cbf wealth management

Our guide to protecting your business

Is your business at risk?

In the day-to-day challenges of running your business to achieve the commercial success you strive for, it would not be surprising if the financial implications of your death or serious illness and, if relevant, your co-owners or key employees, were not "front of mind". But this understandable "fact of business life" does not make the potential detrimental consequences of these events any less serious.

The following information has been provided to give you a balanced overview of the risks associated to the potential benefits you are about to read in this document.

CBF Wealth Management provides financial planning advice which includes taking into account any tax planning opportunities that may be applicable to your individual goals. If you require specific advice on tax liabilities and treatments, then you should speak to a tax professional.

We feel it's our responsibility to make you aware of the risks that death and serious illness can bring to your business and the ways in which you can financially provide for them.

The risks for the business owners– and how to provide for them

As a business owner, either alone or with co-owners, you are likely to be critically important to the continued success of your business. This is also likely to be true in relation to your co-owners and maybe also some key employees.

Consequently, the death or serious illness of any of these "key" people will almost inevitably cause serious problems in relation to:

- the business revenue and profit;

and, following the death or serious illness of an owner:

- the ownership of the business or the share the business owned by the deceased or seriously ill owner.

And if you are a sole trader, it may be that the business will cease if you are no longer around to carry it on.

Let's look at these challenges one by one in a little more detail and consider how you might:

- put in place plans to protect against the resulting financial loss and future ownership uncertainty; or
- review and, if necessary, improve the plans that you already have in place.

Before looking at the detail though we would encourage you, with your co-owners if appropriate, to envisage what 'business life' would be like and how you and your family would be affected (emotionally and financially) if inadequate or no financial and legal arrangements existed and the death or serious illness of you, your co-owners or key employees occurred.

A CBF Wealth Management financial planner will be happy to talk you through the financial, tax and legal considerations of having no or inadequate plans in place.

1. Financial loss for a continuing business following the death or serious illness of an owner or key employee: business continuation strategies

1.1 Death of a business owner

The challenge

A business owner's death or serious illness (causing them to be unable to work either permanently or for an extended period) and the resulting loss of business revenue that person would have otherwise generated could lead to some or all of the following consequences:

- Reduced profits (or increased losses) for the business.
- Reduced living standards for the owners and/or the family of the deceased or seriously ill owner.
- Difficulty in repaying debts, including any outstanding debts owed to the deceased or seriously ill owner.
- Loss of trust/confidence by suppliers, clients and/or lenders.
- Loss of clients.
- Difficulty in meeting costs that may continue at the same level.
- Increased costs – for replacement/recruitment.

Of course, the exact level of financial loss and how long it will be sustained for will be difficult (if not impossible) to predict in advance but, as you will appreciate, it could be substantial.

The answer

Through discussion with a financial planner you will be able to arrive at a broad estimate of the potential loss and likely business financial needs arising from an owner's serious illness or death.

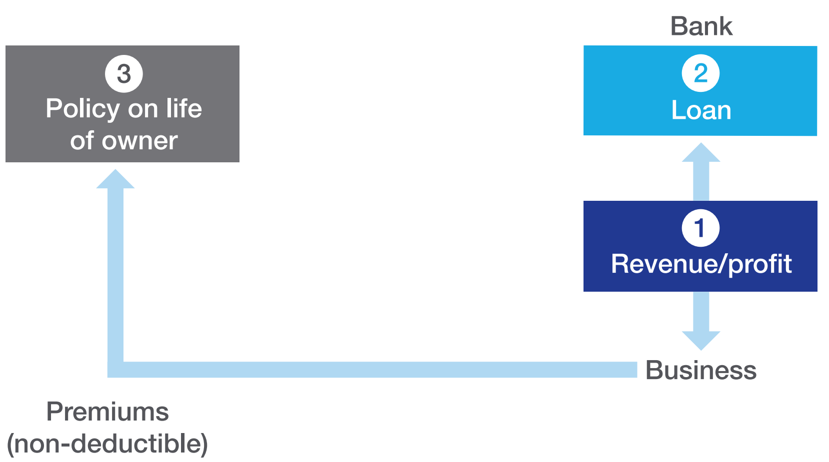
The sums required can often be efficiently provided through appropriate insurance – to provide lump sums or regular payments as appropriate.

The cost will depend, of course, on a number of factors, including the amount to be insured, the terms of the cover (which can be very flexible), and the age and state of health of the insured. A financial planner will be able to search out and recommend the most appropriate cover for you.

Typically, the business would take out the insurance but, depending on the type of business you have, some careful planning regarding the optimal way to set up and hold the chosen insurance policies may be necessary. Again a CBF Wealth Management financial planner can guide you on this.

Generally speaking, the premiums paid will not be tax deductible and lump sums paid under insurance policies on the death or serious illness of the insured owner will usually be tax free.

Business continuation cover for business owners



1. Shortfall for business (reduced revenue, increased costs = reduced profit).
2. Possible loan or overdraft outstanding and less ability to repay following death of an owner.
3. Policy on life of owner, owned by business, premiums non-deductible but sum assured paid tax free to business to replace reduced profit and/or repay any loans.

