



DIRECTOR'S SHARE PROTECTION

Technical Guide

Business made easier by Legal & General



Introduction

The purpose of this guide is to explain how our director's share protection scheme operates.

This guide aims to answer the most common questions that you may be faced with whilst dealing with this topic.

This guide refers to director's or shareholding director's in a Private Limited Company but in fact the plan can normally extend to include other beneficial owners of ordinary shares in the company.

This guide describes our method of setting up director's share protection utilising life or life and critical illness (if selected) policies, plus a written agreement between the directors.

The documents we've used in this guide are for specimen purposes only and professional advice should be sought. All examples used in this guide are based on using our trust forms. There may be other documents that may be more suitable.

Descriptions of agreements and trust forms in this guide are based on specimens we've produced. However, clients should get their own advice as to how their agreements and trust forms are drawn up and what documentation is required.

We accept no responsibility for ensuring that the trust form and cross option agreement meets the directors' requirements.

What is the aim of the agreement?

A share protection arrangement is required to enable directors to purchase the shares from the deceased director's estate and to provide the deceased director's dependants with a willing buyer and cash instead of shares.



Our director's share protection plan is designed to ensure that funds are available in the right hands to purchase a director's shares on their death. An option is also given to the deceased's personal representatives to sell the deceased's shares to the continuing shareholding directors on death.

Critical illness cover can also be added at an extra cost, to give the director affected the option to sell their shares if they are diagnosed with one of the critical illnesses we cover.

An effective director's share protection plan should provide:

1. Flexibility.
2. Capital that is available in the right hands at the right time.
3. Tax efficiency.

In order for the agreement to be implemented each director must effect a life or life and critical illness (if selected) policy which is written in trust for the other directors. The cross option agreement provides the basis for the share purchase and details how the purchase can be made.

The cross option agreement should be entered into, with one agreement covering all the directors. The completed trust document will be returned by us to the trustees and should be kept with the policy(ies)

Why is an agreement needed?

Without an agreement, upon the death of a director, the surviving directors run the risk of the shares passing to someone with no interest in the company, or even to another company that might then be in a position to make a takeover bid.

On the death of a shareholding director, the Articles of Association should stipulate what happens. Usually their personal representatives and subsequently their beneficiaries will become entitled to their shareholding. Unless the deceased director owned a majority of the shares, the beneficiaries will probably find ownership of the shares provides very little benefit. Sales of shareholdings to outsiders may be restricted and a sale to the continuing shareholding directors may only be possible if funding has been arranged in advance. This could mean that the family of the deceased director may not receive the best price for their shareholding or indeed not find a buyer at all.

Most surviving directors in this situation will want to buy the deceased director's shares and keep control of the company, but only a few will have the right amount of cash available at the right time. Some businesses may turn to their bankers, but many have existing loans that would rule out further advances. Also a crisis, such as the death of a director, tends to create uncertainty and instability within a company, so banks will be less likely to be willing to make a loan. A serious illness could have a similar impact.

The solution is forward planning to ensure the right amount of cash is available at the right time through a life assurance and or life and critical illness cover policy.

How does the agreement operate?

The agreement is able to include options on death and, if required, critical illness. The directors should indicate in the agreement which events they wish to plan for, which should also be reflected in the type of policies that are being arranged. The agreement operates as follows:

Death - on the death of a director, their personal representatives have the option to sell their shares in the company to the surviving directors. Equally, the surviving directors have the option to buy the deceased director's shares from the personal representatives. If an option is exercised by either party then the other party would be bound to buy or sell, as the case may be.

The directors can exercise their option to buy the shares at any time within three months of the date of death.

The personal representatives can exercise their option to sell the shares at any time within six months of the date of death.

Critical Illness - Any directors suffering from one of the specified critical illnesses we cover or a disability that results in a payment under a life and critical illness policy, will have the option to sell their shares to the other directors. This option is available for six months after the date of receipt of the sum assured under the life and critical illness policy, and not from the date that the critical illness is diagnosed. You should note that there is NOT an option for the other directors to buy the shares from the critically ill director. Although this option could be attractive to the other directors, it may not be for the director who has had a very mild heart attack and who intends to resume work, once fully recovered, after only a few months. A single option agreement leaves the critically ill director in control, with the option to sell if they so desire but with no corresponding option to buy given to his/her co-directors. On payment of a valid critical illness claim no further benefits will be payable and the policy will end.

Under their agreement, each shareholding director must effect and maintain a life or life and critical illness policy under an appropriate trust, to provide the required amount of money to purchase the shareholding. The beneficiaries of the trust would be the co-directors, so that the proceeds from a policy are available for them to buy the director's shares on death or diagnosis of a critical illness.

