



our guide to
business protection
for advisers

Welcome to our guide to business protection. With useful information on how to calculate and set up cover to providing sample letter text for the taxman, this step-by-step guide will help you to protect your client's business.

contents

Section 1

- 3 key person and loan protection
- 4 calculating the cover
- 5 how to set up the cover
- 8 other considerations

Section 2

- 9 ownership protection
- 10 individual purchase
- 12 company purchase
- 13 automatic accrual
- 14 equalisation of premiums
- 15 calculating the value

Section 3

- 16 a combined approach

Section 4

- 19 information we may ask for

Section 5

- 21 taxation
- 21 key person and loan protection
- 25 ownership protection
- 28 sample letters to HM Revenue and Customs

Section 6

- 31 Bright Grey's Business Protection Menu
- 32 the options available
- 34 instant cover

Section 7

- 37 our Helping Hand service
- 38 keeping your client's business on track
- 40 literature available

helping you to **protect** your client's business

Most businesses understand the need to manage the risks they face every day. They insure their premises, equipment and stock against fire, flood and theft. They insure their vehicles. But many don't stop to think what would happen if they lost their most important asset – their people.

The fact is many small and medium-sized businesses **rely on certain key people**. It could be the sales manager, whose contacts and relationships with customers make sure that sales remain on target and the business is profitable. Or it could be a designer responsible for the development of new products. Without these people the business could suffer serious financial loss, or even have to stop trading altogether.

But it's not just about the loss of profit a business could suffer. What would happen if one of the owners died or suffered a critical illness? Who would take their place in the boardroom? Would that person have the skills necessary to fill the role? Would they want to?

Business protection is designed to protect businesses against the effects of losing one of their key people or one of the owners through death, critical illness or temporary disability. There are many businesses without any cover at all. The business protection gap is currently around £1.1 trillion in sums assured.¹

This guide explains the options available and gives you an excellent **opportunity to help your clients** find the right cover to meet their needs.

Sources

¹ Research commissioned through the British Chamber of Commerce, 2009.

² Office for National Statistics, October 2009.

4.8 million

is the estimated number of business enterprises in the UK at the start of 2008.²



key person and loan protection

key person and loan protection	3
calculating the cover	4
how to set up the cover	5
other considerations	8

1

You will find that the success of almost all small and medium-sized businesses is dependent on a few people who make a significant contribution.

These key people can include the owners, senior directors, sales people, production managers, research and development staff or other people with specialist skills or knowledge.

Often a person's value to the business is reflected in their remuneration package. When you are trying to identify the key people this can be a good place to start, although this may not always be the case.

Whatever the key person does, their loss could have disastrous consequences for the business. Some of the problems the business may face are:

- Loss of profits.
- The need to recruit or train a replacement.
- Loss of important personal or business contacts.
- Difficulties in meeting existing loan repayments.
- Loss of confidence from suppliers and customers.
- Difficulties in raising new finance for new developments.
- Loss of detailed knowledge of the businesses processes and systems.
- Having to repay a loan the key person has made to the business.
- Loss of goodwill.

Having the right protection in place can help to ease all of these problems. Bright Grey's Business Protection Menu is **designed to provide a cash injection** if the key person dies or suffers a critical illness. It can also provide a regular income for the business if the key person is temporarily disabled and unable to work.

It can't stop the unthinkable from happening, but it can make dealing with the consequences a little easier.

Source

¹ Office for National Statistics, October 2009.

99.3%

of business enterprises in 2008 were classed as small, having 0 to 49 employees.¹

key person and loan protection	3
calculating the cover	4
how to set up the cover	5
other considerations	8

calculating the cover

There are no hard and fast rules when assessing the financial value of a key person. Each key person must be dealt with on their own merits.

There are several options available to guide you in assessing a reasonable amount of cover, and these are outlined below.

Multiple of profits

As one of the main objectives of key person cover is to protect the profitability of the business, looking at profit is a sensible first step.

The normal multiples would be as follows, although higher multiples may be justified for a rapidly expanding business:

- 2 x gross profit, or
- 5 x net profit.

However, these would be the upper limits on the business as a whole. So where there is more than one key person, cover would need to be apportioned according to each person's contribution.

Multiple of salary

A multiple of gross salary including benefits in kind can give a useful guide to the amount needed to recruit a replacement. Between 7 and 10 x gross salary may be considered. While this could be a useful guide for non-shareholding employees, care needs to be taken with shareholders who may be taking a reduced salary to build the business or taking dividends for tax reasons.

Proportion of salary roll

This method covers the key person's contribution to turnover. In a similar way to the multiple of salary route, a shareholding key person may show salary that is artificially low so care needs to be taken. The formula used would be:

**Key person's salary x turnover x years
to recruit and train a replacement**

Total salaries

Loan security

Any outstanding business loans will need to be covered (apportioned between the relevant key people as appropriate). As well as the lender usually requiring this cover, many directors may have given personal guarantees and/or used their own residential home as security, so there is the added need to ensure that dependants are protected.

Directors may well have made loans to the company themselves either by making a cash injection or leaving salary, bonus or dividends in the business. These are known as director loan accounts. On death they become repayable to the estate of the deceased key person and therefore need to be included in the sum assured. On critical illness the repayment of such a loan would give the director much needed personal financial security.

In a partnership there may be similar loan accounts owed to individual partners and these need to be covered in the same way.

Special circumstances

Business start-up

When a company starts up it requires working capital. This can be at risk until profit flows have stabilised. So it is sensible to cover the key person's proportion of this risk.

Management buyout

A management buyout will often be financed by a bank or venture capitalist. This could be through a loan or equity finance. Either way the providers of the finance will want to protect their investment by covering the proportion each key person is liable for. As with any loan there is also the question of any personal security that has been offered and the need to protect dependants.

These guidelines should help advisers work out the appropriate level of cover. But all businesses are different and their needs will be particular to their own circumstances.

key person and loan protection	3
calculating the cover	4
how to set up the cover	5
other considerations	8

how to set up the cover

Each type of business needs a different solution.

Limited companies

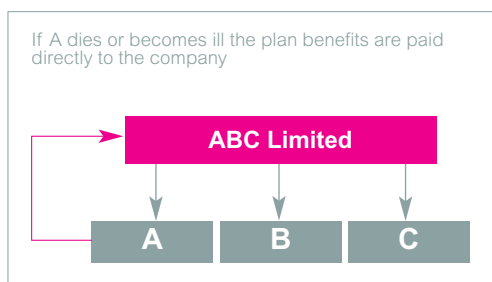
There are 2 solutions that can be considered for key person and loan protection for companies.

Life of another

The company takes out a 'life of another' plan on the key person. The Bright Grey Business Protection Menu allows you to combine Life Cover, Critical Illness Cover and Life or Critical Illness Cover into one plan that suits each company's particular needs. Then, if the key person suffers a critical illness or dies, the benefits would be paid directly to the company. These funds can be used to meet the company's financial needs while it reorganises or recruits a replacement. In the case of a critical illness claim it is possible the key person will return to work, so the funds could be used to pay for a temporary replacement or replace lost profits (see chart below).

Key Person Income Cover for Sickness could also be taken out. This provides a regular payment if the key person is absent through illness or an accident for any length of time. The income can be used to compensate for loss of revenue, to fund loan repayments, to pay a temporary replacement or to fund sick pay for the key person. Key Person Income Cover for Sickness differs from Personal Income Cover for Sickness in that the cover limits are higher.

Key Person Income Cover for Sickness can cover up to 75% of the gross profit that would be lost if the key person was no longer there. Income Cover for Sickness will only cover 50% of the key person's salary. And as the cover is to finance the short-term loss of profit caused by the loss of a key person the maximum payment period is 5 years. It is therefore not suitable as a long-term salary replacement vehicle.



Own life in trust

If the key person is a shareholding director they can take out a plan on their own life, written under a Bright Grey business trust for all of the other shareholders. Should the key person die or suffer a critical illness the other shareholders will receive the benefits provided by the plan, through the trustees.

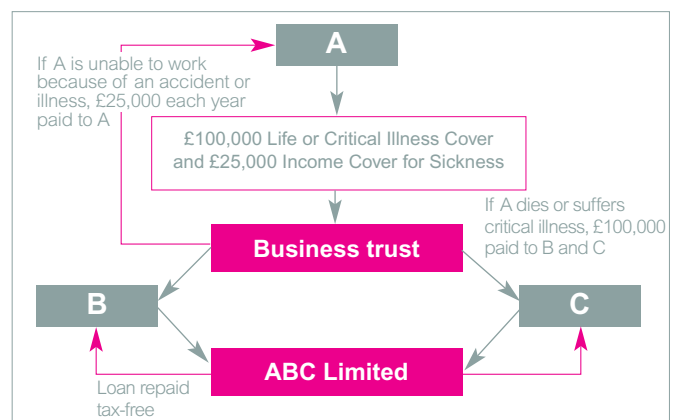
The shareholders can then lend the benefits to the company to offset the potential loss of revenue while they reorganise or recruit a replacement. This is done by creating or increasing directors' loan accounts.

The key advantage of this method is the extra flexibility it offers as the other directors can choose when the money is loaned and how much of it they use. Because the money has only been loaned to the company, once the business is back on its feet again it can be withdrawn at any time without any tax liability.

The downside of this is the cost because the premiums have to be met from post-tax income. Or if the company pays, the premiums would be treated as income in the hands of the shareholders. There is more detail about the tax treatment within the taxation section on page 21.

Each shareholder could also take out Income Cover for Sickness to protect their income if they are unable to work because of illness or an accident. The Bright Grey business trust makes sure that this cover is always payable for their benefit rather than the other shareholders (see chart below).

Key Person Income Cover for Sickness should not be taken out using this method as the benefits would be payable to the ill shareholder instead of the company. If Key Person Income Cover for Sickness is needed, this should always be applied for as a life-of-another plan.



