

# Business Protection

## Guide to Business Succession for Partnerships

For intermediary use only – not for use with your clients

This technical guide details the need for business succession planning for partnerships, suitable solutions, and the impact and tax treatment of applying them.

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In this guide we are looking at business succession – what happens to the ownership of the partnership should a partner die, or be unable to return to work due to critical illness. We look at the need to make financial provision both from the perspective of the partner's family and dependants and of the co-partners. We also look at the basics of how arrangements are put in place.

### What is a partnership?

A partnership is defined in Section 1 of the Partnership Act 1890 as 'the relationship which exists between persons carrying on business in common with a view of profit, other than by way of membership of a body corporate.' There is no limit to the number of partners a business can have.

In a partnership, each partner has an interest in the business rather than, as is the case with a limited company, ownership of ordinary shares.

Whenever the composition of a partnership changes, whether through the introduction of a new partner, retirement or death, in law the partnership is, without a partnership agreement expressing something different, deemed to be dissolved or to have come to an end, and a new one will have come into existence.

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# 1 The Need

## On death

- Should a partner die, the widow (widower, civil partner or other financial dependants) of the partner, could potentially be in a difficult financial position.
- The only, or at least a significant, source of income may have vanished (though there may be an entitlement to some form of pension).
- It is very unlikely, and most likely legally impossible, that the partner's family will be in a position to step into the partner's shoes.
- The overwhelming likelihood is that they will be entitled to the value of the deceased's interest in the partnership via the partner's Will.
- Equally likely, is that they will probably have no interest in the business or will not be technically able to take part in it.

The most obvious course of action for the personal representatives of the deceased partner will be to dispose of the deceased's partnership interest to the surviving partners. However, the following will need to be considered:

- On what basis will the partner's interest be valued?
- Will there be pressure to accept less than the true value of the share?
- What happens if the surviving partner(s) don't wish to buy?
- What happens if the surviving partner(s) can't raise the cash?

Without an agreement specifying what is to happen, the partnership will be dissolved on the death of a partner. Strictly speaking, the personal representatives will only have a right to a share of the dissolution value of the partnership. In practice though, in many cases, the surviving partners are

likely to want to continue to trade and so a deal to buy the deceased's interest/compensate the personal representatives for their rights to a share in the partnership assets will need to be agreed. Of course, the personal representatives would be entitled to the repayment of any loans due to the deceased partner in addition to this.

Where the partners have agreed, on the death of one of them, to dissolve the partnership and realise the value of its assets, thereby being able to pay to the deceased's estate their share of the value of the business, and all partners are happy with the financial, commercial and lifestyle consequences of this, there would be no need for additional cash through insurance.

Where the partnership is to continue, the surviving partners will need to be able to buy the deceased partner's share from the deceased's estate. Naturally, to achieve this they need money.

The major requirement of a deceased partner's family following the partner's death will, in all likelihood, be cash.

## Critical illness

- If a partner is unable to return to work due to critical illness, then their right to continue to share in profits will depend on what is stated in the partnership agreement.
- If nothing is stated, the law would provide for the right to share in profits to continue.
- A critically ill partner may wish to sell their partnership share (in most cases to the surviving partner(s)) but without the requisite amount of cash, this may be difficult.

## 2 The Solution

### Introduction

The first step in constructing a solution is for the partners to agree what they want to happen on death or critical illness and to see this all in an appropriate agreement.

What will then be needed is enough cash in the right hands, at the right time to achieve their objectives.

The money could be made available to the surviving partner(s) through bank loans. The bank will charge interest on the loans, although tax relief is likely to be available to the borrower. The bank will want the loan to be repaid and will also require security, perhaps in the form of a charge on the borrower's house, or in the form of a life assurance policy, and very likely both. The surviving partner(s) may be unwilling to borrow money to purchase part of what they already regard as their own.

The simple solution is to plan ahead. In this way it might be possible to avoid completely, the need to borrow money and all the problems this involves – including the possible difficulty in accessing funds, the potentially high costs of interest and repayment. A life assurance (and/or critical illness) policy on the life of each of the partners is a means by which funds can be provided at the time they are most needed – on the death of the partner, or when the partner suffers a critical illness.