For further information on the critical illnesses we cover please ask for a copy of our Guide to critical illness cover.

Why is the agreement not a binding contract for sale?

Under current legislation many shares will qualify for 100% Business Property Relief for Inheritance Tax. However, if the share purchase agreement in force was a binding contract for sale, such as a buy and sell agreement, this valuable Business Property Relief would be lost. This may not be important if the shares are to pass on death to the spouse (which is fully exempt from Inheritance Tax). Nevertheless, this exemption should not be relied upon as the spouse may die before the director. Consequently, if a binding agreement for sale were in place, further inheritance tax planning might be required.

A cross option agreement however is not a binding contract for sale and therefore this method preserves Business Property Relief. This method simply gives the surviving directors an option to buy the director's shares and the personal representatives of the deceased have a matching option to sell to the surviving directors.



What price is to be paid for the shares?

It is important that when putting a Cross-Option agreement in place that an appropriate method is agreed as to how the shares are to be valued.

The open market value of the business could be used. This would ensure that all parties are fairly treated. This can, however, lead to certain practical problems, such as how can one be sure that the amount of cover in force equates to the value that would have to be paid? Indeed, the very reference to open-market value means that such a value has to be formally arrived at. This will inevitably cause some delay in the completion of the sale and purchase but perhaps more seriously, it is this issue that often means the whole plan is delayed or even never finalised.

The answer for many companies may be to elect for a fixed value for the shares for the purpose of the Cross Option agreement. By adopting a fixed price method of valuation, one is merely adopting a method of valuing a share in a business. This method ensures that the appropriate level of life cover can be effected.

Legal & General's specimen cross option agreement has been drafted on the basis that should death (or payment under a life and critical illness policy) occur within three years of the agreement being established a specified value (as written into the agreement) will be the price to pay for the shares. However, if death (or payment under a life and critical illness policy) occurs more than three years after the date of the agreement a 'fair value' will be paid. The Fair Value of the Shares of each Shareholder will be the relevant proportion of the market value of the Company as at the date of the Shareholder's death or the Payment Date (as the case may be). This amount will be determined by an independent auditor or professional valuer who will be appointed by the surviving Shareholders and the personal representatives of the deceased Shareholder. If such a valuation is not carried out then the 'fair value' of the Shares shall be the relevant proportion of the said market value as determined by the President for the time being of the Institute of Chartered Accountants in England and Wales.

Such an arrangement should be reviewed at least every three years. Once the agreement is set up it should not just be left to rest but constantly reviewed and kept in line with reality. This should also give a good opportunity to review the life and critical illness (if selected) policy. If the specified sum is not reviewed, then the price to be paid under the agreement reverts to the 'fair value'.

Whilst Legal & General provide a specimen cross option agreement, it is important that the shareholders get their agreement approved by their own legal advisers.

What if new directors join the business?

All new shareholding directors should enter into the arrangement by completing a supplemental agreement. An additional life or life and critical illness policy must also be effected and the appropriate trust forms completed.

If the beneficiaries section on the trust form is left blank, then the trust will automatically pay out to all the surviving directors in proportion to their shareholding.

If the beneficiaries section was completed and a new director joined, the trustees will need to add them to the trust. This is quite simple to do and we can provide the necessary forms.

How long does the agreement last for?

The agreement can last indefinitely but, as mentioned earlier, regular reviews should be carried out.

What are the taxation effects of the cross option agreement?

Inheritance Tax

Provided that all shareholding directors participate, there'll be no Inheritance Tax on the premiums payable as it will be considered to be a bona fide commercial arrangement. If for some reason this were not the case, life policy premiums would usually fall within one or more of the Inheritance Tax exemptions. The proceeds of the life or life and critical illness policy when written under trust will be payable to the trustees normally free from Inheritance Tax, since they don't form part of the deceased's estate. The estate of the deceased shareholder includes the shares and not cash, thus preserving Business Property Relief on the value of the shareholding.

Capital Gains Tax

There is no Capital Gains Tax on death but there could be a liability on beneficiaries of the estate on the increase in value of the shares between death and sale, although in practice this would be rare.

A Capital Gains Tax liability may arise, in the event of the sale of a director's shares due to critical illness.

How are the funds to make the purchase provided?

A life or life and critical illness policy is written on the director's own life. The cross option agreement states that each director shall, no later than one month after the date of the agreement, effect either a life policy or life and critical illness policy. Each policy will be subject to a trust for the other directors so that, if there is a death or critical illness claim, the proceeds of the plan would be paid to the continuing directors to enable them to purchase the deceased's/critically ill director's shares. Examples of these forms are available from us, and details on how to complete the trust is included in this guide.

