KEEP MOVING FORWARD

A Guide to Corporate Co-Director Insurance

Corporate Co-Director Insurance

INTRODUCING ROYAL LONDON

Ever since we started as a Friendly Society over 150 years ago, at Royal London we've believed that our difference is our strength. Today, we're the UK and Ireland's largest mutual life and pensions company. Whoever you are and whatever your aims, we'll look to provide you with great long-term value, first class service and support at all times.

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CORPORATE CO-DIRECTOR INSURANCE FROM ROYAL LONDON

At Royal London, we know that protecting and minimising the risk to you and your business is of the highest importance to you and your fellow Directors. As prudent business people you will most likely have already put measures in place to protect your company, such as insuring its property, equipment, stock and vehicles.

Whilst these are all very sensible precautions, it is possible to neglect to ask yourself one very important question. If one of the shareholders in your firm were to die, what would happen to your company?

Although this is not a question any of us like to think about, the reality is that the chances of one of the shareholders in a company dying during their working life is much higher than you may think. And the business consequences can be devastating.

DID YOU KNOW?

Within 5 years of the death of the founder of the business, statistics show that 72% of businesses ceased trading.

Source: BDO Simpson Xavier

HOW WOULD **YOUR BUSINESS COPE?**

In addition to the emotional distress and upset caused, the untimely death of a shareholder can, and often does, have severe financial implications for the surviving shareholders. Both the company and the next of kin may be faced with a number of challenges.

The business

Inability to buy out the deceased shareholder

The ideal solution, from the other shareholders' perspective, might be to buy back the deceased's shares.

However, the remaining shareholders may be unable to raise the required capital particularly in these challenging times, when finance and loans are hard to get. Or indeed, the next of kin may refuse to sell.

A new shareholder

In the normal course of events the deceased's shares in the company will become part of their estate. They may therefore pass to a new share owner, perhaps the deceased's spouse or one of their surviving children.

This could, depending on the circumstances and the individual cause problems for the business, particularly if the deceased shareholder owned a large percentage of the company. For example, the new share owner may not have in-depth experience of the business, or they may wish to move the company in a new or unwelcome direction.

Alternatively, the family may simply not want to take a position in the company.

Loss of control

If the deceased shareholder owned more than 50% of the company, their next of kin may automatically become the new majority shareholder.

Depending on the circumstances of the new shareholder, they may wish to take over control of the company immediately, or they may wish to sell their shareholding to an external party. In this circumstance the remaining shareholders will have limited control over such decisions.

In all of these scenarios, neither the deceased's estate or the surviving Directors are placed in a very satisfactory position.

The next of kin

As well as the untimely death of a loved one and the emotional distress involved, the next of kin may also find themselves facing some difficult decisions.

They may for example, be in full time employment in another organisation and may have no interest in taking on the shareholder's role, preferring instead to sell their shares for an immediate capital sum.

Potential difficulties in the sale of shares

The company's Articles of Association may in fact give the other shareholders the right to block the sale of the shares to an outside party.

Without any way to sell the shares on the open market at their true value, the deceased's next of kin could be forced into a 'fire sale' of the shares to the other shareholders, at a lower price than that of the current market value.

Cash flow difficulties

The deceased's salary will cease on death. If the shares are not sold, the next of kin may be left holding a 'paper asset,' particularly if they now own a minority holding in the company, producing little or no income.

The cash flow problem could be exacerbated if the shares inherited also give rise to an immediate Inheritance Tax liability.

THE SOLUTION

There is however a solution available that safeguards the future of your business in the event of the death of a colleague.

Corporate Co-Director Insurance from Royal London offers you a cost effective way:

- To put the measures in place to protect the business
- To help enable the **continued financial stability of your business**
- To ensure the deceased's next of kin receive a **capital sum** for the deceased's shareholding.

SO, WHAT EXACTLY IS IT?

