceased shareholder's shares but the following points need to be acknowledged and understood:

- the company's Articles of Association must authorise the company to purchase its own shares. Some older companies, particularly those incorporated prior to 1982, may not have this express power set out in their Articles and these would therefore have to be changed. A change in the company's Articles, to permit purchase by the company, may increase the value of the shareholding
- before a company can effect a purchase of its own shares, its directors must give a statutory declaration of solvency (i.e. confirm the company will still be solvent after the shareholder dies), backed by a favourable report from the company's auditors
- assuming the company is able to legally purchase its own shares (there are various conditions to satisfy under the Companies Act), HMRC requires that certain conditions be satisfied in order for the purchase to be treated as a capital transaction and not a 'distribution' in the hands of the shareholder. To achieve this, legal advice should be sought by the company
- it should be noted that proceeds from a life assurance plan, initiated by the company to facilitate the purchase of the shares of a shareholding director, will increase the value of the company. The deceased's personal representatives may wish this to be taken into account when selling the shares to the company. The sum assured of any shareholder protection must therefore be sufficient to actually allow for the purchase of the shares. A further factor to consider is that the death of the shareholder director is likely to have deprived the company of one of its principal assets, and any loans he/she made on behalf of the business will have to be repaid. This may have a balancing effect of reducing the value of the company.

It is usual for the share option agreement to be a single option only, i.e. the company should have the option to purchase. If the deceased's personal representatives have the option to require the company to buy the shares, the directors may not be able to provide the necessary statutory declaration and the company would not be allowed to buy the shares under the Companies Act.

The complexity of the company share purchase arrangement means buying shareholder protection insurance should not be considered without the assistance of legal advisers as it needs to comply with current legislation and any other arrangements in place relating to the company.

The sum assured for each shareholder reflects the value of each shareholding in the business



The process effectively increases the proportionate shareholdings of the other shareholders.

Partnership protection

What is partnership protection?

If a business partner dies or wants to leave the partnership when they are diagnosed with a critical illness, most partners will want to buy the affected partner's share in the business and keep control. But only a few will have enough cash to do so.

Partnership protection is taken out to ensure that funds are available to allow the remaining partner(s) in a business to buy a partner's shareholding if they die, become terminally ill or suffer a critical illness. This in turn gives each partner the security of knowing that their beneficiaries or personal representatives will have a ready and willing buyer instead of having to maintain an interest in the business.

What is a partnership?

Partnerships come in different shapes and sizes but the Partnership Act 1890 defines a partnership as "the relationship which exists between persons carrying on a business in common with a view of profit". The Act also provides a basic framework for people trading in partnership. For example, Section 33 of the Act states the partnership will be dissolved on the death of a partner.

A written partnership agreement can modify or exclude many of the provisions of the Act but a partnership agreement would normally include the following:

- date the partnership comes into effect
- partners' responsibilities and duties
- shareholding of the profits
- arrangements on the resignation of a partner
- arrangements on the retirement of a partner
- arrangements on the death of a partner, and
- dissolution of the partnership.

A partnership in England and Wales has its own legal identity and individual partners are personally responsible for any liabilities of the business. Failure of the business could therefore result in a partner losing both their shareholding in the business and all or part of their private assets as well.

A Scottish partnership has its own separate legal identity from that of the individual partners, as does a limited liability partnership in England and Wales.

What is a limited liability partnership?

A limited liability partnership (LLP) in England and Wales has its own legal identity and can own assets in its own right. The Limited Liability Partnerships Act 2000 permits the formation of LLPs which limit the liability of members under the following conditions:

- the firm must be registered as an LLP at Companies House, and
- financial statements must be disclosed in the same manner as for limited companies.

An LLP differs from a traditional partnership in a number of key respects:

- an LLP is treated as a corporate body, i.e. it is a distinct legal entity with full legal capacity
- the liability of members is limited to their actual and pledged contributions and any personal liability that they may incur, and
- similar rules apply to members as those imposed on company directors, for example, rules relating to wrongful trading, etc.

Each member has an 'interest' in the business, rather than ownership of ordinary shares. If there is no membership agreement, Section 7 of the Partnerships Act says where the member has died, their personal representatives will not be permitted to become involved in the management of the business. That said, they are entitled to receive whatever the member's 'interest' was in the business.

What happens if a partner dies?

Even if there is an agreement to allow the business to carry on after the death of a partner (including a member of an LLP), there may be insufficient funds to adequately compensate the estate or the business for the loss of the individual.

