

## **Key Person Cover**

Key person cover is designed to protect the loss of profits which would result in the event of the death, or critical illness, of an employee who is important to the profitability and growth of a business.

### *Shareholder Protection*

Shareholder protection relates to need to protect surviving shareholders by implementing a strategy to allow them to force the sale of shares from a deceased's shareholders estate. To ensure that the deceased's estate is compensated a mechanism to provide capital and a fair value for the shareholding is catered for. This allows the family of the deceased to be properly compensated for the shareholding and the surviving shareholders to retain control of the business and how they are remunerated.

More detail on shareholder protection is provided later.

Depending on your circumstances one of the above, or both, may be suitable to ensure that your business is protected.

### *Type of Insurance*

The most common type of insurance arrangement used to provide protection in the event of a key employee dying or being critically ill is level term assurance. Ordinarily, to control costs, it is advisable to look at a policy with a 5 or 10 year term. To ensure that cover can be continued at the end of the original term with no medical underwriting it is important to include the option to renew cover.

This allows the plan to be continued for a further term regardless of the health of the life assured at the renewal date. Premiums will increase to reflect the increased age of the life assured.

Where the key employees are relatively young and the business is likely to continue for a substantial period then a 10 year term policy, again with the option to renew for a further term, can often be more suitable. This fixes the premium for the first 10 years of the plan rather than facing rising premiums after an initial 5 year term.

A wide range of insurance options exist and it is not possible to cover them all within a brief summary.

For key person cover the application would be arranged so that in the event of a claim the sum assured is paid to the Company who will be the plan owners. Should an employee leave the policy can normally be assigned to the individual who can then continue paying premiums. Alternatively the policy can be cancelled.

## **Taxation**

From the company's perspective the premiums for key person cover are unlikely to be an allowable business expense as to qualify, the policy should be of short term nature (less than 5 years) with no option to renew with no critical illness provision. In addition the relationship must be solely that of employer and employee, where an employee has a significant shareholding then this is not purely an employee/employer relationship.

Generally where the premiums do not qualify as an allowable business expense the sum assured is not then taxed as a trading receipt.

This is a general rule of thumb and you should check with your local inspector of taxes who has some discretion in deciding the tax treatment of keyperson cover. It may well be that the premiums will become allowable with the sum assured on payment then taxed as a trading receipt.

### **Shareholder Protection**

Shareholder protection is designed to achieve the following:-

- It enables the remaining shareholders to maintain control over the business.
- It provides funds to enable the purchase of shares from the deceased's estate.
- It safeguards the standard of living of the deceased shareholders dependants.
- It may assist the deceased's shareholders estate to fund an inheritance tax liability.

#### *Valuation*

It is important to check that under the Articles of Association, the Company is able to purchase the shareholding from the deceased's estate if a company share purchase is envisaged; it is more common for the surviving shareholders to purchase the shares from the deceased's estate. The main issue is the valuation, and this can normally be dealt with via a shareholder purchase (cross option) agreement and with the help of your accountant.

Ensuring that the valuation is realistic will ensure that the estate of the deceased receives fair value, providing financial security whilst passing back control.

### **Method of Purchasing Shares**

#### *Purchase by the Surviving Shareholders*

It is often more preferable for the surviving shareholders to be given the option to purchase the shares from the deceased's estate. This ensures that they retain control and rather than their shareholding being increased automatically by the Company purchasing shares and then cancelling them to create unissued share capital, they will simply purchase the agreed proportion from the deceased's estate.

#### *Company Purchase*

A Company can buy back its own shares provided they have the necessary powers in their Articles of Association. If the Company's Articles do not already give sufficient power, they can be altered before the purchase takes place.

There are a number of technical criteria that must be met to allow the Company to buy back the shares and for the payment to be deemed from capital. If the payment is deemed to be from income then this would most likely be taxed in the same manner as a dividend distribution.

It is complex to arrange for the Company to purchase shares from the estate of the deceased and the method of valuation could give rise to a tax charge.

#### *Cross Option Agreement*

This most commonly gives the deceased shareholder's personal representatives the option to sell the shares and the surviving shareholders the option to buy the shares.

The cross option agreement is completely separate to the Articles of Association; a draft option agreement can be provided for reference. You should always check legal documents with your solicitor before proceeding.

The main advantage of including an option is to preserve business property relief for inheritance tax purposes. Where a binding agreement is in place this relief is often lost which could result in an unnecessary tax liability.

### *Life Insurance*

The most common method of providing the surviving shareholders with sufficient capital to meet their obligation to purchase the shares (assuming the option within the agreement is implemented) is to effect life cover for each shareholder.

The level of life cover should be in proportion to the value of the shares in the Company (of partnership) and is normally then held in trust for the benefit of the surviving shareholders. They should then have sufficient capital to fund the purchase of the deceased shareholding.

Where the life cover is insufficient then the cross option agreement would normally provide for the difference to be funded over a period of time.

Our service is as follows:-

- We will provide an assessment of the most appropriate insurance option and the basis on which this should be structured to suit your business needs.
- We will review the premium and contract terms from a wide range of insurance providers to obtain the terms which most suit your requirements, in general we prefer premium rates which are guaranteed not to increase throughout your chosen plan term (some providers review rates regularly and can increase these).
- We will assist you with the completion of applications.