1

key person and loan protection	3
calculating the cover	4
how to set up the cover	5
other considerations	8

Partnerships

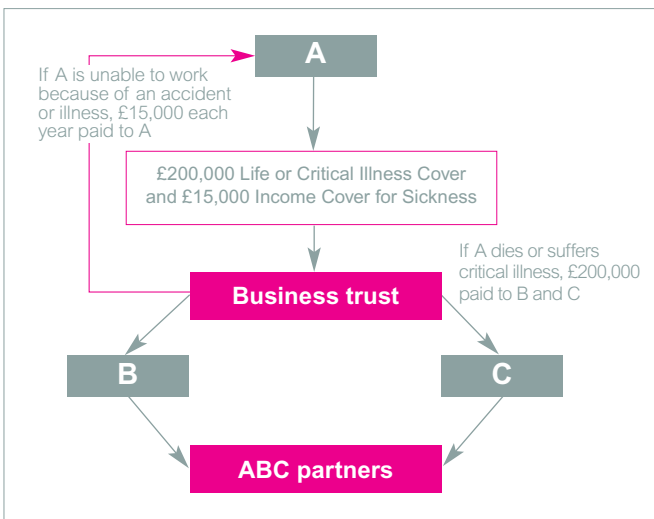
Partnerships in England, Wales and Northern Ireland do not have a separate legal entity. This means they cannot enter into a contract in the same way a limited company can, so a different approach is needed.

There are 2 different key person needs affecting partnerships.

A partner

Each partner takes out a plan on their own life which is written under the Bright Grey business trust for their co-partners. If one of the partners suffers a critical illness or dies, the plan benefits are paid, through the trustees, to the remaining partners. They can then be invested in the firm once the future of the deceased or ill partner's share has been decided (see chart below).

Each partner could also take out Income Cover for Sickness to protect their income if they are unable to work because of illness or an accident. The Bright Grey business trust makes sure that this cover is always payable for their benefit rather than to the other partners.



An employee

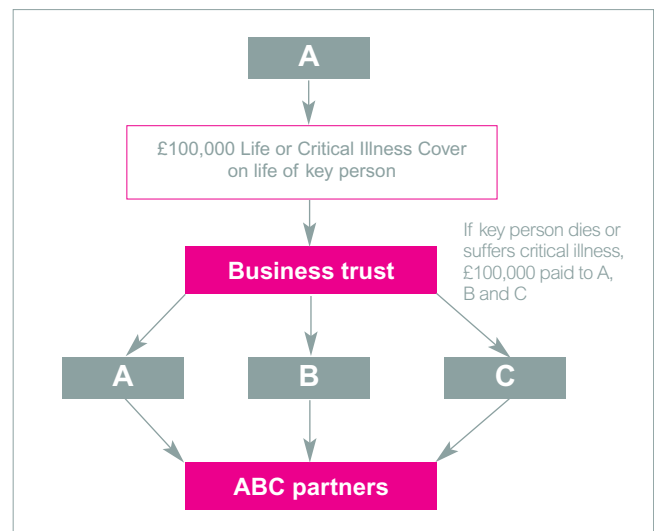
If the key person is not a partner, but is employed by the partnership, then one or more of the partners needs to take out a life-of-another plan on the key person written under trust for all of the partners. If the key person suffers a critical illness or dies, the partners will receive the benefits provided by the plan, through the trustees.

Alternatively if there are only 2 or 3 partners, each partner could take out a life-of-another plan on the life of the key person. The amount of cover for each would be their proportion of the overall loss the partnership would suffer following the loss of the key person.

These funds can then be used to meet the firm's financial responsibilities while it reorganises or recruits a replacement. In the case of a critical illness claim it is possible the key person will return to work, so the funds could be used to pay for a temporary replacement, or replace lost profits (see chart below).

Key Person Income Cover for Sickness could also be taken out in the same way to provide a regular payment if the key person is absent through illness or an accident for any length of time. This income can be used to compensate for loss of revenue, to pay a temporary replacement or to fund sick pay for the key person.

In Scotland a partnership is a separate legal entity and can take out the plan itself.



key person and loan protection	3
calculating the cover	4
how to set up the cover	5
other considerations	8

Sole traders

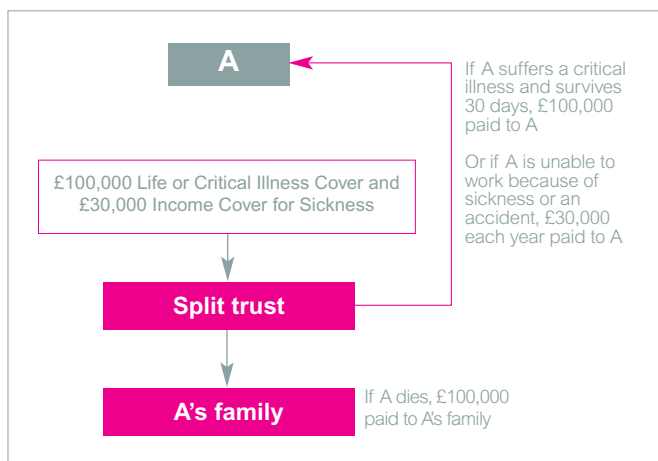
There are 2 key person situations a sole trader may need to protect against.

The sole trader

The solution for a sole trader is to take out a plan on their own life with both Critical Illness Cover and Life Cover. The plan is written under a Bright Grey split trust with their family as the beneficiaries. If the sole trader suffers a critical illness the plan will pay them the benefits if they survive the illness by 30 days. The sole trader can then meet the financial responsibilities of the business, change their lifestyle if necessary and safeguard the future of their family.

In the event of the sole trader's death the plan will pay the benefits to their family allowing them to meet the financial responsibilities of the business and safeguard their future financial wellbeing. If the family decide to continue the business after the sole trader's death, the benefits from the plan can help considerably.

Income Cover for Sickness could also be taken out to provide a regular payment if the sole trader was unable to work through illness for any length of time. This income could be used to compensate for lost profit or to pay a temporary replacement (see chart below).

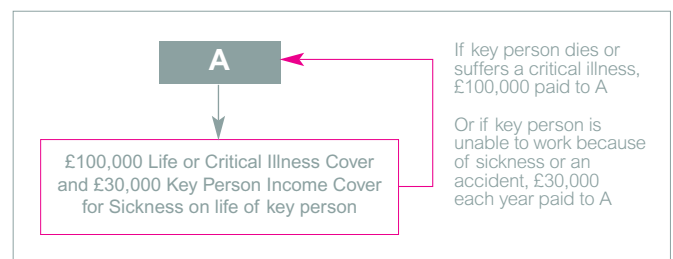


An employee

In addition to being a key person, the sole trader may employ someone who is also key to the success of the business. The loss of this person could have the same impact on a sole trader as it could on any other business.

The solution for the sole trader is to take out a 'life-of-another' plan on the key person. In the event of the key person suffering a critical illness, dying or being unable to work due to long-term illness, the sole trader will receive the benefits of the plan. These funds can then be used to meet the sole trader's financial responsibilities while they reorganise or recruit a replacement. In the case of a critical illness claim it is possible the key person will return to work, so the funds could be used to pay a temporary replacement or replace lost profits.

Key Person Income Cover for Sickness could also be taken out to provide a regular payment if the key person is absent through illness for any length of time. This income can be used to compensate for loss of revenue, to pay a temporary replacement or to fund sick pay for the key person.



key person and loan protection	3
calculating the cover	4
how to set up the cover	5
other considerations	8

Limited liability partnerships (LLP)

A partnership created under the Limited Liability Partnership Act 2000 is effectively halfway between a limited company and a partnership, while the taxation of the individual partners is similar to a traditional partnership. Their individual liability is limited to the amount they have subscribed to the partnership.

In a similar way to a limited company, a limited liability partnership has its own legal persona and can contract in its own name. Therefore it can take out policies for Life Cover, Critical Illness Cover, Life or Critical Illness Cover and Key Person Income Cover for Sickness on the life of the key person or member in the same way a limited company can.

This business format is becoming increasingly common, especially among professional practices such as accountants and solicitors.

other considerations

Board/partners'/members' resolution

Before taking out the cover the business should record its intentions in the minutes of a board, members or partners meeting. Suggested wording is shown below but this should be amended to suit each client's requirements.

Company resolution

'RESOLVED THAT the company shall effect a protection plan on the life of <name of key person> for the amount of <amount of cover> payable on death <or diagnosis of a critical illness>.

The plan is being taken out solely for the purpose of protecting the company against the financial loss to the company likely to arise in the event of <his/her> death <or being diagnosed with a critical illness> while in the service of the company and is not intended for the benefit of <key person name> or <his/her> family.'

Members' resolution

'RESOLVED THAT <the limited liability partnership>("the LLP"), shall effect a protection plan on the life of <name of key person> for the amount of <amount of cover> payable on death <or diagnosis of a critical illness>.

or

'RESOLVED THAT <name of key person> shall effect a protection plan on <his/her> life for the amount of <amount of cover> payable on death <or diagnosis of critical illness>. The plan shall immediately be placed under trust for the benefit of the present members of <name of LLP>("the LLP") other than <name of key person>

and

'The plan is being taken out solely for the purpose of protecting the LLP against the financial loss to the LLP likely to arise in the event of <his/her> death <or being diagnosed with a critical illness> while in the service of the LLP and is not intended for the benefit of <name of key person> or <his/her> family.'

Partners' resolution

'RESOLVED THAT <name of key person> shall effect a protection plan on <his/her> life for the amount of <amount of cover> payable on death <or diagnosis of a critical illness>. The plan shall immediately be placed under trust for the benefit of the present partners in the firm of <name of partnership> other than <name of key person>.

The plan is being taken out solely for the purpose of protecting the firm against the financial loss to the firm likely to arise in the event of <his/her> death <or being diagnosed with a critical illness> while in the service of the firm and is not intended for the benefit of <name of key person> or <his/her> family.'