The solution to the problems faced by many partners lies in the proper use of life assurance policies (held in trust), in conjunction with a properly drafted partnership agreement.

### STEP 1: The Agreement

#### **1. Double option agreement to cover partnership sale/purchase on death**

The first step in constructing a solution for business succession on death is a double option agreement.

The partners should enter into an agreement which provides for the purchase and sale of a partner's share in the business in the event of the death of any one of them. Most modern agreements involve options to buy and sell, rather than a firm sale and purchase agreement. This type of share purchase agreement is called a 'double option' or a 'cross option' agreement. The agreement could be included in the Partnership Agreement, or as is more likely to be the case, in a separate agreement entered into by the partners.

The agreement, whether in the Partnership Agreement or separate from it, would typically incorporate two parts. The first would give the deceased's executors the option to sell the share. The second would give the surviving partner(s) a similar option to buy, hence the term 'double (or cross) option' agreement. In a double option agreement, the seller can effectively force the other partner(s) to buy, and the partners can force the deceased's executors to sell.

So, a properly drafted double option agreement will give the seller an option to sell. It should state that, if this option is exercised, the surviving partner(s) must buy, and equally, if they exercise their option to buy, the deceased's executors must sell. Clearly, the agreement must cover a number of factors which will depend on the circumstances of each case.

Some of the factors to be considered are outlined below:

#### Time limit

There should be a time limit within which the options can be exercised. This will generally be between three and twelve months. Less than three months may be impractical while more than twelve months could mean long delays for the deceased's beneficiaries. It is usually recommended, so as to make clear that the agreement is not binding, for the time limit for the option to sell to be different from that in connection with the option to buy.

#### What price should be paid?

A fixed price could give rise to an Inheritance Tax (IHT) or Capital Gains Tax (CGT) liability if the amount paid is anything other than commercial. So if a fixed price is incorporated into the agreement, it must reflect the value of the business at the time it is entered into. As the fixed price is unlikely to still represent a reasonable price after a number of years, regular reviews will be necessary. Reviews will be required with greater frequency if the partnership ownership is likely to change, if the shares are very disparate, or partners are of very different ages or in ill-health. The advantage of a fixed price, as long as it is reasonable, is that it can be 'matched' with life assurance policies.

An alternative to a fixed price, would be for the price to be the market value of the partnership share at the time of the death of a partner. The agreement could provide for an independent valuation to be made by an appropriately qualified valuer as this could avoid many of the problems and disputes that can arise in these situations. Some partners might however think that this method of valuation is less certain, and lacks the control of a fixed price.

Unless a fixed price applies, the amount paid out by the life assurance plan could exceed or be less than the amount required to purchase the deceased's share. The agreement should provide for this eventuality and this is discussed later.

#### Covenants regarding payments

There should be a covenant in the agreement that payments on the life assurance policies will be paid and that if any policy becomes void or otherwise ceases, a further policy will be effected to replace it. Also, any options available under a policy should be exercisable only with the consent of the co-partner(s).

It is important that the agreement should not restrict the partners' rights to dispose of their interests, as this could have adverse tax consequences.

#### Proportion of the deceased's partnership interest to be bought by the surviving partner(s)

The agreement should state the proportions in which the survivors will purchase the deceased's share. In many cases, surviving partner(s) will wish to purchase the deceased's interest in equal shares.

These are just some features that a double option agreement could contain. Quite clearly, different conditions and requirements exist for each individual case. The important thing is that professional advice should always be sought, which is why most such agreements are provided as drafts.



## 2. Option agreement covering sale/purchase of the partnership interest of a critically ill partner

The option agreement covering a sale/purchase of a partnership interest following a partner's critical illness can be either:

- a single option agreement (under which only the critically ill partner has the right to sell),  
or
- a double option agreement (under which the critically ill partner has the right to sell and the continuing partner(s) the right to buy).

A single option agreement prevents the other partner(s) from insisting that the partner who is critically ill sells their share, though if the critically ill partner decided to sell, his co-partner(s) must buy, affording some measure of protection if they believe he, will not return to the business. This style of agreement is the one that is usually chosen for this purpose.

