

Shareholder Protection ONLY

(For Companies and Partnerships; protecting the value of their shareholdings)

Important Note

The information to follow is intended as guidance only and is not intended to provide taxation advice. In all cases the insured and the business should seek specialist taxation advice based upon their own specific circumstances. It should also be noted that taxation rules change and this guidance has been prepared based upon our understanding of current tax legislation at the release date. Zinc Insurance Services can accept no responsibility for actions taken as a result of this release.

Release date 28 February 2009

General Tax Guidance

The tax treatment of a policy will depend on the particular mix of benefits provided.

From the perspective of obtaining tax relief for insurance premiums, it is necessary to review the benefits which can be expected to be obtained. In general, tax relief is only available to a business if the expense is wholly and exclusively incurred for the purposes of that business. For example any part of a premium which is intended to provide a future benefit to the shareholders of a company, (as under the specific Shareholder Protection cover) will not be allowable for tax purposes and is likely to "taint" the deductibility of the whole premium. HMRC may however allow a proportion of the premium as a tax deduction so far as it only relates to protecting the business. Alternatively the whole of a premium may be allowable if, for example, **the benefit to the shareholders is purely ancillary** and perhaps arises only because a protected business should not suffer any impairment in share value as a result of the circumstances crystallising a claim.

The treatment for tax purposes of the proceeds arising from a claim will depend upon the terms under which the insurance payments are due. **In general, if tax relief is obtained for the policy premium then the insurance proceeds will be taxable.** Further guidance in respect of the policy is given below.

As a general point where the cover reimburses a tax deductible cost of the business the overall position should be tax neutral. There could however be a timing difference between the tax due on the insurance receipt and the tax relief due on the costs, particularly if those costs are not incurred in the same accounting period as the insurance proceeds are received (noting that reimbursement is usually paid a month in arrears).

Shareholder Protection

*Provides **protection to the shareholders of the business** by providing a lump sum payment, following permanent disability to the insured person from usual occupation, allowing the remaining shareholders to purchase the insured persons shares within the business.*

As the premiums have a capital purpose, that is to enable the company to purchase the insured person's shares, **they are unlikely to be viewed by HMRC as wholly and exclusively for the purposes of the company's trade.** As a result they are unlikely to be deductible for tax purposes. **The insurance proceeds should not however be taxable trading receipts as the insurance does not relate to the business' ability to generate profits.**

Specialist taxation advice is recommended for companies so that appropriate tax efficient succession planning can be put in place. This is a particularly complex area.

The insured person should for example take taxation advice prior to disposing of their shares in order to secure the most beneficial treatment for them as the proceeds arising from a company purchase of its own shares could be subject to either capital gains tax or income tax depending on the specific circumstances.

If the purchase of the shares follows the accidental death of the insured person then it is important that there is no binding contract for sale in either the shareholder's agreement, articles of association or any other agreement as this will jeopardise inheritance tax reliefs potentially available to the deceased's estate which exempt the value of the shares from inheritance tax. Often forms of option agreement are instead put in place to assist in business succession issues. Specialist taxation advice should be obtained in this regard from the company's solicitor or accountant.

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Partner Protection

*The cover will **pay the business a lump sum**. It provides **protection for the partners** by providing a lump sum payment allowing the remaining partners to purchase the injured person's share in the partnership.*

Specialist taxation advice is recommended for partnerships so that appropriate tax efficient succession planning can be put in place. This is a particularly complex area.

To qualify for tax relief against the profits of partnership a cost must be wholly and exclusively for the purpose of the trade. **The significant personal benefit to the partners when receiving the insurance proceeds means that this test is unlikely to be met and so the cost of the insurance is unlikely to be tax deductible from the profits of the business.**

A lump sum payment for partner protection should not be taxed as income of the business, however, as it has a capital purpose, enabling the remaining partners to purchase the injured person's partnership share.

If the purchase of the partner's share of the business follows the accidental death of the insured then it is important that there is no binding contract for sale in either the

partnership agreement or any other agreement as this will jeopardise inheritance tax reliefs potentially available to the deceased's estate to exempt the value of their partnership share from inheritance tax. Often forms of option agreement are instead put in place to assist in business successions. Specialist taxation advice should be obtained in this regard.

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