Confirmation of tax position

General guidance on the tax position of key person protection plans is given later in this guide. But the actual treatment is dependent on the specific circumstances of each business. Your client should therefore attempt to get written confirmation from their local Inspector of Taxes as to how any plan they take out will be treated for tax purposes. A draft letter to HM Revenue and Customs is included within the taxation section on page 28.

ownership protection

ownership protection	9
individual purchase	10
company purchase	12
automatic accrual	13
equalisation of premiums	14
calculating the value	15

2

The loss of a partner, member or shareholding director can have a major impact on the success of a business in terms of ensuring continued control for the remaining owners.

However, we also need to think of the effect on the dependants of a deceased owner, or the position of a critically ill owner who might wish to leave the business.

The potential problems that might arise can depend on the business type, the size of the business share, and the procedures laid down in the articles of association or the membership or partnership agreement if there is one.

For example, if one of the owners of a limited company becomes critically ill or dies:

- They or their family might want to sell their share of the business. This could be to a competitor or some other unsuitable buyer. If the owner was a majority shareholder then control of the business has been lost.
- If the outgoing owner had at least 75% of the shares then they could also force the outright sale or winding up of the business.
- Perhaps the owner's family may wish to become involved in the business, which may be at best disruptive or at worst unacceptable to the other owners. A majority shareholding allows the new owner to appoint themselves as a director and remove other directors, gaining day-to-day control of the business.
- The other owners may have to use funds they intended for other purposes to buy the share of the deceased or ill owner.

In a partnership the existence of a partnership agreement will be important:

- If there is no agreement then the Partnership Act 1890 will dictate what happens. If a partner dies then the partnership has to be wound up and their estate will usually require the partnership share to be paid out.

The existence of a membership agreement will also be important for a LLP:

- If there is no agreement the Limited Liability Partnership Act 2000 will dictate what happens. If a member dies and their membership interest passes to someone else, the other person may not interfere with the management of the business, but they will be entitled to receive anything that would have been due to the member.

If there is an agreement:

- Then it should dictate how the share is to be paid out to the estate or a retiring partner or member. Typically this might mean payment over a 5-year period.

In any of these situations the need to find a large cash sum would come at a time when the business is also suffering the financial impact of losing a key partner or member.

So it is important that, if this happens, plans are in place for the remaining owners to be able to buy a critically ill or deceased colleague's share of the business.

The aim in setting up this cover is to ensure:

- The remaining business owners retain continued control of their business
- The estate of the deceased owner, or the outgoing critically ill owner, gets fair value for selling their share of the business
- The arrangement is set up in a tax-efficient manner

There are several ways this can be done, depending on the type of business, which are explained over the page.

ownership protection	9
individual purchase	10
company purchase	12
automatic accrual	13
equalisation of premiums	14
calculating the value	15

individual purchase – companies, LLPs and partnerships

The first solution is for each owner to take out a protection plan on their own life for the value of their share of the business. This plan is written under the Bright Grey business trust for their co-owners. All owners enter into an appropriate agreement. If one of the owners suffers a critical illness or dies, the others would receive the funds to purchase the ill or deceased owner's share from the owner or his personal representatives.

The deceased's personal representatives would distribute the proceeds in accordance with the deceased's will or the rules of intestacy.

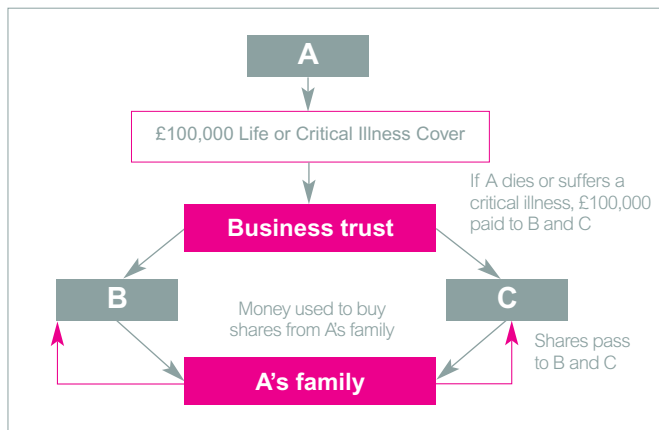
Alternatively, if there are only 2 or 3 owners it is possible for each owner to take out a life-of-another plan on the lives of each of the other owners. If one of the owners dies or suffers a critical illness, the plan would pay out directly to the other owner. They would therefore have the money available to buy the ill or deceased owner's share of the business.

Using the Bright Grey Business Protection Menu you can have separate amounts of cover for 2 different people in the same plan. For up to 3 owners they could therefore take out cover using this method with only one quote, one application and one plan charge for each owner. However, this route would not be appropriate if there are more than 3 owners or it is likely the ownership will change in the future. In these circumstances own life policies written under the Bright Grey business trust should be used.

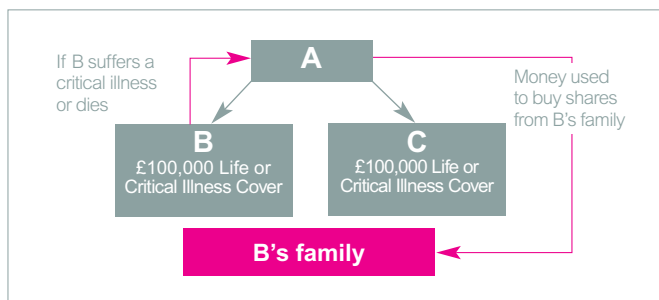
The trust

The Bright Grey business trust has been designed specifically for use with business protection plans. The trust is a fully discretionary trust giving the flexibility to automatically add any new partner, member or shareholder who joins the business and remove any partner, member or shareholder who leaves.

The plan **MUST be written in trust from inception.** Please see the taxation section on page 22 for a full explanation.



OR



ownership protection	9
individual purchase	10
company purchase	12
automatic accrual	13
equalisation of premiums	14
calculating the value	15

The cross option agreement

An appropriate agreement is needed between the shareholders for the disposal of shares on death or critical illness. It must not be a binding agreement for sale otherwise business property relief from inheritance tax will not be available. There is further information on business property relief in the taxation section.

The business's legal adviser should draw up the cross option agreement to make sure it does not conflict with the articles of association or an existing partnership or membership agreement. The agreement works by creating a 'sell' option for each owner in the event of their death and/or critical illness and a 'buy' option for the co-owners in the event of death only. The exercise of the sell option will mean the surviving owners must buy the dead or critically ill owner's share; the buy option will require the deceased owner's personal representatives to sell the deceased's share to the surviving co-owners.

If the arrangement is to include options on critical illness your clients need to consider whether they only want an owner who suffers a critical illness to have a single option allowing them to sell, or if they also want the other owners to have an option to buy.

If they choose a single option on critical illness, the owner who suffers a critical illness cannot be forced out of the business against their will. This gives that owner the opportunity to continue in the business if they recover and are able to return to work. But it also means that if they are unable to return, the remaining owners have no right to buy their share of the business. This could mean that the ill person is still entitled to their share of any profit even though they are no longer contributing to the business.

Alternatively, your client could choose to include a double option in the event of a critical illness. However, this would operate differently to the cross option on death. In the event of an owner suffering a critical illness, they have an immediate option to sell. If they exercise that option the other owners must buy that share of the business. But the other owners would not be able to force the ill owner out immediately. Instead they would have an option to buy only if the ill owner does not return to their normal duties within a specified period, usually 12 months. This gives the ill owner the opportunity to return to the business if they are able, and the other owners the security of being able to remove an owner who is no longer able to contribute.

A specimen cross option agreement for consideration by the business' legal advisers and a specially designed business trust along with a comprehensive guide on how to complete the form, are available from the literature section of our website www.brightadviser.co.uk or can be ordered at www.brightadviser.co.uk/literature

ownership protection	9
individual purchase	10
company purchase	12
automatic accrual	13
equalisation of premiums	14
calculating the value	15

company purchase – companies only

The second solution is for the company to purchase the shares of the deceased or ill shareholder. The result of the share buyback is that the shares purchased are cancelled and revert to unissued share capital. The actual number of shares of the remaining shareholders remains the same, but the proportion of the issued share capital that each shareholding represents increases.

Company share purchase must be permitted by the articles of association, and is subject to a number of conditions. The most important of these are outlined below. You should refer to the Companies Act 2006 Part 18 for full details.

The general rule is that any purchase of a company's own shares must be made out of the distributable profits of the company or out of the proceeds of a fresh issue of shares made for the purpose of the purchase.

Subject to stringent requirements a repurchase of shares out of capital reserves may be allowed. Such a capital payment may only be made after all distributable profits have been exhausted and is made by reference to 'relevant accounts'. The directors must also make a statement and the auditors will be required to report to the directors whether they feel a purchase out of capital is acceptable given the financial position of the company.

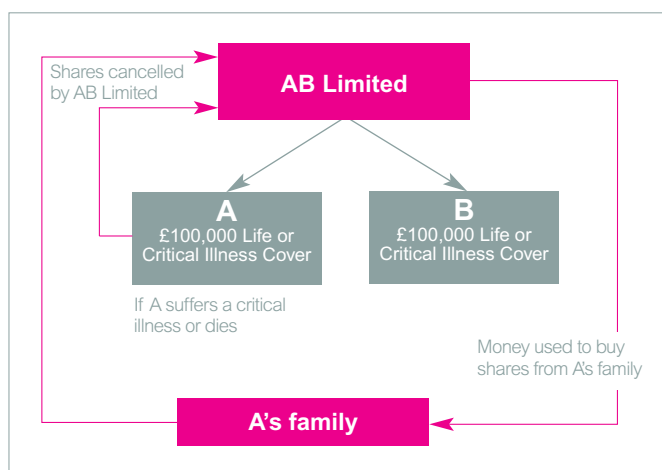
The company and each shareholder individually enter into an appropriate agreement that would provide for the purchase of the shareholder's shares on death or critical illness. At the same time the company takes out Life or Critical Illness Cover on the shareholder, the sum assured of which would pay for the share purchase.