The agreement covering sale/purchase on critical illness can be a 'stand-alone' agreement or could be merged with that covering sale/purchase on death.

## 3. Automatic accrual of goodwill

If the partnership agreement provides for the automatic accrual of goodwill (covered in more detail later in this guide) then only the value of the partner's right in the partnership exclusive of goodwill needs to be taken into account under the single/double option agreement.

In practice, automatic accrual, if it exists, is more likely to apply on death than on critical illness. Each case must, however, be considered based on its own merits.

## STEP 2: Providing funds through life assurance

Life assurance/critical illness insurance is recognised as being the most effective method of providing the necessary funds to facilitate a partnership share purchase on death/critical illness of a partner.

If life assurance cover is to be established, it is important to ensure:

- That the correct people have control over the policies;
- That the correct people will receive the sum assured from the policy at the right time;
- That the amount of cover is adequate and aligned with the amount required under the option agreements.

Ensuring that the sum assured is appropriate should not be difficult. In deciding how to structure the policies, partners should be aware that there are two routes:

- the trust route and,
- the life of another route.

The trust route is recognised as being the most flexible and a widely adopted solution. The business trust that should be used to facilitate this solution is described in detail in 'STEP 3' [The Business Trust](#).

However, the consequences of the life of another route are summarised as follows:

- If there are three partners, A, B and C, A would take out policies on the lives of both B and C, B (on A and C) and C (on A and B) would similarly take out two policies each, giving a total of six policies.

The advantage of this is simplicity at the outset, because each of the partners would be an applicant and own one or more of the policies. It is they who will be entitled to the proceeds and they will be making payment to the policies from which they will ultimately benefit. No trusts would be required.

However, the method is not without its problems:

- A partner may leave the business. On doing so that partner may no longer have a use for the policies. The appropriate solution would be for them to assign their policies to whoever takes their place. This raises another problem. An assignment in these circumstances might well be for 'actual consideration' which could mean that the policies would not be tax-free when the sum assured is paid.
- Subject to the health/age of the partners concerned, if there are more than, two partners the solution could become very complicated and potentially inflexible. With four partners, for example, there would be a need for twelve policies.

On balance, it is reiterated that the only partnership for whom a life of another solution could be appropriate would be a two person partnership who envisage relative stability with no departures and no new partners.

As stated above, the most appropriate solution for most partnerships would usually be for each partner to take out a policy on his own life, written subject to a business trust for the benefit of the other partner(s). This can remove all the difficulties raised in respect of life of another arrangements.

The procedure in this case is for the life assured as the settlor to take out the policy and to declare a trust.

In the example of a partnership with three partners, A would take out a policy on their own life in trust for B and C. B and C would also take out a policy each, making a total of just three policies, each with their own trust.

Each settlor will be the initial trustee of their policy and will appoint additional trustees who may, or may not, include all the partners. The trust will provide for the ownership of the policy to appoint trustees who may or may not, include all the partners. For administrative reasons, no more than four trustees should act. The trustees would be the legal owners of the policy and would hold it in trust for the beneficiaries, who would be the co-partners of the life assured in each case. Thus, on A's policy, the trustees would be A, B and C. The beneficiaries would be B and C.

## STEP 3: The Business Trust

### What type of trust?

The most appropriate form of trust is likely to be the flexible business trust. The trustees must be able to change the beneficiaries, or the beneficiaries will automatically change whenever a change in the partnership takes place. The way in which this will happen will depend on the way in which the trust is drafted, and advice should always be taken on this. The power to change the beneficiaries (if positive action is required) should always lie with the trustees as a whole, rather than one individual.

If a partner leaves, selling their share, the policy could be retained and used for other purposes. This can usually be done, though the method will be governed by the trust. It will usually be possible to use the policy, for example, in another share purchase agreement. In such circumstances, the trust could provide for an automatic reversion of benefits to the departing partner or give the trustees power to appoint the policy to the departing partner. In a commercial arrangement, this power for the life assured to benefit under their own policy would not cause an IHT problem to arise through the reservation of benefit provisions.