Corporate Co-Director Insurance is an arrangement between a private trading company and one or more of its shareholding Directors which enables the company to buy back a shareholder's stake in the company from their personal representatives on death, when needed.

A legally binding agreement between the company and its shareholders is drawn up, and one or more Life Cover policies **owned by the company** are put in place. This ensures that the company has the required funds available from the Life Cover policy proceeds to purchase the shares from the deceased's estate within a specified period after their death. The next of kin will receive the value of the deceased's shareholding.

The key benefits of Corporate Co-Director Insurance are:

- On the death of a Director the surviving shareholders retain control of the company, as funds are available to ensure the deceased's shares are bought back by the company and cancelled. (This ensures certainty of ownership for the remaining Directors)
- Dependants of the deceased shareholder realise and receive the value of the shares. (This ensures funds are available for a fair and just provision for the dependants of the deceased Director)

Peace of mind provided by:

- Pre-empting the problem before it occurs
- Obtaining agreement by all parties
- Providing the funds when needed, to match the solution

Finally one of the key benefits of Corporate Co-Director Insurance versus traditional Co-Director Insurance, is that the **cost is borne totally by the company and not by the shareholders personally.** This is subject to certain criteria being met. You'll find full details on pages 13–14.

Why take out Corporate Co-Director Insurance?

They may not be pleasant statistics to ponder, but the probability of at least one of the shareholders in a company dying could be much higher than you may think.

No. of shareholders in firm	Probability of at least one shareholder dying before age 65
2	24%
3	34%
4	43%
5	50%
6	57%
7	62%
8	67%

Source: CSO Table 15 on Irish Life 2005/07; all key persons assumed to be aged 40 and males.

How does Corporate Co-Director Insurance work?

Corporate Co-Director Insurance is a contract entered into between the company and each shareholding Director. The contract specifies that in the event of a Director's death the company would acquire the option, (to be exercised within a limited period, usually three months, after death), that compels the deceased shareholder's next of kin to sell their shares back to the company at a fair value. This is referred to as a **'Call Option.'**

The company arranges appropriate Life Cover on the relevant shareholder, so that if a shareholder died, funds are available to buy back their shares.

Likewise the deceased's personal representatives would acquire an option to compel the company to purchase the shares from them at a fair value. This is called a **'Put Option.'**

In this way Corporate Co-Director Insurance enables either the company itself (not the surviving Directors) or the deceased's next of kin to trigger the purchase/sale of the deceased's shares after death.

In the event of the death of a shareholder covered by such a **Contingent Purchase Contract** (also known as a **Double Option** agreement), the company would use the proceeds of the policy to buy back the deceased's shares on death and cancel them, or hold them as 'treasury shares.' The surviving shareholders would therefore gain full ownership of the company.

Whilst the cost of the Life Cover is borne totally by the company, with no personal outlay for the shareholders, Corporate Co-Director Insurance arrangements can be complex, and may not be appropriate for all companies. A number of taxation issues arise and certain legal restrictions apply. More details on these are set out in the Appendix section of this brochure.

In summary, having Corporate Co-Director Insurance in place ensures:

The next of kin of a deceased shareholder are not tied to the company in the long-term, and can rapidly realise their shares for a capital lump sum.

The surviving shareholders retain full control over the company as the company itself will buy back the shares of a deceased shareholder.

The cost of the Life Cover is borne totally by the company and not personally by the individual Directors.

Your Financial Broker will be happy to take you through the range of benefits associated with Corporate Co-Director Insurance from Royal London. They can assist you throughout the entire process, outlined on the following pages.

BUSINESS CASE EXAMPLE

AB Ltd. is a manufacturing company comprised of three shareholding Directors, Tony, Michael and Martin, each owning 33% of the limited company.

They want to ensure that if they die:

1. The surviving Directors retain control of the company, as **funds are available** to ensure the deceased's shares are bought back by the company and held as 'Treasury Shares' or cancelled.
2. Dependants of the deceased shareholder receive the **value** of the deceased's shareholding.