The cross option agreement

An appropriate agreement is required between the shareholder and the company for the disposal of shares on death or critical illness of the shareholder. Separate cross option agreements may be required for each shareholder.

The company's legal adviser draws up a cross option agreement. The agreement works by creating a 'sell' option for the shareholder in the event of their death and/or critical illness and a 'buy' option for the company in the event of death only. The exercise of the sell option will require the company to buy the dead or critically ill shareholder's shares. The buy option will require the deceased shareholder's personal representatives to sell the deceased's shareholding to the company.

This is subject to meeting the relevant company law requirements. This may mean that even with the agreement and protection plans in place the purchase and sale of the shares cannot take place. A specimen cross option agreement for consideration by the company's legal advisers is available from the literature section of our website www.brightadviser.co.uk or can be ordered at www.brightadviser.co.uk/literature



ownership protection	9
individual purchase	10
company purchase	12
automatic accrual	13
equalisation of premiums	14
calculating the value	15

automatic accrual – partnerships and limited liability partnerships only

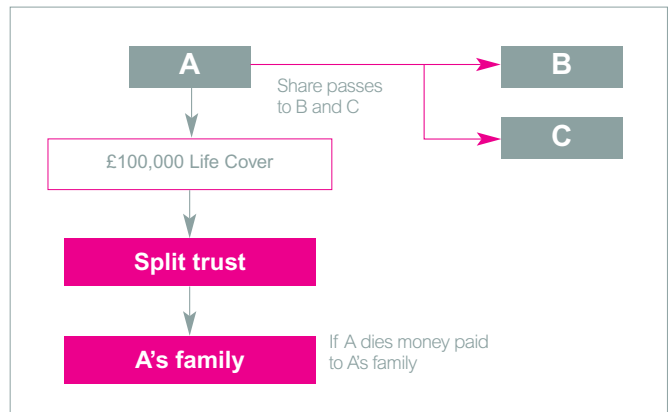
This arrangement would usually provide that on the death of a partner or member their interest (or more commonly the value of the goodwill) would pass automatically to the remaining partners or members. The deceased’s family receives no payment for that interest or goodwill. The family is compensated for the loss of this interest by a protection plan set up by the partner or member on their own life.

An automatic accrual agreement should include an undertaking by each partner or member to maintain a protection plan on their own life to the value of their share.

The protection plan should be written under the Bright Grey split trust for the partner’s or member’s family. This will avoid the cover falling within their estate for inheritance tax and the delays that accompany the probate process.

Automatic accrual arrangements may also cover retirement. This will need to be taken into account in planning for future financial security.

Automatic accrual agreements are commonly found in professional practices, where goodwill forms a significant part of the value. However, it is important to note that these agreements usually ignore the value of the partner’s or member’s, capital account and any loan accounts that are outstanding. These can sometimes be substantial and it will often be necessary to consider appropriate protection plans for co-partners or co-members to provide the necessary funds that are needed to repay any partnership or membership loan account that is still outstanding on a partner’s or member’s death.



ownership protection	9
individual purchase	10
company purchase	12
automatic accrual	13
equalisation of premiums	14
calculating the value	15

equalisation of premiums

Where each of the shareholders, members or partners has set up trust plans for share purchase, it is possible to make an equitable arrangement to even out any differences between the premiums that each is paying.

The partners, members or shareholders may agree to equalise costs according to the potential benefit each may receive. Equalisation removes the inequality of an older or more significant shareholder, member or partner paying more for cover than younger or more minor shareholders, members or partners, while gaining less benefit.

Equalisation brings about a fair distribution of costs. In addition, where there are significant differences in the costs and benefits there is a danger that HM Revenue and Customs might view this inequality as conveying a 'gift' from one partner or member to another. If so, the arrangement may not be considered commercial and the premiums and policy proceeds would go back into the estate for inheritance tax purposes. This danger is particularly acute in family companies, especially in generational arrangements such as parent and child where HM Revenue and Customs will be more likely to assume there is an intention to gift.

For example:

ABC Ltd. share capital £200,000

Shareholder	Age	Share	Value +£	Premium
A	51	40%	£80,000	£740
B	41	30%	£60,000	£210
C	31	30%	£60,000	£200

If A dies, B and C will be entitled to purchase his share of the company between them on a proportionate basis. The portion each can buy is:

own holding

joint holding of remaining shareholders

As they hold 30% each they are entitled to purchase one half each ($30/(30+30)$) of A's shares. Therefore A's premium should be paid 30/60ths by B and 30/60ths by C.

If B dies, a similar situation arises except that A owns 40% and C owns 30%, therefore A will be entitled to purchase 40/70ths of B's shares and C 30/70ths.

If C dies, A will be entitled to 40/70ths and B 30/70ths.

It is therefore equitable if the share of the total premiums actually paid is related to the potential benefits each receives.

In A's case: $(40/70 \times 210) + (40/70 \times 200) = \text{£}234.29$

In B's case: $(30/60 \times 740) + (30/70 \times 200) = \text{£}455.71$

In C's case: $(30/60 \times 740) + (30/70 \times 210) = \text{£}460.00$

To help you provide these figures for your clients we have developed an equalisation calculator. You can find this on our website at www.brightadviser.co.uk

In summary:

Theoretically each shareholder is responsible for paying his or her own premium. They then arrange to equalise the costs by working out the difference between what they are actually paying and what they should be paying:

B to pay A $\text{£}455.71 - \text{£}210.00 = \text{£}245.71$ a year and

C to pay A $\text{£}460.00 - \text{£}200.00 = \text{£}260.00$ a year

Note: The above premium figures are for illustration purposes only. Full details and individual quotations are available on request.

ownership protection	9
individual purchase	10
company purchase	12
automatic accrual	13
equalisation of premiums	14
calculating the value	15

calculating the value

Valuing a business is a difficult task. The sensible course of action is to involve the business's other professional advisers, their solicitor and accountant, to find the most appropriate valuation method.

Companies

In valuing a company always refer to the company's articles of association to see what, if any, restrictions there are on the transfer of shares and if there is a valuation clause included. The number 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. The valuation methods could range from allowing the company's auditors or an expert valuer to fix the price or putting a fixed price on any transfer, for example £1 per share.

There are however 3 commonly used methods. These are:

1. Dividend yield

By applying the level of yield a buyer might require from their investment to the actual dividend produced we could find the capitalised value or the price per share they might be willing to pay.

2. Capitalised earnings

In this method a price/earnings (p/e) ratio is used to capitalise a company's earnings after the deduction of corporation tax to determine the value of shares.

3. Net assets

Net assets shown on a company's balance sheet are not necessarily a helpful guide to the valuation of shares as they will usually be valued on the 'historic cost' of their purchase, and then down-valued each year in line with the depreciation method adopted by the accountants. This could result in a property with a market value of say £1 million being valued in the books at a less than £200,000 if it was purchased some time ago.

However, whichever method is used in producing a valuation it is essential to keep in mind the net asset position. It is also necessary, where possible, to replace the written down asset values shown in the balance sheet for their open market value.

Partnerships and LLPs

Partnerships and LLPs are particularly difficult types of businesses to value as much of a partnership's or LLP's value is often in the form of goodwill.

Commonly used methods include:

Average partnership or membership profits

The value of the partnership or LLP can be expressed as a multiple of the average of the last given number of years' profits.

Value goodwill

An agreement can be made among the partners or members after taking professional advice on a method to value the goodwill of the firm.

Net assets

As with companies, the net assets are not always a helpful guide to the firm's value, but they should be taken into account.

Sole trader

A sole trader has 2 choices: to sell their business as a going concern, in which case there will be a market value, or to wind up their business realising the value of assets less debts. As a sole trader's protection will be set up on an individual basis, an exact valuation is not vital. But the cover needs to be enough to provide for their family and pay all the business debts.

a combined approach

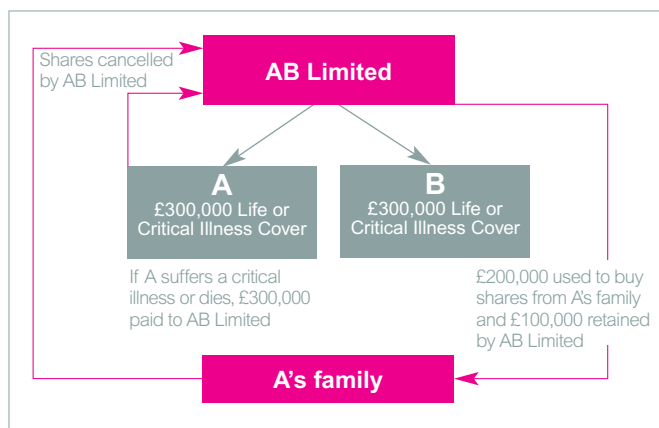
It should be remembered that key person and ownership protection are not mutually exclusive and many businesses will require both for the same person.

As a result, it is possible for key person and ownership protection needs to be combined into one, rather than 2 plans.

Companies – life of another

The company would take out a protection plan on the life of each of the shareholders. The amount of cover would be sufficient to allow both the purchase of the shares and provide key person cover. The company would then enter into an appropriate agreement that would provide for the purchase of the deceased or critically ill shareholder's shares on death or critical illness.

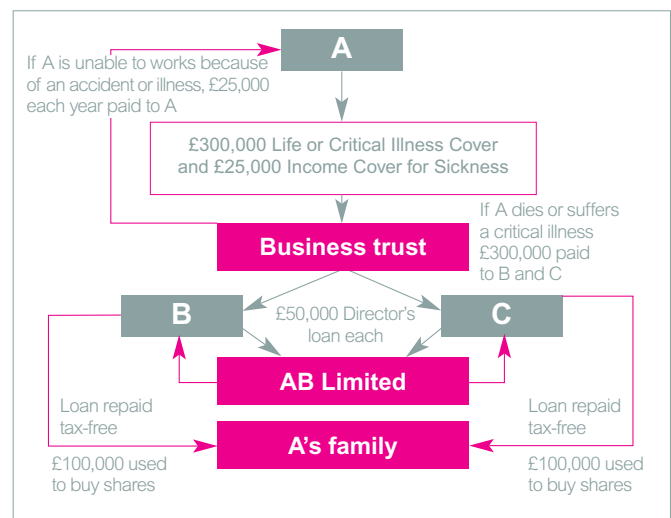
Then, if one of the shareholders suffers a critical illness or dies, part of the benefits would be used to purchase his or her shares. The company could hold the remaining funds for key person purposes (see chart below).