Who should pay the premiums?

Each director undertakes to pay premiums on their own life. These may not be all be the same because of different ages and sums assured. If possible, the company should adjust their pay or fees to compensate for this.

If the company pays the premium on behalf of the director this will be a benefit in kind and the director will become liable for income tax on it.

What type of policy should be effected?

This will depend upon individual circumstances and what can reasonably be afforded. For example, if it is not known when a director will retire, a Whole of Life Protection Plan may be an appropriate policy.

If critical illness cover is required this can usually be arranged as an additional option to a term assurance policy.

What if a director leaves the business?

If a director leaves the company the agreement will normally cease to apply to that director.

The policy on their life may be appointed to them if all the trustees agree, may be maintained, or lapsed by the Trustees.

It's possible for outgoing directors, if they retain their shareholding, to stay in the scheme but this is rare.

What if the sum assured doesn't match the price to be paid for the shares as specified in the agreement?

If there are regular reviews of the agreement and it's amended it's unlikely that the proceeds of the life policies won't match the price to be paid for the shares. However, of course, if the specified sum isn't reviewed and the agreement not amended, then the price to be paid under the agreement reverts to the open market value. This is the traditional method of share valuation, and this could mean that the sums assured under the policies may not match the price to be paid. The agreement should therefore be frequently reviewed.

If the sum assured is less than the agreed value the agreement gives the option for the balance to be paid to the shareholder's personal representatives in instalments over an agreed period. The agreement allows specific details to be inserted regarding the number and frequency of payments. This amount may or may not bear interest and the appropriate wording should be deleted.

If however, the sum assured exceeds the agreed value, the co-directors can, if they wish, pass the excess to the shareholder's personal representatives or keep it themselves. The agreement caters for either arrangement and if this form is used then the appropriate wording should be inserted.



What if the directors don't wish to specify a value for the shares to be purchased?

Directors should be encouraged to specify a value and, if they don't, then an amendment to the agreement will be needed in order to revert to the ordinary open market value at the time the purchase is made.

Will the agreement prevent a director from selling any of their shares during their lifetime?

The Articles of Association should govern this but the provisions detailed in the sample agreement will not in any way prevent any sale or other disposal of the director's shares during his lifetime. The agreement only covers share transfer on death or critical illness (if selected) of the shareholder.

What if there's already a share purchase agreement in force?

It'll be important to encourage the clients to review this agreement. We provide a specimen agreement for the consideration of the client's legal advisers, should they wish to change it. The company's legal advisers should ensure there is no conflict between any existing agreement and the wording of the cross option agreement.

Other share protection arrangements

You may come across other methods of share protection (for example, buy and sell) and other ways of writing the life policy (for example, life of another, Absolute trust, joint life first death).

The buy and sell agreement. With this method the directors enter into an agreement whereby on retirement or death, the retiring director or their estate will sell their share to the remaining directors who, in turn, will buy. The directors will purchase the shares in the proportion in which the remaining shareholding is held. There may be disadvantages in using the buy and sell method such as the loss of Business Property Relief, so if a director dies, their shares may be liable to Inheritance Tax.

Life of another, as a way of writing the life policy, has its limitations in that it's inflexible when the business dissolves or when new directors join. In addition, if there are more than two participants each has to have a policy on the lives of all the other directors, resulting in a large number of policies.

If there are only two participants a joint life policy can be written. Again, there is no flexibility when someone joins or leaves, and if one director dies the survivor no longer has any life cover.

Note: Similar share protection schemes can be arranged for partnerships – See our technical guide entitled 'Partner's Share Protection'.

Case study

Overleaf is a completed trust form based on the following case study:

John Spencer, Stephen Young and Mark Jones are directors in Spencers Plant Hire Ltd.

Each director effects a term assurance policy for a sum assured which matches the current value of their shareholdings. All three policies are written under trust. One cross option agreement is required.



Director's share protection trust documentation

Specimen of correctly completed Declaration of Trust



Directors' Share Protection Documentation Pack

DECLARATION OF TRUST FOR SHAREHOLDING DIRECTORS

Date of life assurance application form

Full name of life assured

Contract name

Name of the company, that is the business of the settlor

This section should be left blank unless the beneficiaries are NOT the directors in the company in shares equivalent to their shareholdings, in which case the names and shares should be entered

Name and addresses of the additional trustees – usually the Settlor's co-shareholders in the company

This Declaration of Trust is to be incorporated in the application form dated **14/05/09** ("the Application") made by **JOHN SPENCER** ("the Settlor") for (a) **TERM ASSURANCE** policy(ies) on the life of the Settlor.