The solution

The shareholding Directors, Tony, Michael and Martin, have decided to arrange Corporate Co-Director Insurance.

They are putting Corporate Co-Director Insurance in place as it has, subject to meeting Revenue and Companies legislation criteria, **cost benefits versus 'traditional' Co-Director Insurance**.

Having considered the current estimated market value of the company (€1,200,000), and their individual share values (€400,000 approximately as they each own 33% of the company), they each enter into a Double Option/ Contingent Purchase contract with their Limited company.

Shareholder	Share Value
Tony	€400,000
Michael	€400,000
Martin	€400,000

AB Ltd would then take out Corporate Co-Director Insurance on each director

Please note: examination of the company's Memorandum and Articles of Association, as well as in-depth investigation into Capital Gains Tax treatment is absolutely imperative. In some instances, a Shareholding Director may be excluded from the insurance arrangement should they not meet all 7 tests outlined in Appendix 1.

In the case of **Tony** the value of his shareholding is €400,000 so he requires Life Cover of €400,000 (for say) a cost of €600 p.a.

Martin also has a shareholding of €400,000 and so he requires Life Cover of €400,000 (for say) a cost of €600 p.a. The same will apply for Michael.

In this example, the total cost of the three policies is €1,800 p.a. Premiums are paid by the company.

Proceeds payable on death are treated as a realised capital receipt in the hands of the company. Therefore, they are exempt from Capital Gains Tax (CGT) if the sole purpose of the policy is to enable the company to purchase its own shares, and the premiums are not deducted for Corporation Tax purposes.

In the event of the death of Tony, AB Ltd. would acquire the right to exercise a **'Call option,'** compelling Tony's next of kin to sell their shares back to the company.

Alternatively, Tony's next of kin can also exercise their **'Put Option,'** compelling AB Ltd to buy back their shares. Both the **'Put Option & Call Option'** are usually exercised within a limited period of time, usually 3 months.

Once they buy Tony's shares, the company can then choose to hold them as **Treasury Shares**, or cancel them.

Tony's estate receive the €400,000 value of his share of the firm.

Benefits of Corporate Co-Director Insurance

The cost is borne totally by the company and not the individual Directors.

The shareholding Directors are not subject to benefit in kind charge in respect of the premiums paid by the company.

Nor do the company have to increase Tony, Michael or Martin's salary so they can pay for their Life Cover premiums. This would also be more expensive as they would have to additionally take income tax among other charges into account.

There is therefore a **greater cost saving** for the company with Corporate Co-Director Insurance over traditional Co-Director Insurance, where the burden of premium payments falls on the Directors personally.

However, there are Revenue and Companies legislation criteria which **must be met** in order to benefit from Corporate Co-Director Insurance. If your company does not meet these criteria you should proceed with Traditional Co-Director cover (please refer to Appendix 1 for more details).

Companies and their shareholders must consult with their relevant Legal, Taxation Advisor and/or Financial Broker to consider the potential suitability of a Corporate Co-Director Insurance arrangement, **before** entering into such an arrangement.

SETTING IT **ALL UP**

There are a number of steps involved in setting up a Corporate Co-Director Insurance arrangement:

Step 1 – Who should be included?

All shareholding Directors should be considered for inclusion.

Step 2 – Examining the company's Articles & Memorandum of Association

The company's Articles of Association may need to be changed in order to provide the company with the power to buy back its own shares.

The company's Memorandum of Association may also need to be changed to specifically include an object permitting the payment of premiums under a Corporate Co-Director Insurance arrangement. A Special Resolution of the members of the company is necessary in order to amend its Articles of Association.