Most surviving partners in this situation will want to buy the deceased partner's share in the business and keep control, but only a few will have the right amount of cash at the right time.

Some businesses may turn to the bank for a loan, but the bank may also have concerns over the future stability of the business which could leave it less likely to make a further loan payment. A partner suffering a serious illness or disability could lead to similar consequences.

What happens if a partner dies and there is no partnership agreement?

Without a partnership agreement, the death of a partner automatically dissolves the partnership and the estate of the deceased partner becomes entitled to the value of the deceased partner's interest in the business.

For the remaining partner(s), this could require them to:

- sell the business to pay off the estate
- sell assets to pay off the estate
- set up business as a sole trader
- start a new partnership with someone else, or
- come to an arrangement with the deceased partner's estate.

In some cases, it could require them to set up a new partnership with the late partner's beneficiaries. These same beneficiaries may feel there is inadequate compensation for the late partner's business interest, which may force them to become involved in the business against their will.

If the business operates as an LLP, the death of a member does not dissolve the LLP, but in the absence of an LLP agreement the member's interest would pass to their beneficiaries via their will or through intestacy. It might be wise to set up a well-drafted Members' Agreement which sets out what would happen in the event of a member's death or serious illness.

You can help partnerships and LLPs understand the impact that the death, serious illness or permanent disablement of a partner could have on the business, and help them put an appropriate solution in place.

How can Aviva help?

It's important that sufficient funds are available to enable the remaining partner(s) to purchase their partner's interest. This can be achieved by taking out partnership protection on each partner's life for an amount that reflects the value of their individual interest in the business. Partners should agree from the outset how the value of the business will be established.

The cover would be written under trust so any proceeds pass directly to the surviving partners after the death of the assured. Where appropriate, you could also provide insurance to a partner in the event of serious illness or disability.

Partnership protection offers:

- protection for most types of partnership and LLP
- a choice between life insurance or life and critical illness cover
- a choice about the amount of cover needed and how much to pay
- the flexibility to change insurance cover when the financial needs of the business change, and
- the option to write the policy for a specified term or on a 5 or 10 year renewable basis.

How do I calculate the value of a partnership or LLP?

Partners must agree upon the value of the business at the outset. They will often have a good idea as to the value of the business. However, difficulty often arises as much of a partnership's value is in the form of goodwill. It is therefore helpful to understand how the value of a partnership can be calculated:

- average partnership profits: the value of a partnership can be expressed as a multiple of the average profit over a given number of years
- valuing goodwill: an agreement can be made among partners, after taking professional advice, on a method for valuing the goodwill of the business
- net assets: as with companies, the net assets are not always a helpful guide to the business's value but they should be taken into account.

In the same way you might value a company for shareholder protection, Aviva would initially consider a multiple of seven times net profit before tax (based on the average of the last three years' audited accounts) to be an appropriate calculation for partnership protection. We might consider multiples above this if presented with reasonable justification. The sum assured should be equivalent to the partners' percentage share in the business.

The value of any business can fluctuate. It is therefore important that any partnership protection arrangement is regularly reviewed and updated.

How do I arrange a business protection solution for partners?

Life of another applications

Where a partnership is made up of two individuals, insuring the life of another is a simple and straightforward way of securing protection. Each partner takes out insurance on the life of the other partner. This application process avoids the need for trust documents and trustees, and prevents any long-term trust taxation issues from emerging later.

The disadvantage of this arrangement is that if there are more than two partners, a series of life of another applications are needed to cover each of the owners. The inflexibility of this arrangement becomes increasingly apparent when partners join or leave the partnership.

Own life applications

Each partner takes out an own life policy and writes it under trust for their co-partners. It is important to note that Aviva Business Protection must be written in trust from inception. We have included notes with our trust documentation to assist with completion.

Aviva requires that, once completed, the trust document is sent directly to us.

The partners must also enter into a double option and/or single option agreement. If any of the partners die, the remaining partners will have the funds and the option to buy a partner's share from the deceased's personal representatives. If a partner suffers a critical illness, they will have the option to sell, while the remaining partners will have the funds to buy their shares.

How does a double option agreement work for a partnership?

With partnership protection in place, the partners will want to be sure that, if one of them dies, the deceased partner's personal representatives will agree to sell them their interest. This can be done using a double option agreement.

A double option agreement creates a 'buy' and 'sell' option. If the remaining partners want to buy, the deceased's personal representatives must agree to sell. If the personal representatives want to sell, the remaining partners must agree to buy.