In this Declaration of Trust the following expressions shall have the following meanings:-

SECTION A
The Beneficiaries means the Settlor and the individuals beneficially owning ordinary shares in the Company
The Company means **SPENCER'S PLANT HIRE LTD**
The Policy means the policy or policies effected pursuant to the Application which expression wherever used in this Declaration shall include the benefit of the insurance contract or contracts completed pursuant to the acceptance of the Application and any variation or amendment to the said contract or contracts hereby authorised referred to The Trust Fund means the Policy the full benefit thereof all property at any time held by the Trustees upon the trusts declared in this Declaration of Trust whether by way of further settlement accumulation of income capital accretion or otherwise and all property from time to time representing the foregoing respectively Legal & General means Legal & General Assurance Society Limited.

SECTION B
The Default Beneficiary(ies) are

Name	Share	Name	Share

SECTION C
The Additional Trustees are

First Trustee Name:	Second Trustee Name:
STEPHEN YOUNG	MARK JONES
DOB: 19 OCTOBER 1966	DOB: 04 MAY 1968
Address: 12 THE PARADE BRIGHTON BN2 7AG	Address: 55 GROVE PARK WORTHING BN18 2PW
Third Trustee Name:	Fourth Trustee Name:
DOB:	DOB:
Address:	Address:

The Trust Period means the period of 79 years from the date of this Declaration which period shall be the Perpetuity Period for the purposes hereof. I hereby request and declare that the Policy be issued to me as Trustee and expressed to be held upon an irrevocable trust (hereinafter called the Trust) subject to the trust powers and provisions set out overleaf. I further desire to appoint the Additional Trustees to act with me as trustees of this Trust (and we jointly hereinafter shall be called "the Trustees" which expression shall include the trustees for the time being of the Trust) and the receipt by the Trustees of any moneys payable under the Policy shall be a discharge to Legal & General for all such moneys.

Please refer to completion notes at the back of this section.

TO BE COMPLETED BY IFA/AGENT

Name:	Agency Name:
Address:	Agency Number:
Tel/Fax:	Date:

TRUST PROVISIONS

1. During the Trust Period the Trustees shall have power by deed or deeds revocable (whether by the person(s) making the deed or some other person(s)) during the Trust Period or irrevocable to appoint part or all of the Trust Fund and the income thereof for the benefit of such one or more of the Beneficiaries in such one or more shares and for such interests and subject to such trusts powers and provisions (including protective trusts discretionary trusts or powers operative or exercisable at the discretion of the Trustees or any other persons) as the Trustees shall in their absolute discretion think fit Provided Always that any appointment in favour of the Settlor can only be made by at least two Trustees of whom the Settlor is not one.
2. Subject to and in default of any appointment made under paragraph 1 above and subject to paragraph 5 hereof the Trustees shall hold the Trust Fund and the income thereof absolutely for the Default Beneficiary(ies) and if more than one in the percentage shares specified in Section B above and if no shares are specified in equal shares absolutely.
3. If no Default Beneficiary is indicated in Section B above then subject to and in default of any appointment made under paragraph 1 of the Trust Provisions and subject to paragraph 5 hereof the Trustees shall hold the Trust Fund and the income thereof absolutely for the person or persons (other than the Settlor) who is or are for the time being the Shareholder(s) in the Company and if more than one in the same proportions as each such Shareholder's shareholding in the Company bears for the time being to the aggregate of all such Shareholders' shareholdings in the Company excluding the shareholding of the Settlor and of any Shareholder(s) precluded from benefitting by paragraph 5 below.
4. The trusts hereby declared shall carry the intermediate income but section 31 of the Trustee Act 1925 shall not apply and where the Beneficiary entitled to income is a minor the Trustees shall hold such income for the absolute benefit of any such minor Beneficiary as shall be entitled thereto.
5. Notwithstanding the foregoing, no person shall be capable of benefitting under paragraphs 1-3 hereof unless he has settled a contract of life assurance, critical illness or terminal illness contract on his own life on trusts similar to those contained herein for the Beneficiaries not excluded from benefitting by this paragraph 5 and the benefit to which any such person would but for this paragraph 5 be entitled shall accrue to and form part of the entitlement of the person(s) not so excluded by this paragraph 5 from benefitting and if more than one in proportion to the entitlement inter se that they have in the absence of this paragraph 5.
6. The statutory powers of advancement contained in section 32 of the Trustee Act 1925 or if applicable section 33 of the Trustee Act (Northern Ireland) 1958 shall apply to the trusts hereof with the following variation that is to say the omission in proviso (a) to sub-section (1) of the said section of the words "one-half of" Section 31 of the Trustee Act 1925 or if applicable Section 32 of the Trustee Act (Northern Ireland) 1958 shall not apply to the trusts of this Policy.
7. Any Trustee for the time being (other than the Settlor) being a solicitor or other person engaged in any profession or business shall be entitled to charge and to be paid all usual professional or other charges for business done by him/her or by his/her firm in relation to the trusts thereof.
8. There shall be vested in me a power of removal of any trustee and a power of appointment of a new trustee and or additional trustee(s) during my lifetime and thereafter a power of appointment only shall be vested in the Trustees provided always that a power of removal shall be exercisable only if there are at least two individuals remaining as Trustees of which at least one is not the Settlor.
9. The Trustees may at their discretion and subject to the trusts aforesaid either retain the Policy or deal with the Policy in any manner that they may in their absolute discretion think fit including power (where the Policy so permits but without prejudice to the generality of the foregoing) to surrender the Policy or convert the Policy in accordance with the options available under the Policy. Any new policy or increase or decrease of benefits secured by the Policy or by any new policy or policies which is or are effected under any options which are contained in the Policy shall be subject to the same trusts as are herein declared.
10. Any moneys liable to be invested hereunder may be invested or laid out in the purchase or at interest upon the security of such stocks funds shares securities investments or property of whatsoever nature and wheresoever situate and whether involving liability or not and whether producing income or not (including the improvement repair insurance (in any value and against any risk) rebuilding and decorating of any property for the time being comprised in the property subject to the trusts hereof or the execution of any other works on or for the benefit of any such property) and including any policy or policies of life assurance whether in the name of a nominee or not as the Trustees shall in their absolute discretion think fit to the intent that the Trustees shall have the same full and unrestricted power of investing and transposing investments as if they were absolutely entitled thereto beneficially.