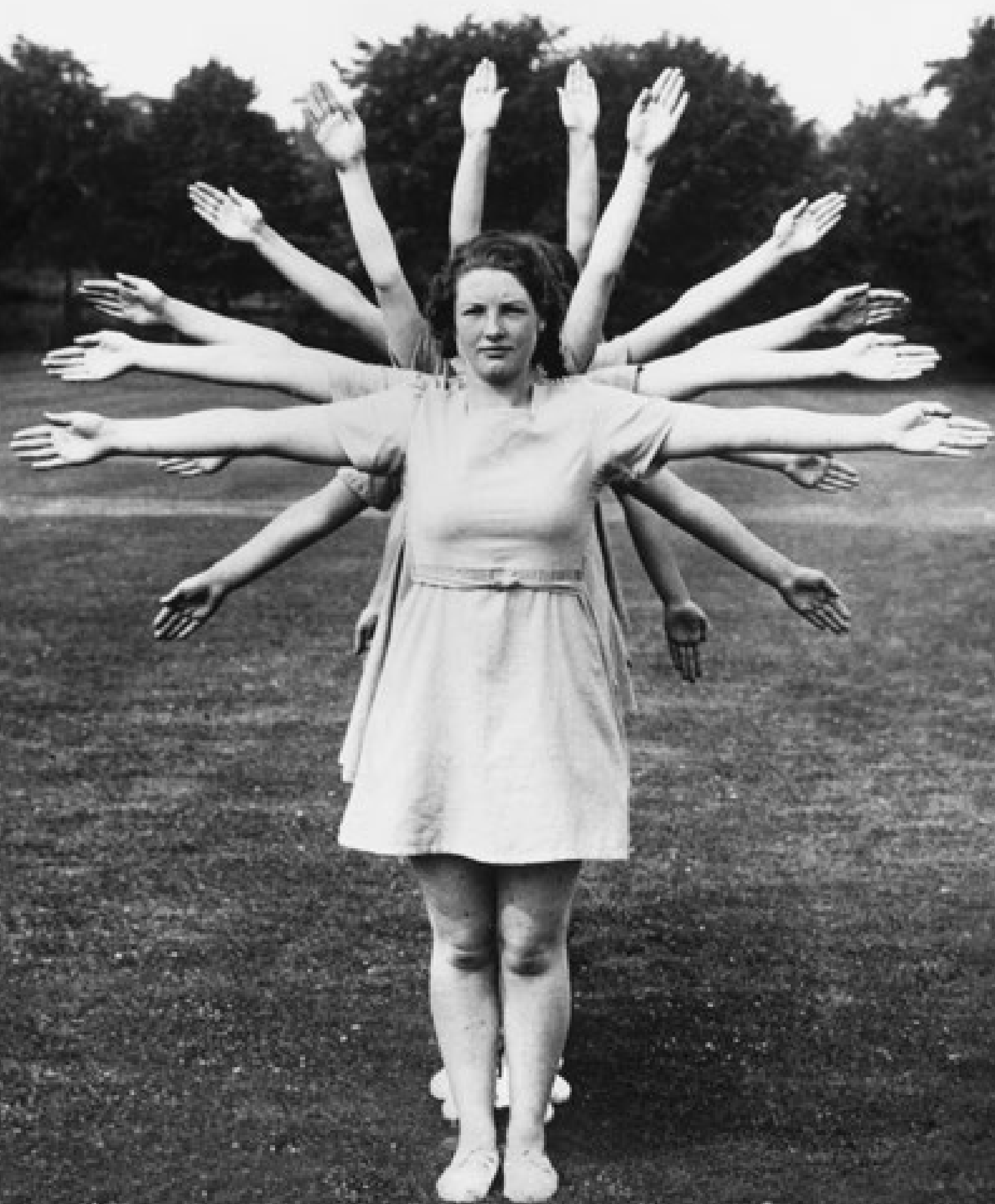
Companies should consult with their relevant Taxation, Legal Advisor and/or Financial Broker when considering a Corporate Co-Director Insurance arrangement.