It may also be necessary to consider the possibility of a Pre-Owned Asset Tax (POAT) charge. However, in most cases this is unlikely to give rise to any liability, see [Making the arrangement tax efficient \(c\)](#) for more details.

Many life offices, including Zurich, have standard trust forms. The key is to ensure is that the trust can be adapted when things change. For example, if new partners join the partnership, can they be added to the beneficiaries under the trust?

The Zurich Flexible Business Trust is highly flexible and can allow for these changes if required.

### So, in summary...

Under the trust route on the death or critical illness of the life assured, the policy's sum assured will become payable to the trustees who will pay the proceeds to the life assured's co-partner(s) in accordance with the terms of the trust.

The next step is for the surviving partner(s) to decide whether to exercise the option to buy the deceased's share from the executors on death, or from the critically ill partner, as appropriate, and for the executors (or critically ill partner) to decide whether to exercise their option to sell to the continuing partner(s). Remember, that under a double option agreement, if one party decides to exercise their option, regardless of the wishes of the other, the other party must comply. Under a single option agreement the decision to sell rests solely with the critically ill partner.



## 3 Issues to consider

### What type of policy?

#### Life cover

Partners will need to consider what they are trying to provide for. If it is merely a lump sum on death before retirement, and the retirement date is fixed, then a term assurance is probably all that is required. Flexibility is nevertheless likely to be important, so options to increase the amount of cover and perhaps an increasing cover option should be included to cater for the probable rise in value of the partner's share, when the value of the partnership is reviewed.

Where retirement dates are not certain, whole of life cover could be appropriate, as there is no prospect of the policy expiring while the life assured is still working. Another factor to be considered is that if late retirement is a possibility, is whether a term assurance policy can continue beyond a particular age, or be extended beyond a particular age. If not, a whole of life policy may be better so as to maintain cover, even if a term policy can be extended.

#### Critical illness cover

Critical illness policies will pay out the proceeds in the event of the partner suffering from one of the critical illnesses covered in the policy. The same choice (term or whole life) needs to be made. In many cases partners may choose a policy that pays out on the earlier of death or critical illness – again, on either a term or whole of life basis.

#### Share valuation in relation to insurance cover

The essential point is to ensure that on each partner's life there is sufficient cover to enable the surviving partners to use the money to buy the appropriate share of the partnership assets from the deceased's estate or the partner following critical illness. A suitable starting point may be for the present value of the partnership to be assessed and to be attributed to each partner according to their share. This could be an initial amount of cover which can be increased whenever a review takes place. If there is a fixed price or 'specified value' expressed in the agreement this should be used.

Proper use of life assurance should remove the need for the surviving partner(s) to borrow money to enable them to buy the deceased's share. Therefore, there will be no interest payable and no requirement for security for any borrowing. Of course, use of the correct trust (see above) will ensure that as little tax as possible is payable.

### Unequal cost

Another aspect to take into account is the payments under each policy. Where co-partners are taking out plans for a similar purpose, the payment under each policy will, of course, be affected by differences in:

- the life assureds' ages,
- the life assureds' states of health,
- the amount of cover required.

It may be that what might be fairly large differences in the payment levels does not worry the partners. Even if there is no concern over payment disparity, the partners should consider equalising the cost so that the arrangement can be shown to be demonstrably 'commercial', therefore CGT and IHT implications can be avoided.

Please refer to our separate 'Premium Equalisation' sales aid for more details.

#### Setting up the life assurance policies – the mechanics

The life assurance company will need all the necessary forms, full details of the life to be assured and the details of the people who are to become the legal owners of the policy as trustees.

The policy will require underwriting and there will be two considerations – financial and medical. Financial underwriting will establish whether the level of cover is correctly assessed and medical underwriting will establish the risk of death or critical illness of the particular life assured within the terms of the policy.

In order to avoid adverse tax consequences it is very important – when using a trust – that the policy is not put in-force before the trust.

