How To Protect The Value Of Your Business For Your Family

PENGUIN

Introduction

For those of you owning shares in a Company the value of those shares will, in most cases, be very important to you.

As with anything which is valuable to you, the reasons for seeking to Protect the value built up are considerable.

Yet very few Shareholders ever protect their share value.

This short guide aims to explain why you should make Plans to introduce such Protection. We will also outline an often-missed aspect to this arrangement. Plus, explain exactly how you need to put the Plans in place.

Why you should Protect the Share Value in your Business

Ask yourself the question, "What would happen to the shares on the death of a Shareholder?" If the answer is that they will be inherited by the deceased's next of kin, then the follow up questions are:

"Is this good for the other Shareholders?" "Is this good for the next of kin?"

"Good" is clearly, in this context, a subjective word to express the position. The point is this: in many, probably most, cases what the next of kin would like and what the surviving Shareholders would like is this:

The surviving Shareholders would like to take control of the shares.

The next of kin would like the cash value of the shares.

Rarely do both parties want to end up in Business together.

Plus you have to think that the death of a Shareholder could also negatively impact the value of the Shareholding.

If there is NO PROTECTION in place, then for the surviving Shareholders to gain control of the shares left to the next of kin, they will have to find the money to buy the shares.

This may be difficult, unpalatable, bad timing or could mean that the surviving Shareholders aim to force the price down (which is not palatable for the next of kin).

In the case of companies where there are more than two Shareholders, for example if there are four, what happens if one Shareholder dies and the remaining Shareholders want to buy the shares, but two can afford to do so and the other one can't?

You can see that in virtually all situations, the death of a Shareholder can create a very messy and unsatisfactory situation.

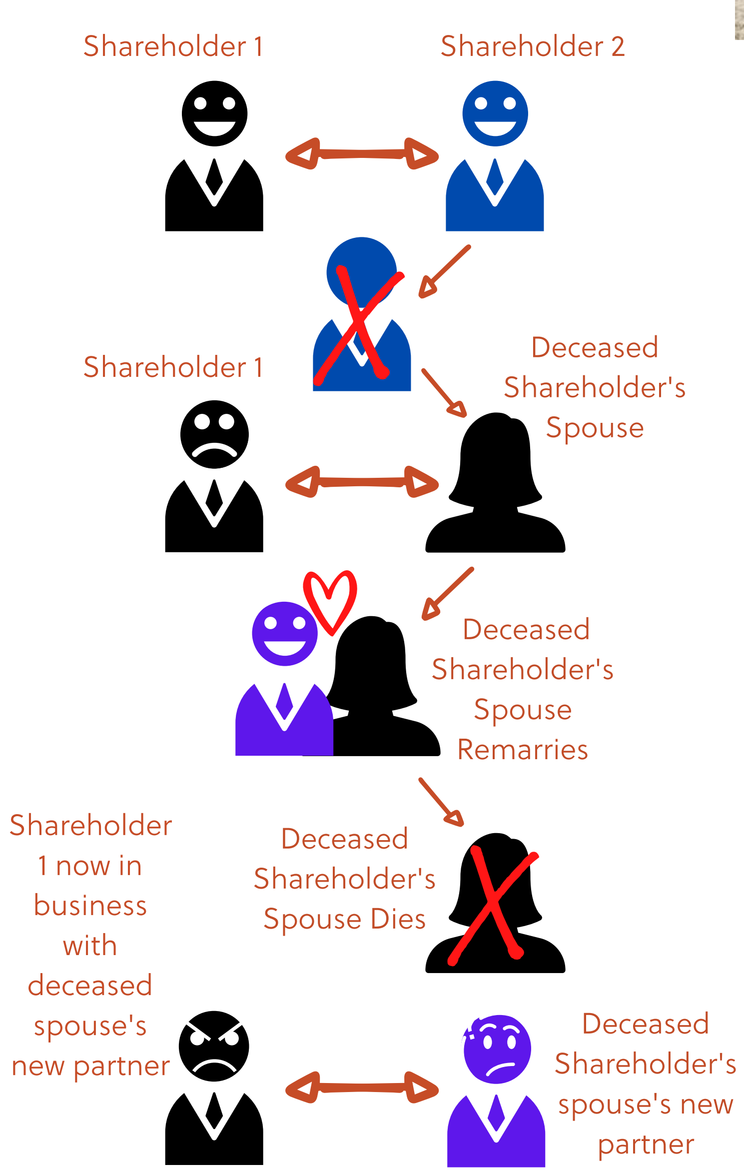
The answer to all this is to put into place Shareholder Protection Plans and to Insure the value of the Shareholding for each Shareholder.