Step 3 – Consider Taxation implications

The potential taxation implications for the company and the shareholder's next of kin of a Corporate Co-Director Insurance arrangement are set out in Appendix 1 of this brochure. The circumstances of each shareholder to be included in the arrangement should be checked in order to verify whether all of the seven tests outlined in Appendix 1 will be likely to apply on the purchase of their shares by the company on death.

If a particular shareholder's circumstances are such that all seven tests are unlikely to be met, then strong consideration should be given to excluding that Director from this insurance arrangement, as the taxation implications of a distribution is likely to be unattractive for all parties concerned.

Indeed, it may prove more beneficial to insure all of the Directors under a traditional Co-Director arrangement, which does not directly involve the company.



It is important that all parties to be involved in the arrangement are satisfied that the Capital Gains Tax treatment will apply on the sale of the shares to the company before the insurance arrangement is set up.

Companies and their shareholders must consult with their relevant Legal, Taxation Advisor and/or Financial Broker to consider the potential suitability of a Corporate Co-Director Insurance arrangement, before entering into such an arrangement.

Step 4 – Prepare the Appropriate Contingent Purchase Agreement

Assuming that any changes required to the company's Memorandum and Articles of Association have been made, the company in conjunction with its own Legal and Taxation advisers, should then prepare a separate **Contingent Purchase Agreement** in respect of each shareholder.

Royal London can provide a specimen Agreement, but this should not be used without consultation with the company's own Legal and Taxation advisers who should draft an agreement suitable to the company's own needs and circumstances.

Step 5 — Approve the Contingent Purchase Agreement by Special Resolution

Each of the proposed Agreements must be available at the company's registered office for at least 21 days before the meeting held to approve the Agreements, and must be available at the meeting itself. (See Appendix 2 for more details).

A Special Resolution must be approved by the company in respect of each Agreement; however any shareholder with equity in the company of more than 25%, who is the subject of an Agreement, must abstain from voting to allow the other shareholders to vote the Resolution through.

Step 6 — Set Up the required company-owned life assurance policies

At this final stage, Applications for the relevant policies are submitted to Royal London, in order to initiate the process of putting the required cover in place.

In most cases the Application will contain all the information we need.

However, in some cases the individual to be insured may also be required to attend a medical examination.

Also in certain circumstances, the company may be asked to complete a financial questionnaire in order to assist Royal London in their examination of the amount of cover proposed.

IN SUMMARY

Corporate Co-Director Insurance from Royal London enables the shareholders of a private company to put in place a structure to allow the shares of a deceased shareholder to be bought by the company shortly after death, thereby allowing the surviving shareholders to retain control of the company.

Of course, the upset and anguish caused by the death of a colleague can never be compensated for.

However, by taking out Corporate Co-Director Insurance with Royal London you can have the funds available to help limit the financial damage and disruption caused by the untimely death of a Director in your firm.

The ultimate aim of Corporate Co-Director Insurance is to put the structures, processes and monetary agreements in place now, to pre-empt the problems caused by a Director's death.

Most importantly, it allows you to place a financial worth on each Director's share of the company. This can help ensure you have the funds available to protect your business and the deceased's estate financially, in the face of the death of one of the firm's Directors.

Your Financial Broker will be happy to take you through the range of benefits associated with Corporate Co-Director Insurance from Royal London. They can help you put a solution in place to meet the individual needs of your company.

ADDED **PROTECTION**

Specified Serious Illness Cover from Royal London provides additional security to you and your business.

How would your business cope?

As well as protecting your business from the adverse financial affects of the death of a Director, it may also be wise to consider what would happen in the event that they suffer a serious illness or disability, preventing them from continuing as an active participator in the company.

As with the death of a Director in your company, their unexpected serious illness can also undermine the financial stability of your business.

The solution

Having a **Specified Serious Illness Cover** policy in place, as well as Life Cover, to provide the necessary funds to buy back shares following the serious illness of a Director.