Companies – own-life in trust

Each of the shareholders would take out an own-life plan with an amount of cover sufficient to allow both the purchase of the shares and provide key person cover. The plans would be written under Bright Grey business trusts, with the other shareholders as beneficiaries. The shareholders would then enter into an appropriate agreement that would provide for the purchase of the deceased or critically ill shareholder's shares on death or critical illness, by the other shareholders.

If one of the shareholders suffers a critical illness or dies, part of the benefits would be used to purchase his or her shares. The remaining shareholders would then loan the company the remaining funds for its key person needs. This can be repaid to them tax free as a loan repayment once the company recovers (see chart below).



Partnerships and LLPs

Each partner or member takes out an own-life plan with an amount of cover sufficient to allow both the purchase of the share and provide the key person cover. These plans are written under the Bright Grey business trust for his or her co-partners or co-members, and they also enter into a cross option agreement.

If one of the partners or members suffers a critical illness or dies, part of the benefits would be used to purchase his share from his family. The other partners or members could hold the remaining funds until they are required for key person purposes.

Using Bright Grey's Business Protection Menu you can **combine different covers** each with a different term and amount of cover all in one plan. For example you could have Life or Critical Illness Cover with a 5-year renewable term for key person protection plus Life or Critical Illness Cover with a 20-year term for ownership protection all in the same plan. You can find more information on the Business Protection Menu on page 31.



information we may ask for

The following guidelines set out any additional information we will need from you in support of the application.

For Life Cover up to £1,500,000 or Critical Illness Cover or Life or Critical Illness Cover up to £400,000 we do not normally request any additional financial information. The guidelines shown will apply where the amount of cover is above these levels.

However, if during the underwriting process it appears the amount of cover is disproportionate to the business risk, we may request additional information.

If you have any questions about the information we need, you can contact our Business Protection Team on 0845 6094 500 or email us at businessprotection@brightgrey.com

Life Cover

Amount of cover	Business financial questionnaire	Last 3 years' reports and accounts	Questionnaire countersigned by accountant, solicitor or bank manager	Other additional financial information
Up to £1,500,000	Not normally required.	Not normally required.	Not normally required.	Not normally required.
£1,500,001 to £2,000,000	Yes.	Not normally required.	Not normally required.	Corporate loan – Copy of loan offer. Depending on the lender it may be possible to allow up to £2,000,000 Life Cover without a copy of the full and final loan offer. Please contact Bright Grey for more details.
£2,000,001 to £5,000,000	Yes.	Yes.	Yes.	Corporate loan – Copy of loan offer. Key person – Copy of company valuation report, copy of service agreement/CV. Partnership/Shareholder cover – Copy of company valuation report, copy of double option or buy and sell agreement.

Critical Illness Cover or Life or Critical Illness Cover

Amount of cover	Business financial questionnaire	Last 3 years' reports and accounts	Questionnaire countersigned by accountant, solicitor or bank manager	Other additional financial information
Up to £400,000	Not normally required.	Not normally required.	Not normally required.	Not normally required.
£400,001 to £700,000	Yes.	Not normally required.	Not normally required.	Not normally required.
£700,001 to £1,000,000	Yes.	Yes.	Yes.	Corporate loan – Copy of loan offer. Key person – Copy of company valuation report, copy of service agreement/CV. Partnership/Shareholder cover – Copy of company valuation report, copy of double option or buy and sell agreement.

The maximum amount of cover available for business cover is £1,000,000 for Critical Illness Cover or Life or Critical Illness Cover and £5,000,000 for Life Cover.

Income Cover for Sickness

If you have applied for more than £36,000 in total we will need evidence of income from the last 2 years. We will accept copies of P60s and self-assessment forms.

Key Person Income Cover for Sickness

These will be looked at from a business level or individual level where appropriate.

The maximum amount of business cover available for each individual is:

- £5,000,000 for Life Cover
- £1,000,000 for Critical Illness Cover and Life or Critical Illness Cover
- £150,000 for Income Cover for Sickness
- £250,000 for Key Person Income Cover for Sickness

Collective/Linked lives

If you are applying for cover on more than one person in the same business (whether this is with Bright Grey or not), we will add together the amounts of cover to decide what financial information we need. Where the total cover for the business is more than the limits in the tables on page 19, we will need the appropriate financial information.

Key person protection

For key person protection, the total amount of cover for the business should not be more than the greater of:

- 7 to 10 times the salary package (i.e. guaranteed earnings plus benefits) of the key person or
- Twice the average gross profit, or
- 5 times the average net profit

Any profits would be averaged over the last 3 years and would have to be attributed to the key person. If the company has suffered a gross or net loss in any of the previous 2 years, we will need an explanation of the reasons for the loss, steps taken to correct this and the key person's role in this.

For a new or start-up business (no financial history available) we will need a copy of the business plan, details of the role the key person will play and their track record and CV.

If more than one person is applying for key person cover, the total cover should not exceed the total profit multiples.

Commercial loan protection

For Life Cover in excess of £1,500,000 we will need a copy of the loan offer.

Where a number of applications are being proposed, the total amount of cover for all applications should not exceed the loan. Any individual applications should be based on the amount of the loan for which each key person is responsible. In certain circumstances we may be able to cover the full loan amount for each application, subject to limits on the amount of cover on each application and the overall sum assured. Please contact Bright Grey for details.

Key person and loan protection

Companies

The taxation implications for a company depend upon the solution, the type of plan chosen, the reason for the cover and the relationship between the key person and the company. However, HM Revenue and Customs will treat each case on its own merits and may take a different approach to that outlined below. It may therefore be advisable to contact the firm's local Inspector of Taxes to find out the approach they will take. A draft letter to HM Revenue and Customs is on page 28.

Life of another

There are 4 tests to see if a premium is a tax-deductible expense for the company.

These are:

- The purpose of the plan is to solely protect against loss of profit.
- The sole relationship should be employer/employee (although very small shareholdings – e.g. under employee share schemes – are likely to be ignored).
- The plan must be a short-term assurance, which is normally understood to mean a non-convertible term insurance plan with a term of no more than 5 years.
- The sum assured must be reasonable.

If the plan fails any of these tests the premium is unlikely to be tax deductible. For example, a plan taken out to provide security for a loan would not meet the requirement for it to protect solely against loss of profit. Therefore, premiums are not normally allowable for corporation tax relief and the sum assured is not normally regarded as a trading receipt.

The premium will not be assessable against the key person for income tax or national insurance as the benefits belong to the company.

If the premiums qualify for relief from corporation tax, then the sum assured, when paid, would usually be treated as a trading receipt and subject to corporation tax. Therefore, to provide a given level of cover the sum assured must be increased to cover the tax loss.

For example:

A company takes out a 5-year term assurance with a sum assured of £500,000 and premiums of £1,500 each year. The corporation tax rate is 28% therefore the net cost of premiums after relief from corporation tax would be £1,080.

In the event of a claim, the corporation tax payable, assuming a corporation tax liability in that year of 28%, would be $£500,000 \times 0.28 = £140,000$.

The original sum assured therefore needs to be increased to £694,444 to cater for the corporation tax liability.

In the past it was thought possible to reduce the impact of corporation tax by arranging the cover to be paid in instalments over a number of years. However under current Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) requirements, it is unlikely this will be successful as the liability to tax will arise in full on claim.

It is important to note that not claiming tax relief, if the premium would have qualified, will not necessarily prevent the sum assured from being treated as a trading receipt and being taxed. Therefore, written confirmation should be obtained from the local HMRC Inspector that the premiums do not qualify as a business expense, and that the benefits will not be taxable. However, this may not always be forthcoming.

Companies – life of another continued

Key Person Income Cover for Sickness is likely to be tax deductible for the company if the plan meets the 4 tests outlined on page 21. If the benefits are used for profit protection, they are likely to be taxed as a trading receipt. If the benefits are going to be used for sick pay, they are likely to be taxed, but when paid out to the employee they would become deductible cancelling out the tax. The employee will of course be taxed on their pay as normal and would therefore continue to be subject to income tax and employee's National Insurance. Therefore, if Key Person Income Cover for Sickness is to be used for sick pay it may be better for the key person to take the plan out on his or her own life, especially as the maximum claim payment period for Key Person Income Cover for Sickness is 5 years. The company could pay the premiums, which would be taxed as a benefit in kind, but the benefit would be tax-free to the employee.

Own life in trust

If the company pays the premium it can deduct the expense for corporation tax purposes as meeting a liability of a shareholder. But it will still have to pay employer's National Insurance.

The shareholder who takes out the plan will be assessed for income tax and National Insurance on the amount of the premium. But the sum assured will pass to the trustees of the business trust free of taxation. There should not normally be any inheritance tax due as this is part of a commercial arrangement. But there could be a liability if the money received from the plan is kept within the trust past the next 10-year anniversary of the creation of the trust, and the value of the trust is more than the then nil-rate band.

If there is a positive director's loan account then premiums can be treated as a repayment of this loan, thus generating no further tax implication on that director. In this case there would be no corporation tax relief for the company.

The plan must be written under trust from commencement. It is not recommended that an existing plan is assigned into a business trust as this could give rise to a liability to capital gains tax. This is because it is possible for HM Revenue and Customs to argue that as this is part of a commercial arrangement, the plan is being disposed of by someone who is not the original beneficial owner (the trustees) and they acquired their interest for consideration. Any gain, the difference between the amount they receive following a claim and the premiums paid, would therefore be assessed for capital gains tax (Section 210 Taxation of Chargeable Gains Act 1992). This can be avoided by asking that the plan is issued under trust from the start so that the trustees are the original owners.