1.2 Serious illness of an owner

The challenge

Serious illness causing long-term or permanent absence from work can cause the same financial pressures as those identified in relation to an owner's death.

The answer

Appropriate insurance can provide finance for the business to continue to meet an income commitment to the seriously ill owner and also to cover some of the other needs for financial help, e.g. to replace revenue, repay debt or meet additional expenses.

Premiums probably won't be tax deductible but neither will the benefits usually be taxable.

1.3 The death or serious illness of a key employee

The challenge

Where the loss of the services of a key employee through death or serious illness would cause financial damage to the business which cannot be easily or speedily avoided by recruiting a replacement, then there may be a need for financial provision.

The answer

The answer is usually found in appropriate insurance. A financial planner can give you guidance on how much cover you need and for what term. In most cases the policy providing the cover would be effected by the business and, depending on certain conditions being satisfied, the premiums may be tax deductible. However, this is likely to mean that the sum assured would be taxable. Again, advice is essential to establish the right initial solution – and then to keep it reviewed and up to date.

And in addition...

As an employer you might also like to consider the value to your key employees of:

- Income replacement/protection cover for times when your employees are absent from work due to long-term sickness; and
- Family protection insurance through a highly tax efficient relevant life policy. Under such a policy the premiums paid by the business will usually be tax deductible but neither the premiums nor the sum assured will be an income tax-assessable benefit for the employee. The death benefit would also usually be paid free of inheritance tax under a trust to your employee's family. So, all round, this type of policy could be highly tax efficient.

2. Business ownership challenges caused by death or serious illness: Business succession strategies

Where you own your own business with others, i.e. as shareholders, partners or members of a limited liability partnership (LLP), your death or serious illness (causing you to cease work) is likely to require you to consider the destination and future ownership of your share in the business.

A good starting point (if you haven't already done this or haven't considered this recently) is for you and your co-owners to consider what you would want to happen to your share in the business following the death or serious illness of any one of you. Having done this, it's important to keep your decision under review so that, as far as possible, it reflects your current wishes.

You should then check whether these wishes are reflected in the governing documents for the business e.g. the Articles of Association for company or the Partnership Agreement for a partnership or any specific agreements that might exist providing for business succession. To the extent that your wishes are not accurately legally reflected some action should be taken to correct this. We consider some of the main possibilities below.

(a) Ownership/business succession following death

The challenge

The requirement for the destination of your business share will, of course, depend on your circumstances, but in many cases an owner will want their share of the business to pass to the continuing owners with the deceased's family receiving an appropriate level of financial compensation.

Without appropriate arrangements in place, what you and your co-owners may wish to happen almost certainly won't happen. An effective "business intestacy" will take place and the law (rather than you) will dictate what should happen. This could mean that the surviving co-owners cannot continue to run the business themselves and the deceased's family do not receive financial compensation in the form of a capital sum or continuing income.

A possible answer

Each owner could take out an appropriate life assurance policy in trust for their co-owners. At the same time the owners would enter into an agreement which would specify the terms on which the business share of a deceased owner would be bought and sold following death, using the proceeds of the life assurance policy. Properly planned and executed this solution would, generally, provide for the deceased's family/dependants to receive, tax free, an appropriate sum of money and for the continuing owners of the business to continue to run and fully own the business.

A financial planner (perhaps working with your legal advisers) can help you to set up this kind of solution on the basis that best meets your needs. A regular review programme can then be established to ensure that the solution always meets your current needs.

Some variations

The solution discussed in this section is likely, in some form or other, to be appropriate for many businesses. However, other variations may be encountered. For example:

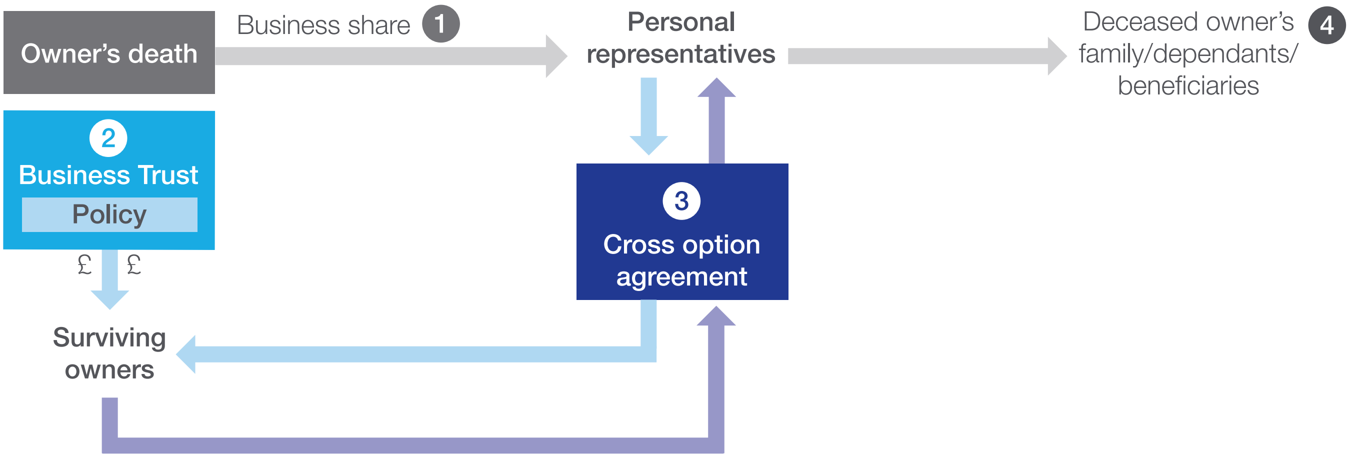
The family business – where the share of an owner will be left to a family member or members without payment. There may, however, still be a need for life assurance held in trust to 'compensate' another family member or members who do not benefit from the business share.