The Double Option Agreement could provide for the buy back of a Director's shareholding in such circumstances, in addition to a buy back on death.

What is Specified Serious Illness Cover?

Specified Serious Illness Cover from Royal London provides additional security to you and your Business. It pays a guaranteed lump sum if the insured person on a Corporate Co-Director policy is diagnosed as suffering from one of the 51 full payment specified serious illnesses we currently cover, during the term of the policy. We also currently provide 22 partial payment benefits. That's **73 illnesses** covered in total.

Why take out Specified Serious Illness Cover?

You may think that the chances are unlikely, but the probability of suffering a serious illness may be much higher than you think. Did you know that:

- One in three Irish people will develop cancer by age 75
- Up to 10,000 Irish people suffer a stroke each year

Sources: National Cancer Registry Institute (NCRI), Irish Heart Foundation.

But with adequate Specified Serious Illness Cover and Life Cover in place, you will have a lump sum available to help deal with any adverse financial consequences caused by the death or serious illness, of a Director in your company.

Your Financial Broker can offer you impartial advice to meet the specific needs and offer the best solutions for your firm.

Please note: Not all incidences of illnesses such as cancer or a stroke will be covered under Royal London's Specified Serious Illness policy. We will only pay a claim based on our Specified Serious Illness Definitions. Royal London's 'Specified Serious Illness Definitions Guide' provides a detailed description and explanation of the 73 specified serious illnesses we cover. This guide clearly states the exact conditions which must be met for a claim to be paid. This guide is available on request.

APPENDIX 1

Taxation Treatment of Corporate Co-Director Insurance

As part of a Corporate Co-Director Insurance arrangement, the company will be required to effect and maintain a policy on the life of each shareholding Director who is to be a party to a Contingent Purchase Contract with the company.

The following is intended as a guideline only in respect of the Taxation treatment of Corporate Co-Director Insurance policies. **Royal London recommends that before effecting this type of insurance, companies should seek independent legal and taxation advice on the suitability and taxation treatment of a Corporate Co-Director Insurance arrangement.**

Taxation of Premiums

Under current Revenue practice the premiums on such policies are not allowable deductions for Corporation Tax purposes.

Policy Proceeds

- The proceeds payable on death would be treated as a realised capital receipt in the hands of the company, and exempt from Capital Gains Tax provided the sole purpose of the policy is to provide funds to enable the company to purchase its own shares.
- If the buy back of the shares is deemed to be a distribution (see the following paragraph) then the company would be required to deduct Dividend Withholding Tax at the standard rate on the payment.

The Director and Next of Kin Distribution

Where a company redeems its shares, any amount paid by the company in excess of the original issue price may be treated as a distribution for tax purposes. There are two implications if this treatment were to apply to the purchase by the company of its own shares:

- The company would have to deduct Dividend Withholding Tax at standard rate on the amount paid for the shares; and
- The vendor of the shares would be liable to income tax at marginal rate under Schedule F on the amount of the net distribution received plus Withholding Tax, but with a credit allowed for the Withholding Tax deducted at source.

Not a distribution

However the purchase by a company of its own shares might not be treated as a distribution if all of the following seven conditions apply. In this case the sale of the shares by the vendor to the company would be treated as a disposal (and not a distribution) for Capital Gains Tax purpose:

1. *The company must be an unquoted trading company, or the unquoted holding company of a trading group.*
2. *The purchase of the shares is made wholly or mainly for the purpose of benefiting a trade carried on by the company.*
3. *The purchase of the shares must not form part of any scheme or arrangement, the main purpose of which is to enable the owner of the shares to participate in the profits of the company, without receiving a dividend. Where shares are being bought back after the death of a shareholder, it is clear that the intention of such a buy back is not to avoid taking dividends, but rather to facilitate the disposal of the shares by the next of kin.*
4. *The vendor must be resident and ordinarily resident in the State for the year in which the company purchases the shares. The residence and ordinary residence of the deceased's personal representatives are taken as those of the deceased shareholder immediately before his or her death.*
5. *The shares must have been owned by the vendor for at least 5 years before the shares are purchased, or 3 years where the shares are being purchased after the shareholder's death. The period during which the deceased's personal representatives*

own the shares also counts towards the 3-year ownership requirement.