Partnerships and LLPs

If the life assured is a partner or member the premiums are generally treated as being payable out of the partners' or members' income after tax.

The plan must be written under trust from the start. It is not recommended that an existing plan is assigned into a business trust as this could give rise to a liability to capital gains tax. This is because it is possible for HM Revenue and Customs to argue that as this is part of a commercial arrangement, the plan is being disposed of by someone who is not the original beneficial owner (the trustees) and they acquired their interest for consideration. Any gain, the difference between the amount they receive following a claim and the premiums paid, would therefore be assessed for capital gains tax (Section 210 Taxation of Chargeable Gains Act 1992). This can be avoided by requesting that the plan is issued under trust from the start so that the trustees are the original owners.

However, where the plan is set up as key person cover on the life of an employee of the firm, it may be possible for the partners or members to argue that the expense, if met by the partnership or limited liability partnership, is a deductible expense incurred for a revenue purpose. This depends on the plan fulfilling the 4 tests below and being on the balance sheet as a partnership or membership asset. It may also be necessary for there to be some form of commitment to make sure that the proceeds would be payable to and held as a partnership or membership asset. It may therefore be advisable for an approach to be made to the firm's local Inspector of Taxes to find out the approach they will take. Draft letters to HM Revenue and Customs are on page 28.

There are 4 tests to see if a premium is a tax-deductible expense for the partnership or limited liability partnership.

These are:

- 1 The purpose of the plan is to solely protect against loss of profit.
- 2 The sole relationship should be employer/employee.
- 3 The plan must be a short-term assurance, which is normally understood to mean a non-convertible term insurance plan with a term of no more than 5 years.
- 4 The sum assured must be reasonable.

If the plan fails any of these tests, the premium will not normally be tax-deductible for the partnership or limited liability partnership. For example, if the key person cover is taken out on a partner or member it is unlikely that tax relief on the premiums would be granted, even if all 3 other conditions were met.

Only if the premiums qualify for relief from income tax will the sum assured, when paid, usually be treated as a trading receipt and subject to income tax. Therefore, in order to provide a given level of cover, the sum assured must be increased to cover the 'tax loss'. The premium will not be assessable against the key person for income tax or National Insurance if he or she is an employee of the partnership or limited liability partnership as the benefits belong to the business.

Key Person Income Cover for Sickness is likely to be tax deductible for the partnership or LLP if it meets the 4 tests opposite. The benefits are likely to be taxed as a trading receipt in the hands of the partners or members. If the benefits are going to be used for sick pay, they are still likely to be taxed in the hands of the partners or members, but when paid out to the employee they would become deductible, cancelling out the tax. The employee will of course be taxed on their pay as normal and they would therefore continue to pay income tax and employee's National Insurance. Therefore, if it is intended to use Key Person Income Cover for Sickness for sick pay, it may be preferable for the key person to take the plan out on his or her own life. The firm could pay the premiums, which would be taxed as a benefit in kind, but the benefit would be tax-free to the employee.

It is important to note that not claiming tax relief if the premium would have qualified will not prevent the sum assured being treated as a trading receipt and being taxed. Therefore, written confirmation should be obtained from the local HM Revenue and Customs Inspector that the premiums do not qualify for income tax relief, and that the benefits will not be taxable. However, this may not always be forthcoming. Draft letters to HM Revenue and Customs are on page 28.

Sole traders

If the plan is written on the sole trader's own life, premiums will be seen as personal expenditure and will not be deductible as a business expense. This usually results in the sum assured not being taxable. It may, however, be possible for the sole trader to argue that the premiums should be a deductible expense if the plan is on the life of an employee and meets the 4 tests below. If such a claim is successful then the payment of the sum assured may be taxable.

There are 4 tests to see if a premium is a tax-deductible expense for the sole trader.

These are:

- 1 The purpose of the plan is to solely protect against loss of profit.
- 2 The sole relationship should be employer/employee.
- 3 The plan must be a short-term assurance, which is normally understood to mean a non-convertible term insurance plan with a term of no more than 5 years.
- 4 The sum assured must be reasonable.

If the plan fails any of these tests, the premium will not be tax-deductible. For example, if the key person cover is taken out for a capital purpose it is unlikely that tax relief on the premiums would be granted, even if all 3 other conditions were met.

If the premiums qualify for relief from income tax, then the sum assured, when paid, would usually be treated as a trading receipt and subject to income tax. Therefore, to provide a given level of cover the sum assured must be increased to cover the 'tax loss'.

Key Person Income Cover for Sickness is likely to be tax deductible for the sole trader if it meets the 4 tests on the left. The benefits are likely to be taxed as a trading receipt in the hands of the sole trader. If the benefits are used for sick pay, they would become deductible when paid out to the employee, cancelling out the tax. The employee would of course be taxed on their pay as normal and would therefore continue to pay income tax and National Insurance. The sole trader would also still have to pay employer's National Insurance. Therefore, if it is intended to use Key Person Income Cover for Sickness for sick pay, it may be better for the key person to take the plan out on his or her own life. The sole trader could pay the premiums, which would be taxed as a benefit in kind, but the benefit would be tax-free to the employee.

It is important to note that not claiming tax relief if the premium would have qualified will not prevent the sum assured being treated as a trading receipt and being taxed. Therefore, written confirmation should be obtained from the local HM Revenue and Customs Inspector that the premiums do not qualify for income tax relief, and that the benefits will not be taxable. However, this may not always be easy to get. Draft letters to HM Inspector of Taxes are on page 28.

For example:

The sole trader takes out a 5-year term assurance with a sum assured of £75,000, with premiums of £300 a year. The income tax rate is 40% therefore the net cost of premiums after income tax relief would be £180.

In the event of a claim the income tax payable, assuming an income tax liability in that year of 40%, would be $£75,000 \times 0.40 = £30,000$. So the original sum assured needs to be increased to £125,000 to cater for the income tax liability.

taxation	
key person and loan protection	21
ownership protection	25
sample letters to HM Revenue and Customs	28

Ownership protection

The taxation treatment will depend on the solution and the type of plan chosen.

Life of another

- **Corporation tax**

Plans to cover company ownership will not meet the criteria for relief from corporation tax on the premiums. Therefore, payment of the sum assured for a term assurance plan will not be classed as a trading receipt, and so is unlikely to suffer corporation tax.

- **Capital gains tax**

As long as certain conditions are met, the purchase of the shares by the company can be treated as a capital gain rather than a distribution for taxation purposes. The advantage of this is that if the shareholder has died, the base value of their shares is revalued to the value at the date of death. Providing the shares have not increased in value between the shareholder's death and their sale to the company, the capital gains tax charge will be zero.

The conditions that need to be met are:

- The company must be an unquoted trading company or the holding company of a trading group.
- The purchase should take place for the benefit of the company's trade.
- The purchase is not part of a scheme to avoid tax.
- The seller should be resident and ordinarily resident in the United Kingdom in the tax year of the purchase.
- The shares must have been owned for at least 5 years before the date of the sale (3 years if they were inherited).
- The seller must not retain an interest of 30% or more in the issued share capital of the company.
- The vendor's interest should be substantially reduced. The holding after the repurchase should not be more than 75% of the holding before the purchase.

The percentage shareholdings detailed above include shareholdings in the name of the vendor's spouse or minor children.

It is important to remember in the event of a transfer of shares due to critical illness, that the critically ill shareholder may be liable to capital gains tax on any increase in the value of the shares over their acquisition costs.

It is therefore vital that the company consults with their accountant before agreeing the purchase.

- **Inheritance tax**

If the shares were sold because of the death of the shareholder, business property relief allows the transfer of 'relevant business property' at reduced rates of inheritance tax. In this context relevant business property is unquoted shareholdings that have been held for 2 years. Unquoted shares are any shares not listed on the main stockmarket; alternative investment market quoted shares count as unquoted. Currently, the business property relief for unquoted shares is 100%.

Own life in trust

• Income tax

If the individual shareholder, member or partner pays the premiums, this will come from their taxed income.

In the event of a partnership or LLP paying the premiums on behalf of a partner or member they will be taxed as partnership or membership drawings, unless the premiums are deducted from the partner's or member's capital, current or loan accounts.

If a company pays the premium on behalf of a shareholder the premium will be assessed for income tax and National Insurance on that benefit unless the premiums are deducted from a director's loan account.

There is no liability to income tax on the payment of the sum assured under a Bright Grey Business Protection Menu plan.

• Corporation tax

If the company pays the premium it can deduct the expense for corporation tax purposes as meeting a liability of a shareholder.

• Capital gains tax (CGT)

There is no personal liability, provided that the plan is written in trust from the start. If an existing plan is assigned into trust under a commercial arrangement it could be argued that the trustees acquired the plan for consideration. Any subsequent disposal by them, including a claim on the plan, could therefore give rise to a liability to capital gains tax as the original beneficial owner is not disposing of the plan and it was acquired for 'money or money's worth'.

The liability would be calculated by reference to the disposal proceeds, that is the amount they receive following a claim, less the premiums paid. Therefore a substantial capital gains tax liability could arise depending on individual circumstances. For this reason, the business trust can only be used at commencement.

It is important to remember in the event of a transfer of a share of a business due to critical illness, that the critically ill shareholder or partner may be liable to capital gains tax on any increase in the value of the share over their acquisition costs.

• Inheritance tax

The plan should be written in trust from inception. A plan written under trust as part of a bona fide business arrangement on commercial terms is not a gift and is therefore not normally subject to inheritance tax. The evidence of the business arrangement is the cross option agreement in single and/or double option format and the similar plans effected by the other shareholders or partners. It may also be desirable to equalise premiums. It is essential that no one outside the business arrangement should be included as a beneficiary under the trust to maintain commerciality.