If none of the parties wish to exercise their option, the beneficiaries of the deceased's estate will be the new owners of the shares, which they can sell on the open market.

A double option agreement is not a binding sales agreement, so Business Property Relief from Inheritance Tax will be available.

A specimen double option agreement is available at **protection.aviva.com/advisers/literature/trusts**. Please note that double option and single option agreements are in one document.

How does a single option agreement work for a partnership?

If critical illness is included, each partner will want to ensure their partners will agree to buy if they suffer a critical illness and want to sell their interest. This can be done using a single option agreement.

If a partner suffers a critical illness, a single option agreement creates a 'sell' option for the affected partner only. Unlike a double option agreement, it does not give the remaining partners the right to exercise a 'buy' option. This ensures the remaining partners cannot ask the affected partner to sell their interest against their will and allows them to continue working if they wish to.

If the affected partner does not want to sell, the remaining partners can retain the proceeds of a claim in trust, in case the affected partner decides to sell their interest later on.

A specimen single option agreement is available at **protection.aviva.com/advisers/literature/trusts**. Please note that double option and single option agreements are in the same document.

What is automatic accrual?

Automatic accrual is available to business partnerships and ensures a partner's interest in the business (or share of the value of the goodwill) passes automatically to the remaining partners if the partner dies. The deceased's family does not receive payment from the other business partners. Instead, they are compensated by protection insurance set up under trust on the partner's own life.

This means any proceeds of claim are not subject to Inheritance Tax and settlement can be made quickly, due to probate not being required before the payment is received.

Automatic accrual agreements can also cover retirement. These are commonly found in professional practices, such as accountancy or legal firms, where goodwill forms a significant part of the value of the business. However, these agreements usually ignore the value of the partner's capital in the business and any outstanding loans. It's often necessary to consider appropriate protection covers for co-partners to provide the funds needed to repay any partnership loan on a partner's death.

What happens when new partners join the business?

All new partners should enter into the partnership protection arrangement. The protection and trust documentation or option agreements should be set up to match any existing partnership protection arrangements.

This would be an ideal opportunity for existing partners to review their protection arrangements and, where appropriate, adjust their life insurance and critical illness covers to ensure all trust documentation and option agreements are up-to-date.

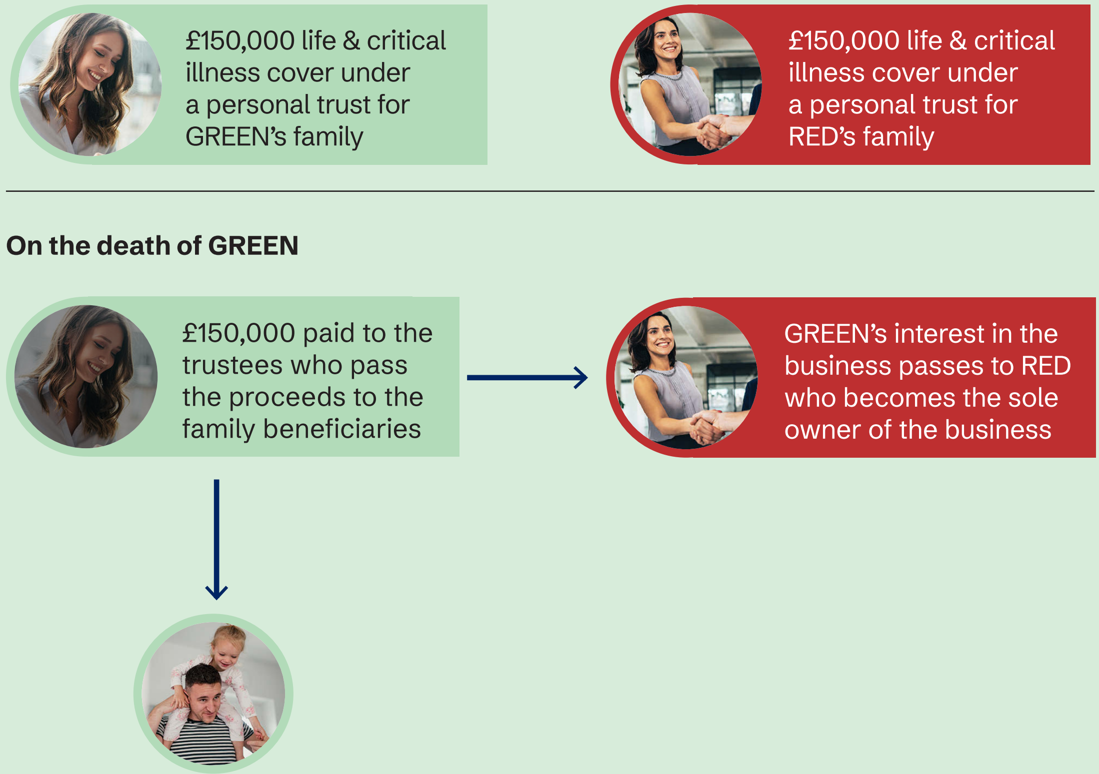
What happens when a partner leaves the business?