An often-missed aspect (benefit) to putting Plans in place

Insure and Ensure

If you Insure your share value and put in place appropriate legal agreements to take care of the shares on death or on serious illness (see below for more about the legal agreements) then you Ensure monies are paid to your fellow Shareholders to buy-out your shares.

This looks after number one – your family in this case.



However, it also stops the possible side effect of the remaining Shareholders ending up in Business with an unwanted party.

Let us assume that you are in Business with another person, a fellow Shareholder. This presumably was a free choice, you both decided to hook up and be in Business together?

If one Shareholder dies and their shares are inherited by the deceased's spouse, now you have two Shareholders who did not choose to be in Business together.

This can get worse.

Assume now the deceased's spouse sometime later remarries. And then the deceased's spouse dies, whilst still holding the shares, now you could be in Business with your former partner's, partner's new partner.

You probably get the point! And see the picture forming here?

The death of a Shareholder can cause a serious disruption to the best laid plans and the best of relationships.

Shareholder Protection Insurance aligned with appropriate legal agreements not only places money into the right hands at the right time to protect the value of the Shareholding, but also automatically ensures the shares revert back to the remaining Shareholder(s). It is Protection all-round.

How to put Plans in place

The way forward for Shareholders is to arrange Insurance policies on each Shareholder for a sum equivalent to the value of that Shareholder's share value.

That sum (the life assurance amount) is then arranged to pay-out on death to the remaining Shareholders. **Not the next of kin.**

Concurrent to arranging the Insurance policies, the Shareholders also instigate a Cross Option Agreement, the legal arrangement we refer to above.

The Cross Option Agreement means that should a Shareholder die, the Insurance is paid to the remaining Shareholders and they have the right (through the Cross Option Agreement) to buy the shares from the next of kin and the next of kin has the right (option) to sell the shares at the pre-determined value or through some other formula pricing the shares at that point.

It is the combination of the Insurance pay-out and the legal agreement that takes **the cash value and places this in the hands of the deceased's next of kin and the shares into the hands of the remaining Shareholders.**

That is the basis of the Shareholder Protection Planning arrangement.

Our description here is 'top-level', the actual 'mechanics' of arranging this are slightly more complex. However, Penguin Wealth are specialists in this area and we can work through any Company situation, with any Shareholder split and/or particular requirements and construct a bespoke solution.

We have described this as a situation which applies to the death of Shareholder but in reality, the position can also be addressed to cover serious illnesses (which could force a Shareholder to leave the Company).

Likewise, there can be variable situations around how costs are met, for example in some situations the costs can be payable by the Company not the individual Shareholders and so on.

Penguin will help you work out the solution that fits your Company and individual circumstances perfectly and get the Protection in place that works for the Company, the Shareholders and the next of Kin, the Families of the Shareholders.

The Case Study

A Penguin client owns a chain of coffee shops, situated in different locations across the UK. The current market value of the Company is £7.25 million. It is owned and managed by three siblings.

The Shareholders recently decided they would like to put a Business Succession arrangement in place. Should one of them die, the surviving Shareholders would like to be in the position to buy the deceased's Shareholding from his personal Beneficiaries.

Buying the shares would allow them to maintain control and full ownership of the Company, avoiding the shares falling into the hands of a third party. In turn, the deceased's Beneficiaries will receive cash according to the market value of the shares. The shares currently attract Business Property Relief (BPR). The Shareholders want to ensure the arrangement they put in place is efficient from an Inheritance Tax (IHT) perspective on their death.

The Remedy

The Shareholders take advice and execute a Double Option Agreement, giving their personal representatives the option to sell the shares and the surviving Shareholders the option to buy these. As this is not a binding contract for sale, the shares should continue to attract BPR.