But a liability may arise if the proceeds of the plan are still held in trust past the next 10-year anniversary of the date the trust was created. This could happen if, for example, a payment is made on critical illness but the ill owner does not immediately exercise their option to sell their share of the business. The plan proceeds could remain in the trust for future use by the other owners should the ill owner not return within 12 months. And the other owners then have an option to buy their share of the business.

taxation	
key person and loan protection	21
ownership protection	25
sample letters to HM	
Revenue and Customs	28

If a single or cross option agreement is used, business property relief that allows the transfer of 'relevant business property' at reduced rates of inheritance tax will be available. In this context relevant business property is unquoted shareholdings which have been held for 2 years or a partner's share in the business. Unquoted shares are any shares not listed on the main stockmarket; alternative investment market quoted shares count as unquoted. Currently, business property relief for unquoted shares or a partner's share in the firm is 100%.

If a buy and sell agreement is used then business property relief would be lost. This is because HM Revenue and Customs regard a buy and sell agreement as a binding contract for sale under which business property relief is not available because the value of the business is regarded as cash in the estate of the deceased owner.

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.

SAMPLE LETTER



Date:
Ref No:

Dear Sir

ABC COMPANY LIMITED

The above company wishes to effect a plan on (name of life assured) for its own benefit. The plan chosen is a Bright Grey Business Protection Menu which will not acquire a surrender value and is non-convertible.

The details of the proposed plan are as follows:

Type of contract: (renewable) term assurance

Benefit type _____

Amount of cover £ _____

Premium amount £ _____

Term _____

Premiums will be paid monthly/annually* (delete as appropriate)

Position held by life assured: _____

Shareholding of life assured: _____

Shareholding of related persons*: _____

Main purpose of plan: _____

Please insert Paragraph A, Paragraph B, Paragraph C or Paragraph D as listed over the page.

Please could you confirm in writing whether or not the premiums paid under the above plan will be treated as a business expense for corporation tax purposes and whether the plan proceeds will be treated as a trading receipt or a non-taxable item on the capital account.

Yours faithfully

A stylized, handwritten signature in black ink, appearing to be a cursive 'A' followed by some illegible characters.

Company Accountant/Secretary

ABC Company Limited
Anywhere House
00 Anywhere Street
Anywhere AB12 3CD

Tel: 0000 000 0000
Fax: 0000 000 0000

info@abccompanyltd.com
www.abccompanyltd.com

taxation	
key person and loan protection	21
ownership protection	25
sample letters to HM Revenue and Customs	28

Sample letters to HM Revenue and Customs

It is important that the tax treatment of company-owned key person and share protection plans is confirmed with HM Inspector of Taxes.

These are suggested wordings for letters to the local Inspector of Taxes.

TERM ASSURANCE PLANS

Suggested wordings for the main purpose of the plan:

- Paragraph A**
His/Her services are considered essential to the operation of the Company and the plan is being effected to protect the Company against the loss of profits that will arise as a result of (him/her) suffering a (critical illness) or on (his/her) untimely death.
- Paragraph B**
He/She has personally guaranteed (a) loan(s) to the Company which may become repayable (as a result of (him/her) suffering a critical illness) or on (his/her) untimely death.
- Paragraph C**
His/Her services are considered essential to the operation of the Company and the plan is being effected to cover the costs of finding a suitable replacement (as a result of (him/her) suffering a critical illness) or on (his/her) untimely death.
- Paragraph D**
On death (or as a result of suffering a critical illness) it is considered essential to the effective management of the Company that (his/her) shareholding is purchased by the Company. The plan is being effected to cover the costs of the share purchase.

Other wordings can be used if the purpose of the plan is different to those described above.

* Related persons could include any person whom the life assured may be able to influence.

Please note:

We cannot accept liability for the wording of the draft letter and financial advisers should satisfy themselves that it complies with the regulations of the Financial Services Authority.



Bright Grey's Business Protection Menu

Bright Grey offers a simple menu-based protection plan. This type of plan allows you to tailor cover to meet each client's specific needs and often more importantly, their budget.

With the Bright Grey Business Protection Menu you can recommend Life Cover on its own, Critical Illness Cover on its own or you can combine them with different amounts, terms and options to suit your client's needs. You can also add Income Cover for Sickness or Key Person Income Cover for Sickness depending on your client's needs and budget.

If you find your client can't afford all the protection they need today, don't worry. The Bright Grey Business Protection Menu gives you the flexibility to recommend a small amount of cover now that your client can build on in the future. This is better than having no protection at all.

The table on the next page gives you information on all of the options available. Please see the plan details for the Business Protection Menu for further information.

Our range of covers

- Life Cover
- Critical Illness Cover
- Life or Critical Illness Cover
- Income Cover for Sickness
- Key Person Income Cover for Sickness
- Payment Cover for Sickness

The options available

What can vary	The options	Life Cover	Critical Illness Cover	Life or Critical Illness Cover	Income Cover for Sickness	Key Person Income Cover for Sickness	Payment Cover for Sickness	What they mean
Which person is covered, and when we pay the cover	Single life	✓	✓	✓	✓	✓	✓	'Single life' means only one person is covered.
	Joint life first event	✓	✓	✓	–	–	✓	'Joint life' means 2 people are covered. 'First event' means we will only pay the first time the event happens.
Term of cover	1-40 years	✓	–	✓	–	–	✓	How long the cover lasts for. ~ not available on decreasing covers.
	5-20 years	–	–	–	–	✓	–	
	5-40 years	–	✓	–	✓	–	–	
	~ 5 year renewable	✓	✓	✓	–	–	✓	
Maximum amount of cover	£5,000,000	✓	–	–	–	–	–	You can apply for any amount up to whichever is the lower of the amounts shown. Gross profit is averaged over last 3 years.
	£1,000,000	–	✓	✓	–	–	–	
	50% of pre-tax earnings	–	–	–	✓	–	–	
	£150,000 each year	–	–	–	✓	–	–	
	75% of gross profit attributable to person covered	–	–	–	–	✓	–	
	£250,000 each year	–	–	–	–	–	✓	
Maximum age when the cover starts	54	–	–	✓	–	–	–	The oldest the person covered can be when the cover starts (attained age). *If cover is renewable. *Only available if payments are reviewable.
	59	–	–	–	✓	✓	–	
	64	+✓	✓	*✓	–	–	–	
	83	✓	–	–	–	–	✓	
Maximum age when the cover ends	84	✓	–	–	–	–	✓	The oldest the person covered can be when the cover ends (attained age). *If cover is renewable. *Only available if payments are reviewable.
	74	+✓	✓	*✓	–	–	–	
	64	–	–	✓	✓	✓	–	
Payment of the cover	Level lump sum	✓	✓	✓	–	–	–	'Lump sum' means the cover is paid as a single amount. 'Increasing' means the cover will go up each year by the rate agreed.
	Increasing lump sum, increasing by a selected rate (2-5%)	✓	✓	✓	–	–	–	
	Increasing lump sum, increasing by RPI (min 2% max 10%)	✓	✓	✓	–	–	–	
	Monthly decreasing lump sum	✓	✓	✓	–	–	–	'Decreasing' means the cover will go down each month in line with a repayment mortgage that has the interest rate shown on your cover summary (0-15%).

What can vary	The options	Life Cover	Critical Illness Cover	Life or Critical Illness Cover	Income Cover for Sickness	Key Person Income Cover for Sickness	Payment Cover for Sickness	What they mean
Payment of the cover continued	Yearly decreasing lump sum	✓	✓	✓	–	–	–	'Decreasing' means the cover will go down each year in line with a repayment mortgage that has the interest rate shown on your cover summary (0-15%).
	Level income	–	–	–	✓	✓	–	'Income' means the cover is paid as a regular payment each month.
	Increasing income, increasing by a selected rate (2-5%)	–	–	–	✓	✓	–	
	Increasing income, increasing by RPI (2-10%)	–	–	–	✓	✓	–	
Whether payments change or not	Guaranteed payments	✓	–	✓	✓	✓	✓	'Guaranteed' means your payments into the plan will not change unless your cover changes. 'Reviewable' means we can review the payments and may change them. Subsequent reviews will be every 5 years.
	Reviewable after 5 years	–	✓	✓	–	–	–	
Definition of Total Permanent Disability or incapacity	Own occupation	–	✓	✓	✓	✓	✓	'Own occupation' means the essential duties of your own occupation (see section D [^]). 'Working tasks' means common tasks to do with work (see section D [^]).
	Working tasks	–	✓	✓	✓	✓	✓	
Deferred period	4, 13, 26 or 52 weeks	–	–	–	✓	✓	✓	The time before we will start paying a claim if you are not working because of illness or injury.
Cover payment period	Throughout	–	–	–	✓	–	✓	The length of time we pay the claim.
	1 year	–	–	–	✓	✓	–	
	2 years	–	–	–	✓	✓	–	
	3 years	–	–	–	–	✓	–	
	4 years	–	–	–	–	✓	–	
	5 years	–	–	–	–	✓	–	
Cover increase options	Increase in value of the key person	✓	✓	✓	–	✓	–	If the plan is accepted on standard terms, the client can increase their cover without any medical evidence if any of these events happen.
	Increasing your business mortgage or loan	✓	✓	✓	–	✓	–	
	An increase in the value of a partner's or shareholding director's interest in the business	✓	✓	✓	–	✓	–	
Children's Critical Illness Cover	Included automatically if you choose Critical Illness Cover or Life or Critical Illness Cover	–	✓	✓	–	–	–	Pays you up to £20,000 if any of your children are diagnosed with a critical illness or Total Permanent Disability.

[^]Section D refers to the plan details for the Business Protection Menu.

Instant cover

When we receive an application we may be able to offer your client cover before their plan starts.

Who is eligible for instant cover?

Instant cover is available to residents of the UK, Channel Islands and Isle of Man who are under the age of 55 when we receive their application form.

On what covers is instant cover available?