## 4 Taxation: Inheritance Tax, Capital Gains Tax and Pre-Owned Asset Tax

### Making the arrangement tax efficient

It is fair to say that the tax implications of share purchase and partnership assurance arrangements can be quite complex. However, tax should not be a significant problem. A solicitor is often involved in the drafting of the share purchase arrangement and there will often be a need for the solicitor and accountant to liaise closely with each other. However, a good start can be made by using a draft option agreement and a draft business trust, usually provided by the insurer.

#### a) Inheritance Tax (IHT) implications

IHT is relevant in four main ways to partnership share purchase schemes:

- Subject to Business Property Relief, the share in the partnership may be subject to IHT as it forms part of the estate of the deceased partner.
- Making payments to life assurance policies, assuming they are large enough, may be transfers for IHT purposes.
- There could be tax implications when changes are made to any trust arrangements.
- IHT may have to be considered in connection with the business trust to which the life/critical illness policies are subject.

#### IHT on the value of the partnership share

The share could form a major part of the partner's estate.

For IHT purposes, HM Revenue & Customs (HMRC) would value the share immediately before the partner's death. Business Property Relief (BPR) is, however, likely to be relevant and this can remove or substantially reduce any IHT otherwise payable on the partnership share.

BPR is a valuable relief which is available on transfers of business property. There are conditions that apply in terms of the type of business and the period the interest has been held. The business or an interest in the business must have been owned for two years and it must be a trading business.

The rates of relief for a partnership are:

A share in a partnership	100%
Land, buildings, plant or machinery owned by the partner and used wholly or mainly in the business of the partnership	50%

In all cases, the relief is only available to the extent that the value of the business is represented by relevant business property – i.e. not investments. Generally, only trading businesses qualify for the relief.

Clearly, where the share is not being left to the partner's spouse, it is important to be able to benefit from this relief. However, the relief can be lost if there is a binding contract for the sale of the share at the date of death. However, HMRC have indicated that a double option agreement is not generally regarded as a contract for sale for these purposes and the relief is still available. It is for this reason that share purchase agreements and partnership arrangements are set up using options to buy and sell, although some agreements may exist which do constitute binding contracts for sale. In these cases, it will usually be better to substitute a new double option agreement for the old one.

IHT should not be relevant in connection with a purchase on commercial terms following a partner's critical illness.

### Making payments to life assurance policies

If the policies are set up on a life of another basis, making payments will not have IHT implications. If, however, the policies are held in trust, payments will, on the face of it, be transfers for IHT purposes. In most cases though, payments paid under a life assurance policy held subject to a business trust will not constitute transfers of value as the payment will be made as part of an 'arm's length' commercial arrangement.

As the trust would be other than a bare trust, any non-exempt transfers would be chargeable transfers and not potentially exempt transfers.

It is in fact essential that the arrangement is 'commercial'. This is because, even if the settlor were not a beneficiary under the trust of the policy he effected on his own life, he will be a beneficiary under the policies effected by his co-partners and they will be beneficiaries under his own policy. This means that each party could indirectly benefit and therefore, if the premiums were treated as gifts, there could be a reservation of benefit by associated operations for IHT. Under the Zurich Business trust the beneficiaries are confined to persons involved in the business and therefore, subject to any premium equalisation (see earlier), the arrangements will usually be treated as commercial. If there is no gift there cannot be a gift with reservation of benefit.

### IHT on the business trust

Payment of the policy's sum assured should not give rise to any IHT problems. If, unusually, the policy is on a life of another basis, the proceeds will be paid to the surviving partner(s) and, because they already own the policy, there is no question of any IHT being payable.

If the policy is held in trust, the proceeds will be paid to the trustees. They will not form part of the deceased partner's estate (because they are trust assets and the arrangement was commercial) and accordingly will not have any impact on the deceased's IHT liability. As the trust would not be a bare trust it would be necessary to consider periodic and exit charges under the 'relevant property regime'.

These may apply even if the arrangement is commercial. These are relatively complex provisions but in most cases no charge should arise – regardless of the size of the sum assured.

There may be a risk of a charge (periodic and subsequent exit) if the policy has a substantial value, the payments paid are substantial, or the life assured is in serious ill health. Professional advice is essential. For policies with large sums assured it may be worth considering providing the required sum assured through a series of policies each effected on different days and each subject to a separate (identical) trust. This would, under current law, ensure that each trust would (in most cases) have its own nil rate band and thus would minimise the risk of any IHT charge. Again, professional advice is essential if this type of planning is to be carried out.