The business protection policy will no longer be needed if a partner leaves the business.

The life insurance cover on their own life would 'revert' under the terms of the business trust into a personal insurance policy for the benefit of the departing shareholder and their business trust will cease. The cover could then be put into a new personal trust to help the leaving shareholder's dependants mitigate against possible Inheritance Tax.

Where an automatic accrual arrangement exists, it's worth recommending co-partners buy appropriate life assurance so they have the necessary funds to repay any outstanding partnership loans when a partner dies.

The sum assured for each shareholder reflects the value of each shareholding in the business



How can a 'fair pay' premium be arranged?

The premiums payable by each partner will rarely be the same for each level of financial protection because partners will be of different ages and state of health and the size of their partnership share in the business may differ. Those standing a greater chance of benefiting could well pay the lowest premiums as a result. However, this can usually be overcome by arranging for the business to pay the premiums on each of the plans, and by making appropriate adjustments to each partner's share of the profits in order to compensate for the difference.

What are the tax implications for partnership protection?

The tax treatment of partnership protection will depend on the way insurance has been arranged.

The individual partner will pay premiums from their taxed income. If the partnership pays the premiums, they will be taxed as partnership business expenses, unless the premiums are deducted from the partner's capital, current or loan accounts (i.e. an account where tax has already been settled).

When a sum assured is paid under an Aviva Business Protection Term Assurance or Business Protection Critical Illness with Term Assurance plan, there is no Income Tax liability.

There will be no Inheritance Tax payable on premiums, provided the arrangements are regarded as commercial, with no element of gift.

Inheritance tax implications for proceeds of claim within a business trust

When initiated as part of a commercial partnership protection arrangement and written under a business trust, the proceeds of a claim made on an Aviva Business Protection plan are payable to the Trustees free from Inheritance Tax. The deceased partner's share of the business which is included in his estate is not viewed as cash. The Business Property Relief available on the value of this share is therefore preserved.

Trustees should be aware that a business trust fund will be treated as 'relevant property' for Inheritance Tax purposes. There could be an Inheritance Tax charge at each 10-year anniversary of the trust, based on the value of the property then held in trust. The value of the property will be, in the case of term assurance cover under Aviva Business Protection, the market value of the cover. However, the plan is not normally considered to have a market value unless the life assured is in ill-health at the time.

In the unlikely event of a tax charge arising, the 'effective rate' will not exceed 6% of the value of the trust property. When any property leaves the trust, it could be subject to a proportionate charge based on an appropriate fraction of the ‘effective rate’. Again, the charge will not exceed 6% (this is because of the proportionate charge being based on the previous periodic charge). If there is no periodic charge, there will be no exit charge either.

If the business is a family business, Inheritance Tax and Business Property Relief are unlikely to be affected as long as the arrangement is solely to protect the business and is arranged to protect only those with direct shareholdings.

Liability to Capital Gains Tax (CGT)

There is no CGT liability on the proceeds of a claim from a life or critical illness policy. However, there could be a liability on death for the beneficiaries of the deceased’s estate, depending on whether or not the partner’s share had increased in value between the date of death and sale of the share.

A CGT liability may arise if a partner’s interest is sold as a result of a critical illness.

Are there any tax advantages from an automatic accrual arrangement?

Yes. The deceased partner’s interest in the firm automatically passes to the surviving partners. That share of the firm will normally qualify for 100% Business Property Relief on a partner’s interest in their firm.