## **Employee Benefits**

Waveney McKenna Limited provides advice on a wide range of employee benefits including:-

- Group Personal Pensions
- Death in Service Schemes
- Group Income Protection
- Group Critical Illness
- Group Private Medical Insurance

We can advise on the type of arrangement suited to your requirements and help with the implementation of a web based employee benefits system. These systems can offer total reward statements giving a consolidated value of the employee's total benefits including the cost of their salary and employer National Insurance contributions. Such systems can also incorporate employer staff manuals, health and safety information as well as allowing employee's to book holiday online. Employers can also monitor employee's sick leave and reasons to see whether there are any trends.

For directors we also provide advice on Self Invested Personal Pensions and Small Self Administered Schemes which can be used for Commercial Property Purchase and, in the case of a SSAS, can make loans to the employer.

### **Group Personal Pensions**

This is simply a group collection facility funding a number of individual personal pensions. There are a number of advantages to a group scheme which includes the ability to negotiate with the pension provider to reduce charges.

As this is not an occupational scheme the employer is not a trustee and the level of paperwork is kept to a minimum; it is possible for schemes to be virtually paperless with all the administration undertaken online.

We will assist with the following:-

- Structure of the scheme in terms of administration and investment options
- Online access for employees
- Negotiating competitive charges with a suitable provider
- Ongoing administration
- Employee review meetings
- Paperwork for new joiners to provide them with sufficient information to join the scheme

Payments made into such a scheme by the employer can be offset against corporation tax and are not taxed as a P11D benefit on the employees.

### **Death in Service Schemes**

These can either be registered scheme or exempt approved schemes. The former are established under pension rules and therefore the sum assured is paid tax free provided the total payable on death to the employee (including all their private pension provision) is less than the lifetime allowance of 1.65m. Any payment above this amount is subject to tax, normally at 55%.

The main benefit of a registered scheme lies in the fact that premiums paid by the employer are relievable against corporation tax and are not taxed as a P11D benefit on the employees. An exempt approved scheme is written under a trust, however, whilst the premiums can be offset against corporation tax in the same manner as PAYE, this is a P11D benefit and the employee will have to pay tax and National Insurance on the benefit in kind. The sum assured is written under trust and is still payable tax free.

Exempt approved schemes tend to be written where business owners have large pension pots or where a registered scheme cannot be established.

Registered schemes tend to provide a sum assured based on a multiple of earnings, 4 times earnings being common. A free cover limit is agreed at outset and any sum assured falling below this limit is automatically covered without any medical underwriting. Employees with higher earnings would be restricted to this free cover limit until underwriting has been completed.

### **Critical Illness Cover**

A group critical illness cover scheme offers a sum assured, often based on a multiple of earnings, which is paid on the diagnosis of a critical illness, I have provided information on some of the illnesses included for standard and comprehensive schemes below:-

#### **Standard Cover**

Alzheimer's Disease  
 Cancer  
 Coronary artery by-pass grafts  
 Heart attack  
 Kidney failure  
 Major organ transplant  
 Motor neurone disease  
 Multiple sclerosis  
 Parkinson's disease  
 Stroke

#### **Comprehensive Schemes**

As well as the above these tend to include the following:-

Aorta graft surgery  
 Benign brain tumour  
 Blindness  
 Coma  
 Coronary angioplasty  
 Deafness  
 Heart valve replacement or repair  
 HIV infection (physical assault)  
 Loss of hands or feet  
 Loss of independent existence  
 Loss of speech  
 Paralysis of limbs  
 Rheumatoid arthritis (chronic)  
 Third degree burns  
 Traumatic head injury

It is worthwhile noting that the above conditions require severe, chronic or permanent conditions to apply before a claim will be met; this means that the severity will be assessed and the sum assured will not be paid unless this meets the predefined criteria for each illness.

Whilst the employer will fund this type of scheme this is often very expensive. As such this can be very costly from a tax perspective for certain members of a scheme. Critical Illness schemes are taxed as a benefit in kind.

### **Group Income Protection**

This provides an individual with a continuing income in the event of incapacity through illness or disability. There is an initial waiting period, called the deferred period, designed so that the insured income commences once company sick pay ceases.

Traditional income protection schemes simply pay the protection benefit once a claim commences and then continues to pay this until the employee returns to work, reaches the termination age under the scheme (65 in this case) or dies. A company with significant claims will face rising costs over time.

An increasing number of companies now offer an ongoing claims management approach which has been developed largely to cope with more modern illnesses including stress. To help with this they ask for early notification of potential claims once an individual has been away from work for 4 weeks through illness. At this stage an assessment is made of the nature of absence and the resources which should be made available to return the individual to work and prevent long term absences.

These resources will often include access to counselling services, however, some illnesses cannot be resolved by these methods and the aim is to also identify those claims which are likely to remain long term. The insurer will normally appoint independent medical agencies to undertake these assessments and in some circumstances, in line with the disability discrimination act, it is envisaged that working closely with the employer will be essential to agree on workplace adjustments for example.

Rehabilitation programmes are also introduced to help aid a claimant's return to work, after a lengthy period of absence there is also a programme aimed at gradually introducing an employee back to work to help them feel comfortable and avoid a relapse.

Employee Assistance Programmes are often made available to all employees and offer 24 hour access to a confidential helpline with the opportunity to speak to medical experts.

### **Group Private Medical Insurance**

This employee benefit offers access to private medical cover with the premiums paid by the employer and taxed as a benefit in kind on the employee.

A wide range of options are available including full in patient and out patient care as well as dental care and even travel insurance. Premiums can be very expensive for the most comprehensive schemes and there are a number of methods used to reduce the cost, including excesses, waiting periods and reducing the level of cover offered.

Providers also take quite different views on the provision of treatment, few insurers offer full cover for cancer and for chronic conditions it is often the case that private medical cover will meet the costs of stabilising the condition with ongoing treatment then funded by the NHS.