Instant cover is available when your client takes out any of the following covers for a business loan:

- Life Cover
- Critical Illness Cover
- Life or Critical Illness Cover
- Income Cover for Sickness

Instant cover is not available on Key Person Income Cover for Sickness or Children's Critical Illness Cover.

When is instant cover available?

Instant cover is only available if, when we receive the application form, your client has answered all the questions in full and has completed the direct debit section correctly and in full. We will not offer instant cover even if we receive any missing information at a later date.

If your client chooses Life or Critical Illness Cover with guaranteed payments, instant cover is only available if:

- Your client answers 'no' to all of the questions in the 'your health' section of the application form.
- Your client's answers to the questions in the 'residency and travel', 'your lifestyle' and 'leisure activities' sections of the application form do not lead to us immediately giving non-standard terms, or asking for more information.

Is there a maximum cover limit?

We will cover your client for the amount they have applied for, but only up to the following limits:

- Life Cover – £500,000
- Critical Illness Cover and Life or Critical Illness Cover – £250,000
- Income Cover for Sickness – £15,000 a year
- We will limit instant cover to the amount of your client's loan. For Income Cover for Sickness claims this means the maximum we will pay is the amount of your client's loan payments.

When does instant cover start?

Instant cover will start on the later of the date we receive the application form with a fully completed direct debit section and the date that the business loan is advanced.

When does instant cover stop?

Instant cover will stop on the earliest of:

- The plan starting, or
- 4 weeks after we send a decision letter, if your client has not accepted our terms, or
- Your client asking for the application to be cancelled.

Instant cover will also stop:

- 4 months after instant cover starts.
- If we decline or defer the cover or plan. By this we mean the date we make the decision and not the date we confirm this decision to your client in writing.
- If we do not receive medical or financial information within 4 weeks of asking for it.

Is there anything else I should know about instant cover?

For Total Permanent Disability (included in critical illness covers) and Income Cover for Sickness, we will use a working tasks definition to assess any claim.

We will pay instant cover on the same basis as the cover your client applies for.

If we pay an instant cover claim for Income Cover for Sickness, your client's cover cannot start until we stop paying the claim. At that time we will tell your client on what terms we can offer Income Cover for Sickness.

If we apply special terms to the plan, these terms will also apply to instant cover from the date we make the decision at Bright Grey and not the date we confirm this to your client in writing.

Are there any circumstances in which you will not pay a claim?

We will not pay an instant cover claim if:

- Your client does not give us all the information we ask for on the application form.
- We discover that information on the application form is untrue, inaccurate, or incomplete (even if it does not relate to the cause of the instant cover claim).
- It is as a result of an intentional self-inflicted injury.
- It is as a result of taking part in a hazardous sport or leisure activity.
- It is as a result of, or related to, a condition your client was already aware of, or was suffering symptoms of, or being treated for, when your client applied.
- Your client sends duplicate applications for cover to other life companies.
- We are unable to collect the first payment for the plan through the direct debit.

We will use the current version of the Business Protection Menu plan details booklet to assess any claim. Your client can ask us for a copy of this at any time.



our **Helping Hand** service

our Helping Hand service	37
keeping your client's business on track	38

7

Bright Grey's Helping Hand service provides much needed support at a very difficult time. And it gives you the opportunity to recommend a product that's best value for your client.

Our Helping Hand service

We've chosen partners with whom we work closely to provide a broad range of practical and emotional support that's available to your client and their business when they need it most.

The service is made up of many parts. From the day your client's plan starts, they and their immediate family will have access to a range of helplines giving legal, medical, personal and career advice.

But what really makes this service invaluable is the access to a qualified nurse who will contact your client to find out what help and support is needed. And depending on the circumstances, they can:

- Arrange a home visit with the most appropriate healthcare specialist – at a time that suits your client.
- Draft a personalised care plan and report.
- Make sure that ongoing support is available, if and when your client needs it.
- Answer questions, give advice and offer practical support.

And this service is not just there for the plan owner, it's also available to their spouse/partner or children if they were to:

- Die.
- Become critically or terminally ill.
- Be unable to work due to long-term sickness or injury.

Our Helping Hand partners

Bright Grey's Helping Hand service is provided by RED ARC Assured Ltd, HCML, and other selected partners.



RED ARC is an independent care advisory company providing information, advice and support to people when they need it most. And they've been offering this service to Bright Grey plan owners since 2003 so it's a tried and tested service that has been very successful in the personal protection market.



HCML is one of the UK's leading rehabilitation case management companies, who can provide the services of a personal rehabilitation case manager, if your client makes an Income Cover for Sickness claim.

keeping your client's business **on track**

Running your own business can be all-consuming. So it's easy to believe that it's the most important thing in your life. Until the unexpected happens, and a bereavement or diagnosis of a critical illness puts everything else into perspective. That's when our Helping Hand can give your client's business much needed support.

Bridging the gap

Should the unthinkable happen and a claim occurs, the business will have a range of problems it may never have had to deal with before. This is especially true for small to medium sized businesses that do not have the luxury of a 'substitute's bench' of reserve talent.

Where does your client start to look for interim help to plug the gap left by the key person? What should they do about recruiting a long-term replacement? If key people have suffered a critical illness or disability, what help is available in rehabilitating them and bringing them back to work, or maybe helping them find alternative employment? What about the legal ramifications; where does this specialist legal advice come from?

Bright Grey's Helping Hand service aims to help businesses with these types of problems, and at no additional cost.

The business solution

Losing a key person – even for a short period of time – can have a big impact on small and medium-sized businesses. Our Helping Hand service **can help your client** recruit a temporary or permanent replacement. And if your client needs advice on employment law relating to a claim or wants information around termination and share buy-back procedures they will have access to a legal helpline.

For more information about the support we can offer your client and their business, please see the table opposite.

Individual support

For death or terminal illness claims

As soon as we are told about a claim we'll ask a RED ARC personal nurse adviser to make contact to see what help and support is required.

This could involve different forms of assistance from contacting support groups to arranging help from a fully qualified and independent bereavement counsellor.

For critical illness or income cover for sickness claims

The nurse adviser will be able to offer immediate support from answering questions to giving professional medical advice. We can also arrange for a healthcare specialist to make a home visit. We will even pay for additional specialist treatment if the nurse adviser feels this will help. Whatever support is needed we will do our best to help.

If your client has Income Cover for Sickness we can help them to get back to work. We work with a company called HCML, one of the UK's leading rehabilitation companies, to offer your client the services of a personal rehabilitation case manager, who's matched to their particular needs.

Career and job support

In the case of illness it could be that the person covered may need to find alternative employment. We offer access to career consultants, including a CV writing service and a comprehensive job seeker's manual.

Business support

Information about an employee's illness

The employer can also speak with a RED ARC personal nurse adviser to understand more about the illness, its symptoms, treatment and the likely impact on the employee and their family.

By contacting RED ARC the employer will be able to find out:

- What the treatment involves
- Any side effects of the treatment
- The impact on the employee's ability to work
- When a return to work would be likely
- What RED ARC are doing to help

This service is designed to help the business deal with what will probably be an unfamiliar event. But, due to strict patient confidentiality rules the nurse will not be able to discuss the specifics of an individual employee's case.

Recruitment solutions for temporary and permanent roles

Our recruitment partner will find management staff for your client's business where a temporary replacement is needed. They will provide details of potential candidates within 48 hours.

They will also give advice and support when it comes to finding a permanent replacement including writing job and person specifications, and drafting adverts and recruitment agency briefs.

Legal help

Your client's business will also have access to a legal helpline. The helpline gives advice on all aspects of employment law relating to a claim including managing sickness and absence, termination and shareholder options.



Note

RED ARC Assured Ltd, HCML, and our specialist recruitment partner are not regulated by the Financial Services Authority.

literature available

Client-facing brochures



Key person protection



Loan protection



Ownership protection



Relevant life policies

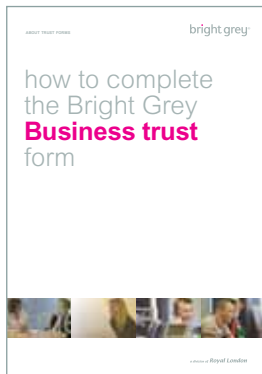
Trusts and supporting documents



Business Trust
England, Wales
and Northern Ireland



Business Trust
Scotland

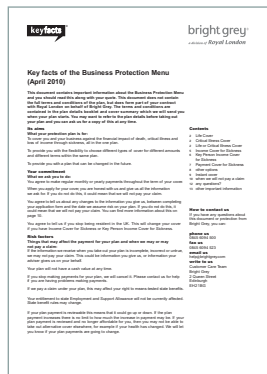


Guide to the
Business trust

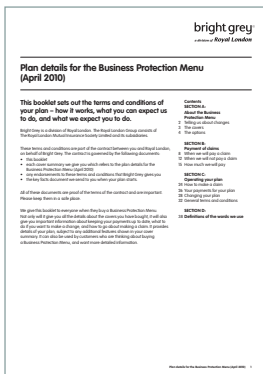


Draft cross option
agreement

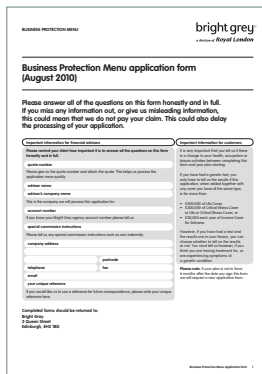
Product literature



Key facts



Plan details



Application form

business protection from Bright Grey

Bright Grey is a division of the Royal London Group which consists of The Royal London Mutual Insurance Society Ltd and its subsidiaries. The Royal London Mutual Insurance Society Ltd provides life and pension products, is a member of the Association of British Insurers, is authorised and regulated by the Financial Services Authority No.117672 and is registered in England and Wales No.99064. The registered office is 55 Gracechurch Street, London, EC3V 0RL. Bright Grey is a member of IFA Promotion Ltd.