6. *The vendor and his associates i.e. spouse, if living together, and children under age 18, must reduce their shareholding after the purchase by the company, by at least 25%. Where all of a vendor's shares are being bought back by a company, and his associates have no other shareholding in the company, then this requirement will clearly be met.*

7. *The vendor and his associates combined must not be connected with the company after shares are sold to the company. This means that after the buy back, the vendor and his associates combined must not own or control more than 30% of the equity of the company. Where the deceased's full shareholding is bought back by a company, and his associates have no other shareholding in the company, then this requirement will clearly be met.*

Capital Gains Tax

Where all of the seven tests outlined above apply, then the sale of the shares to the company may be treated as a disposal for Capital Gains Tax purposes, and not as a distribution.

For Capital Gains Tax purposes, shares on death are deemed to be acquired by the next of kin, at their market value at the date of death. There is then no Capital Gains Tax liability on death.

If the next of kin sell their shares shortly afterwards to the company, a liability to Capital Gains Tax on the shares would only arise in respect of any increase in the value of the shares from the date of death to the date of disposal.

Loss of Business Relief

Please also note that the disposal of the shares by the next of kin shortly after death may result in the loss of any Business Relief applicable to those shares for Capital Acquisition Tax (CAT) purposes. Where the spouse of the deceased would have inherited the shares sold, then no Inheritance Tax would have applied anyway, and so any loss of Business Relief in this case would be immaterial.

Where, however, the shares sold back would have been inherited by some other beneficiary, e.g. a child of the deceased, the potential loss of Business Relief for CAT purposes may be significant and hence should be borne in mind before entering into a Corporate Co-Director Insurance arrangement.

APPENDIX 2

Legal Restrictions on Corporate Co-Director Insurance

The main area that may restrict the setting up of Corporate Co-Director Insurance and hence should be considered carefully before entering into such an arrangement, is the legal power of a company to purchase its own shares.

The Power of a Company to Buy Back Its Own Shares

The Companies Act 1990 allows a private company to buy back its own shares in certain circumstances, and subject to certain conditions:

- A company can only purchase its own shares if its Articles of Association allow it.
- A company can only buy back its own shares under a Contingent Purchase Contract entered into in advance of the purchase, which must be approved by a Special Resolution.
- A copy of the contract must be available for inspection by members both at the registered office of the company for at least 21 days before the meeting at which the resolution will be passed, and at the meeting itself.
- A company cannot buy back all its own shares.
- Only fully paid up shares can be purchased by the company.
- A company purchasing its own shares must pay in full for the shares at the time of purchase.
- A company can only buy back its own shares out of profits available for distribution, as defined in the Companies Act 1990.
- Copies of the contracts of purchase of the shares must be kept at the company's registered office for a period of 10 years after the share buyback.
- The company must make a return to the Register of Companies of details of the number and class of shares purchased, their nominal value and the date on which they were delivered back to the company.

Royal London recommends that you seek advice from your Legal, Taxation Advisor and/or Financial Broker before putting any measures in place and write to your tax office seeking clarification on the relevant tax treatments.

WANT TO
KNOW MORE?

If you have a question about Corporate Co-Director Insurance then you can contact your Financial Broker. They can provide you with any additional information you need. See details below.

For information on other Royal London plans visit our website **royallondon.ie**

Royal London
Royal London House, 47 St Stephen's Green, Dublin 2
T: 01 429 3333 F: 01 662 5095 E: service@royallondon.ie
royallondon.ie

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