Partnerships – where the share of a deceased partner might "automatically" pass to the other partners without payment. Life assurance in trust is usually needed here to financially compensate the family of the deceased.

A CBF Wealth Management financial planner can help you to understand and plan for most variations.

We reiterate, though, that the starting point is for you to consider the consequences of the death of an owner or key employee and how detrimental it could be to your business without appropriate contingency planning being in place.

Business succession plan
Business owned, say three owners – identical solution for each owner



(b) Ownership/business succession following serious illness

The challenge

On an owner's serious illness there may be a need to consider the future ownership of their share in the business.

Much is likely to depend on the seriousness of the illness, the ability of the owner to return to work, the desire of the owner to return to work and the feelings of the co-owners about the affected owner's return to work. In summary, each case is likely to very much depend on its own facts.

The answer

Given the inherent uncertainty surrounding the challenge there is no simple answer. However, having funds available in case the business share of the seriously ill owner is to be sold and purchased will ensure that a solution will not be closed to the interested parties through lack of funds.

With advice it should be feasible to arrange for cover on a basis that should ensure that the sum assured could be used to fund a purchase on serious illness or later death – as appropriate. And if the purchase is to take place during the seller's lifetime i.e. following serious illness, in determining how much cover is required, account should be taken of any possible capital gains tax liability related to the sale.

As for the position on death appropriate trusts and agreements will be required to complete the solution and a CBF Wealth Management financial planner can help you with this.

1. On the death of an owner their business share passes to their personal representatives or administrators if there is no will. Regardless of who benefits under the deceased's will no IHT would usually be payable as the business share would qualify for business property relief. This means that 100% of the value of the share can be excluded for IHT purposes.

2. The surviving owner(s) receive the sum assured under the life assurance policy on the life of the deceased. The policy will be held in a business trust so it will be paid to the surviving business owners, without waiting for probate, and free of inheritance tax.

3. The owners will have entered into a "cross option" agreement under which the surviving owners have the option to buy the deceased's business share and the personal representatives of the deceased have the option to sell. If either party exercise their option the other is bound. So even if only one of the owners wants the business share sale to take place – it has to. By the agreement being in this format potentially valuable business property relief is not put at risk.

   As a result, the owners get the deceased's business share and the personal representatives get the cash proceeds of sale. No CGT usually arises as the share is revalued for CGT on death and a sale would typically take place within a few months following the death of an owner.

4. The personal representatives pass the sale proceeds to the deceased's family, dependants or other people specified in the deceased's will or, if there is no will, in accordance with the rules of intestacy.

3. The financial damage caused by the death or serious illness of a sole trader

"It's essential to carefully plan what you and your family would need and then ensure that the right trust is used so that no unwanted inheritance tax consequences are experienced."

The challenge

If you are a sole trader your death or serious illness with inability to work is likely to have disastrous financial consequences for you and your family (on serious illness) and your family (on your death).

In most cases, if you don't work, there is no income. In that sense, you are the business.

The answer

Appropriate life assurance that pays out

(i) on death; or

(ii) on death or serious illness, whichever happens first,

held subject to a suitable trust can tax efficiently ensure that you and/or your family have money to replace that which has ceased to be available from the business.

In order to arrive at the right amount of cover it's essential to carefully plan what you and your family would need and then ensure that the right trust is used so that no unwanted inheritance tax consequences are experienced.

A CBF Wealth Management financial planner can help you to put in place the right arrangements and then ensure that they are kept under review.

This guide is provided solely for your general consideration and to inform you. No action must be taken or refrained from based on this guide alone.

So what now...

If you are not already 'fully planned' in relation to the risks outlined above that could affect you and your business we would recommend that you

- Give serious thought to what 'financial life' would look like for you and, where relevant, your co-owners and family, should any of the identified events occur;
- Consider what you would like the situation to look like in those circumstances; and
- Set about closing the gap between what will happen if no or insufficient planning is carried out and what you would like to happen.

And where you own your business with others, ensure that everyone is involved in the decision making process and the solution.

A CBF Wealth Management financial planner will be on hand to help.

For further information or to book a consultation with a CBF Wealth Management financial planner, please call 0207 874 1190 or 0207 874 1194.

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