Mutual Understanding

Each of the Shareholders apply for an own life policy and place this in a Business Trust for the benefit of the other Shareholders. Due to the reciprocal nature of this exercise, with each Shareholder setting up a Trust in return for the others doing the same, it is vital the arrangement is fully commercial to avoid invoking the associated operations provisions. If the arrangement does not qualify as an arm's length transaction, it will be viewed as a Gift with reservation. As a result, the value of the Trust fund will form part of the deceased Shareholder's IHT Estate on death.

Access All Areas

Each policy is issued to Trustees from the outset. The ongoing premium payments will not be considered Gifts, where the arrangement is fully commercial. The settlor is included as a Beneficiary under the Trust. This allows him to access the policy when he no longer owns shares in the Company, as this might be at a time when he is otherwise uninsurable.

Under normal circumstances if the settlor is a potential Beneficiary under a Trust and is paying the premiums to maintain a life policy, this would be classed as a Gift with reservation of benefit. However, if the premiums qualify as exempt transfers due to the commercial nature of the arrangement, the IHT benefits of the arrangement should be maintained even if the settlor is a potential Beneficiary.

Practising precautions

Taking the following actions should help:

- The Beneficiaries on the Business Trust should be limited to the settlor and other Shareholders only. They should not include other family members unconnected to the Company.
- The Beneficiaries should be restricted to only those Shareholders who are taking part in the arrangement and taking out similar cover in a Business Trust. This way there is no element of gifting taking place.
- They should make sure the level of cover is adequate and keep this under review. If the cover is too low, the other Shareholders will have to fund the shortfall. If it is too high then arguably the Shareholders stand to get gratuitous benefits or something for nothing. This could have a negative effect on the commerciality of the arrangement.
- Older Shareholders and those in poor health pay higher premiums to maintain their policy, but stand less chance of receiving benefits.
- The Shareholders should consider equalising the premiums they pay to make sure they each bear a cost proportionate to their likelihood of benefiting under the arrangement.
- The Shareholders should make cash adjustments between themselves to rectify the position.

About Penguin Wealth

Our Mission Statement:

The (Financial) Journey Never Ends......One Life. Live It Well.

Plan - What's Your Number?

Life is precious, living it well does not come from having lots of money, it comes from contentment, family, friendships, giving and giving back, good health and achieving success (which is defined in different terms for different people). Money or Wealth is simply the means to the end.

We build a Plan, individual to you, linking your goals, your values and your Finances together.

Perform - One Life, Live It Well

Implementing and Maintaining the Plan is vital. This includes taking on the responsibility of looking after your requirements day in, day out.
For someone in Business this frees up your time to focus on your Business, for those of you with family, it allows you to enjoy time with your family, for those wanting to pursue ambitions and passions, you can be free to spend your time on what you love doing.

Protect - We are the 2nd most important professional you will need

We help you cover all eventualities by protecting you from life's curve balls – keeping you on track to fulfil your goals and dreams, no matter what happens.
Your Planning is only complete when you have ensured that the unexpected is catered for.

Plan – Perform - Protect

Mapping out the future to meet your widest life goals is all about taking the right steps now, making sure your Plan is managed through the years that follow and that all your Plans have an inbuilt Protection for you, your family and your Business. It is about integration and the best support, at all stages, from the best specialists.

We help you achieve all of the above via a mixture of:

- Financial Forecasting (cashflow for your personal life)
- Saving Tax
- Maximising returns on capital
- Managing all your risks for and with you
- Reviewing your Plans and goals
- Working alongside your other professionals
- Supporting your Family Unit

Penguin is a Cardiff based Financial Planning firm that was formed in 2010. Our principles are reflected by our processes, our support team and the accreditations that we have achieved – all of which ensure that we are best placed to help you live the life you deserve.

We were the first firm in the UK to become CISI Accredited, CII Chartered and BS8577 Certified, showing that we "demonstrate the highest professional standards of financial planning service and advice", "our clients are at the heart of our business" and that we ensure our staff members acquire and retain the necessary knowledge and skills to deliver the highest quality advice".

For further information about Penguin Wealth and to meet the team please visit our website www.penguinwealth.com/team.

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