### b) Capital Gains Tax

This tax could be relevant when a partner sells their share of the partnership. For business succession this is particularly relevant on sale following critical illness.

For a sale following death, the share is revalued at the date of death so that any CGT liability to date is effectively wiped out on death. However, if the sale of the share were to take place at a significantly higher value than the value at the date of death (which could happen if there were a lengthy delay between death and the date of exercising the option to buy or sell), there could potentially be a liability to CGT.

For a sale following critical illness there will be no revaluation and so the capital gain realised on sale could be significant albeit charged at a rate of 20% (10% for gains falling within the basic rate band) on gains in excess of the annual exemption. Entrepreneurs' Relief may be helpful as it can reduce the effective tax rate to 10% on gains made up to a (lifetime) cumulative total of £10 million made since 6 April 2008. CGT can of course diminish the net proceeds of a sale, in particular following critical illness.

Its potential impact should thus be taken into account when determining the sum assured required under life assurance in a business succession arrangement.

#### **c) Pre-Owned Asset Tax**

If a business owner can benefit under a trust of a policy effected by them, even if it is part of a commercial arrangement between business owners for enabling share purchase, HMRC could apply the POAT provision, potentially resulting in an income tax charge each year.

If they do, broadly speaking, the charge is found by applying an interest rate, currently 2.5%, to the value of the settled property. However, no tax will be payable unless the POAT charge exceeds £5,000 for each settlor, which would be unlikely in most cases.

## 5 Keeping everything under review

### Dealing with change

Share purchase arrangements are long-term solutions that need regular review. Throughout the course of these arrangements, circumstances change but, properly drafted, they should be able to cope with new situations.

The value of a share of a particular partner can increase (and decrease), so there needs to be some flexibility. Further, as time goes by the needs of individual partners may change. Changing requirements may be looked at from a variety of viewpoints: the cross option agreement, the life policies (both the amount of cover and type of policy), the trust arrangements, and the partners' present and future needs and intentions.

It's important that arrangements are regularly reviewed.

#### The option agreement(s)

The agreement(s) will need to be reviewed regularly to ensure that it reflects the continuing requirements of the partners. For example, it may be decided that a new method of valuation is necessary, or one of the partners may decide that they no longer wish to be a party to the agreement. If changes are required, these may be effected by a supplemental agreement, or the original agreement could be brought to an end and a new one entered into.

#### The life policies

The sum assured under each policy should similarly be reviewed for a variety of reasons:

- The value of an individual's share could change.
- The partner may acquire a greater share, perhaps because another partner has sold their share to them.

In any event, the policies will need to be reviewed on the death of a partner. Often the agreement will provide for it to finish once the sale and purchase is complete. If the agreement is to continue, the policies will need to be increased as each of the surviving partners will have an increased share.

There are two ways of increasing the cover depending on the sort of policy that is in force:

- the partner could take out a further policy, or
- they could exercise an option under the existing one.

The latter course of action, if it is available, could be cheaper for the policy holder, and in some cases, can be done without further medical underwriting, which itself could be a very valuable aspect of the policy. When effecting a policy, it is clearly worth considering how it might be adapted in the future to meet changing needs, not only in terms of increasing the amount of cover, but also (if the policy is convertible) of exercising the option to convert, for example, to a whole of life policy.

#### The trust arrangements

With co-partners coming and going, it is necessary to ensure that the trust continues to reflect requirements. The more flexible the trusts are, the easier it is to change the beneficiaries if this becomes necessary.

#### Partners' present and future needs

A double option agreement is binding on those who are party to it during its lifetime, although it can be amended by agreement. Suppose a partner who is party to an agreement decides that, on their death, or earlier retirement, their interest is to pass to their son or daughter. In such a case, they will not want the other partner(s) to buy the share. Provided agreement can be reached, there is no reason why the arrangements should not be amended to reflect this. Naturally, as a consequence, the other partner(s) may wish to review their intentions, especially over who is to benefit under the trust of the policy on their lives and the terms of the partnership share purchase agreement.

