Integritas Financial Planners Ltd
Nurture · Grow · Protect

PARTNERSHIP PROTECTION (TERM ASSURANCE AND / OR CRITICAL ILLNESS)

What is it?

In the event that one of the partners of the firm were to die, the surviving partners may wish to be in a position to purchase the deceased's share from his / her estate. The ways in which this can be achieved are described below:

The cross option agreement is a formal agreement between business owners which deals with what may happen to their share of the firm on their death or on them becoming terminally or critically ill. The agreement may include a double or a single option, or sometimes both.

Under a single option agreement only one of the parties to the agreement has the right to exercise an option whilst under a double option agreement either party has the right to exercise an option. In either scenario, once an option has been exercised, the agreement becomes binding.

Why use a cross option agreement?

Business relief (BR) is a relief against inheritance tax, covering a business or interest in a business and will often mean that no inheritance tax is payable. If a binding contract for sale of the business property exists at the date of transfer (i.e. on death) BR is lost. Under a cross option agreement, the contract for sale does not become binding until a later date and only if either party chooses to exercise the option, thus preserving the relief.

As the tax treatment of each case is considered on its own merits by HM Revenue & Customs the business should confirm the tax position with its own Inspector of Taxes prior to taking out a policy.

This agreement gives the surviving partners the option to purchase the deceased's share of the partnership from his / her estate and it also gives the estate the option to sell the deceased's share to the surviving partners. If either party exercises the option it becomes binding on all parties.

Where a Critical Illness benefit is included, a single option agreement should be incorporated in respect of this situation. This will provide the option for the partner suffering from the critical illness to sell his / her share of the partnership in the event of a valid claim being made. However, the remaining partners do not have an option to purchase the share should the 'ill' partner not wish to sell – hence, 'single' option agreement.

In order to ensure that the surviving partners have sufficient funds to exercise their option to buy, or meet their obligation to purchase, a deceased partner's share each partner should effect a term assurance policy on their own life subject to a trust for the benefit of the other partners in the same proportions in which they will be entitled to purchase the share.

The simplest way to provide for such an eventuality is for each partner to take out a life policy on their own life and write it in trust for the benefit of the remaining partners.

Term assurance

A level term assurance policy provides for a capital amount (the sum assured) to be paid out in the event of the death of the life assured within a specified term assuming that premiums have been paid when due up to the date of death.

Critical illness cover

In the event that you suffer a critical illness then the sum assured under the contract will become payable. Once this sum assured has been paid the life cover will / will not remain in force. Definitions of a critical illness vary between different insurers and you can find a list of which illnesses are covered within the Key Features Document.

A Critical Illness plan is designed to pay out a lump sum if you are diagnosed as suffering from any of the specified critical illnesses but survive for a period of time after diagnosis (normally 28 days). The lump sum could be used to pay for things like nursing care, home help, adapting your house to accommodate a disability, paying off your mortgage or for a holiday to recover from treatment.

Critical illnesses usually include cancer, coronary artery bypass, heart attack, kidney failure, multiple sclerosis, major organ transplant and stroke. These are known as core conditions and account for the majority of claims. The comprehensiveness of conditions covered by different critical illness policies varies enormously and details of which conditions are / are not covered by the policy we are recommending will be fully explained in any supporting literature which you should check to ensure it meets your purposes.

It is usual to include cover for permanent total disability within the contract. The definition of Permanent Total Disability does vary and some insurers define it as the life assured being unable to follow his / her normal occupation as a result of sickness or accident whilst others will define it as the life assured being unable to independently perform a specified number of Activities of Daily Living (such as dressing or feeding) as a result of sickness or accident.

Writing this policy under trust

The policy may be set up under a Business trust. This type of trust is especially designed for use in conjunction with partnership protection arrangements and incorporates some important areas of flexibility.

The beneficiaries will be anyone who is a partner in the firm, in the proportions in which they own shares. This allows for departing partners to be removed from the trust automatically and new partners to be added, it also provides for changes in partnership shares.

In the event that you cease to be associated with the firm, the life policy would revert back to you.

Using a trust provides a number of benefits, specifically:

- You can identify who the beneficiaries should be (and with some trusts you have the ability to change this)
- Your chosen beneficiaries will receive the benefit soon after your death without the need for probate or prior payment of inheritance tax
- The amounts payable to your beneficiaries are, generally, free from inheritance tax

Eligibility

The minimum age to take out a life assurance contract is 18.

Taxation

Tax relief will not be available to you in respect of premium payments, however no tax would be payable on the proceeds of the plan.

If the firm makes the premium payments on behalf of a partner, the premiums will be shown as drawings from the partner's capital account.

All statements concerning the tax treatment of products and their benefits are based on our understanding of current tax law and HM Revenue and Customs' practice. Levels and bases of tax relief are subject to change.

Inheritance tax

HMRC rules require that premiums paid under arrangements such as this should be 'commercial'. This means that, apart from differences arising as a result of partners owning different size shares in the business, premium payments made by each partner for each partner's policy should be equal.

Provided HMRC accepts that a business protection arrangement is purely commercial, the premiums should be exempt transfers for Inheritance Tax purposes.

What may affect commerciality?

The individual facts of each case will determine whether it is commercial and the following factors will support an arrangement being classed as commercial:

- All the partners will normally be expected to take part in the arrangement
- New partners should be included as appropriate
- Correct and legally binding agreements should be in place
- The amounts covered by life policies should be the individuals' full interests
- The beneficiaries of the business protection trust should be restricted to the settlor and other 'owners' for the time being in the business

Risk considerations

There are a number of risk considerations that need to be taken into account. It is important that you are aware of these.

- This contract is designed to provide you with a high level of cover at minimal cost and therefore does not acquire a surrender value at any time
- If for any reason you stop paying premiums, cover will cease
- Failure to disclose any requested or relevant information may adversely affect any future claims
- Payment will not be made for a critical illness claim arising from an excluded condition (For Critical Illness only)
- At the end of the term selected, cover will cease and no further benefit will be payable
- You may wish to refer to your other professional advisers such as solicitors and accountants before or after implementing this type of plan to ensure that it matches your corporate objectives
- If any relevant information provided, when applying, is not disclosed accurately and honestly, this could result in any cover offered becoming invalid and / or may result in the non-payment of any future claims
- If this policy is to replace any existing policy offering the same type / level of cover, you must not cancel any existing policy until the new policy is in force