Summary of tax implications

	Are premiums tax-deductible (as a business expense)?	Are benefits taxable?	Is there anything else to consider?
Key Person Cover	If Anderson principles are met, yes.* If Anderson principles are not met, no.* If a sole trader, no.	If Anderson principles are met, yes.* If Anderson principles are not met, no.* If a sole trader, no.	If the key person owns a shareholding in excess of 5%, it is unlikely that tax relief on premiums will be allowed.
Business Loan Protection	No	No	No
Shareholder Protection	If the company pays, yes. But premiums will be assessed as a benefit for the shareholder, who will be required to pay Income Tax and National Insurance. If the shareholder pays, no.	No	Business Property Relief (BPR) can be preserved. An automatic accrual arrangement will usually qualify shares for 100% BPR.
Partnership Protection	If the partnership pays, yes. But premiums will be assessed as a benefit for the partner, who will be required to pay Income Tax and National Insurance. If the partner pays, no.	No	Business Property Relief (BPR) can be preserved. An automatic accrual arrangement will usually qualify shares for 100% BPR.

This summary assumes all arrangements have no element of gift and are regarded as commercial transactions. A cash injection may increase the value of shares, so can (indirectly) affect Inheritance Tax and/or Capital Gains Tax. Business trusts are treated as relevant property for IHT purposes, so benefits not used to purchase shares/interest and held in trust may be subject to a charge at each 10-year anniversary.

*The Anderson principles are: the sole relationship must be employer and employee; the policy is to cover loss of profits only; the policy is an annual or short-term insurance (five years or less).

The information provided above is for guidance only. Your client should consult a tax adviser or local tax inspector for a proper assessment of their tax position when purchasing business protection.

Submitting business with Aviva

Our easy-to-use online application helps you quote, submit, track and manage your protection business.

Quote and apply online: When you're ready to proceed, our online system makes it easy to save and recall quotes, edit quote details and submit multi-cover applications.

Customer-friendly underwriting: We've streamlined the application process, making it easier for you and your clients. We only ask for GP reports when we need them - in less than 10% of cases1 - which means you're less likely to get held up chasing medical evidence.
Our online system behaves just like a tele-underwriter – it's fair and flexible and won't load a premium or go for a GP report just because someone has slightly high blood pressure.

Track status online: Over one in three[1] of our cases receive immediate decisions. If we do have to refer to manual underwriting or request medical evidence, we'll tell you straight away. We'll also email you every time there's a change. You can also log in to check the status of your application whenever you need to know what's happening.

Write policies into trust online: With no wet signatures required, it's quick and easy to write policies into trust so your applications are less likely to get stuck in the pipeline. Aviva requires that, once completed, the trust document is sent directly to us.

What level of service can I expect?

The way we do things is not just about processing applications quickly. Our Premier Service team is made up of senior underwriters and administrators who are all experienced in dealing with high value and complex cases. Their role is to help you get your business protection cases on-risk quickly and smoothly by providing the specialist support these cases need at every stage of the application.

Pre-application support: You can discuss your client's individual circumstances with one of our senior underwriters before you go ahead and submit an application. They'll be able to tell you what medical and financial evidence is needed and give you indicative terms.

Post-application support: Our administrators will handle all follow-ups and customer correspondence for you once the case is submitted. This includes keeping you updated and helping you to get the case on-risk as quickly and as smoothly as possible.

Turnaround times: We aim to assess any application, case query or evidence received within two working days.

[1]Correct as at February 2023

Key Person Cover - specimen HMRC tax position letter

This letter can be used as a guide for businesses wishing to find out the tax position on a Key Person Cover policy from HM Revenue & Customs.

Please enter details where indicated, and delete/amend text in red as appropriate.

HM Inspector of Taxes
Address 1
Address 2
City/Town
County
Postcode

Dear Sir/Madam,

Key Person Insurance - NAME OF BUSINESS
Business Tax Reference: ______________________

We have recently effected/wish to effect Key Person insurance as follows:

- Insurer/policy ref: Aviva Protection UK Limited / PXXXXXXXXX
- Sum assured: £ ______________________
- Term of insurance: ______________________
- Premium: £ ______________________

The insured is a 'key person' within our business, and the insurance is intended to compensate it for the loss of profits which, in our opinion, will arise on their death or earlier terminal illness/critical illness. Their details are as follows:

- Name of insured: ______________________
- Job title: ______________________
- Shareholding: ______________________

Our understanding is that the premiums for this policy will/will not be an allowable deduction for Income Tax purposes, and therefore that the sum assured payable upon claim would be treated as a taxable trading receipt/non-taxable.

I would be grateful if you could confirm in writing that our understanding is correct.

Yours faithfully,

Signature here

Need this in a different format?
Please get in touch if you'd prefer this brochure (**EDCO1602**) in large font, braille, or as audio.

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protection.aviva.com

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