### Left-over policies

For a variety of reasons, it is possible that any arrangement entered into will cease to exist, therefore leaving one or more policies that will no longer be needed for partnership share purchase. The partner may sell their share; the partnership may be dissolved; the double option agreement may be terminated; all the partners except one could die, thereby enabling the survivor to buy all the remaining partnership shares under the double option agreement.

In all these situations it must be decided what will be done with the remaining policy. The decision will depend on whether the policy was effected on an own life, or life of another, basis.

1. Where there is a life of another arrangement and a partner sells their partnership share, there will be a need to rearrange the ownership of the policies. For example, if partner A sells his share the best solution would be for the other partner(s) to assign the policy(ies) on A's life to A and for A to assign their interest in the policy(ies) on their co-partner's(s') lives to those continuing in the business. This approach could be followed if the partnership is dissolved, or if the double option agreement comes to an end. In most cases the relevant partner would want to assign their interest in the policies they partly own to the relevant life assured.

Where one of the partners has died, their interest in the other policies, which they have taken out on the lives of the other partners, will also form part of the deceased's estate. They will pass to the chosen beneficiaries under the Will, it is important to bear this in mind. If the policy is a term assurance, the beneficiaries might be prepared to assign their interest in the plan to the relevant life assured. There might, however, be reluctance to do this if the policy has a surrender value.

The inflexibility and difficulty attached to 'life of another policies' make the trust solution far more appealing in most cases.

2. Where the policies are written under a flexible business trust, the position is relatively simple. The trustees should appoint (i.e. redirect) the benefits of the policy in accordance with any power of appointment by means of a simple deed. In many cases the trust will automatically provide for a change of beneficiaries when a partner leaves the business.

Of course, if the life assured becomes entitled to the benefits, the value of the policy will form part of their estate. It will, however, be open to the life assured to make the policy subject to a new trust for the benefit of their family/dependants.

### Surpluses and deficits

The policy's sum assured may not equal the value of the share on the death of the partner. Setting a fixed price for the share and adjusting cover to match the changing agreed value can help substantially and can overcome these problems. Where a fixed price arrangement is not used, given the difficulties in valuing the share, it is almost inevitable that the policy's sum assured would exceed or fall short of the amount required to purchase the deceased partner's share. There should be a provision in the option agreement dealing with this point.

- The agreement should specify that in the event of a deficit, the balance of the purchase money will be paid within a certain period of time. The fact that there might be a deficit will not prejudice the deceased's executors' ability to exercise the option to sell; neither will it affect the obligation of the surviving partners to buy. It will be up to the survivors to raise the necessary amounts, but it could help if the agreement permitted payment by instalments. The agreement could provide for interest on outstanding amounts at an agreed rate. The likelihood of there being an excess or shortfall, and the possibility of disputes arising over valuation, might suggest that an independent valuer should be used.
- Where there is a surplus of cover, it would be usual for the double option agreement to specify that the surplus be paid to the continuing partners who could retain the proceeds for their own use, or to inject into the partnership loan account. What is important is that all these possibilities should be considered when the agreement is entered into.



### Automatic accrual arrangements

Referred to earlier in this guide, automatic accrual arrangements are sometimes found in relation to partnership goodwill in connection with professional partnerships. Where they exist, no payment is required for goodwill which passes automatically to the continuing partners with no payment. Automatic accrual could also apply on critical illness, but is less likely. Each case needs to be carefully considered based on its own merits.

To the extent that goodwill automatically accrues, no partnership insurance (as discussed above) will be needed. However,

- (i) partnership insurance WILL be required in respect of any value NOT covered by the automatic accrual arrangement, and
- (ii) the partner's family (and the partner on critical illness/retirement) will need to be financially compensated for receiving no value in respect of goodwill.

The automatic accrual agreement will normally include a provision requiring each partner to take out appropriate life assurance, critical illness insurance and pension policies to compensate for the automatic accrual of the value.

Professional advice is essential.

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**Zurich Assurance Ltd.**

Registered in England and Wales under company number 02456671.

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