I hereby declare that I intend to pay the premiums under the Policy for the sole benefit of the persons beneficially interested from time to time under this Trust and I hereby irrevocably disclaim any lien or charge on the Policy for the repayment of any such premiums.

It is hereby certified that this instrument falls within Category N of the Schedule to the Stamp Duty (Exempt Instruments) Regulations 1987.

This trust shall be governed in by the law of England and Wales.

Name of Settlor: **JOHN SPENCER**

Signature of Settlor: *John Spencer*

Date: **14th May 2009**

Full name
of settlor

The settlor
should sign
and date.

Deed of assignment

DEED OF ASSIGNMENT/ASSIGNATION

This Assignment/Assignment is made on the _____ day of _____ (year) for Head office use only

Between (name of Grantee) **JOHN SPENCER** D.O.B: **1/1/1958**
of (address) **112 HIGH STREET, CRAWLEY**

hereinafter called 'the Grantee' of the one part and the Grantee
and (name of first Additional Trustee) **STEPHEN YOUNG** D.O.B: **1/1/1955**
of (address) **12 THE PARADE, BRIGHTON, BN2 7AG**

and (name of second Additional Trustee) **MARK JONES** D.O.B: _____
of (address) **55 GROVE PARK, WORTHING, BN18 2PW**

and (name of third Additional Trustee) _____ D.O.B: _____
of (address) _____

and (name of fourth Additional Trustee) _____ D.O.B: _____
of (address) _____

hereinafter called 'the Trustees' of the other part

Whereas the Grantee is the Grantee of the Policy(ies) of Assurance (hereinafter called 'the Policy(ies)') specified in the Schedule hereto and holds the Policy(ies) upon the trusts and with and subject to the powers and provisions therein set out
and whereas the Grantee has appointed the Trustees as Trustees to receive the moneys payable under the Policy(ies) and is desirous of assigning the Policy(ies) to the Trustees
Now this deed witnesseth that the Grantee as Trustee hereby assigns the Policy(ies) unto the Trustees to hold the same unto the Trustees upon the Trusts and with and subject to the powers and provisions upon which and subject to which the Grantee holds the same and the Trustees hereby accept such trusts
It is hereby certified that this instrument falls within Category A of the Schedule to the Stamp Duty (Exempt Instruments) Regulations 1987.
In witness whereof the said parties to these presents have hereunto set their hands the day and year first above written
The Schedule herein before referred to

Office: ~~Legal & General Assurance Society Limited - Date~~ Policy No. _____ for Head office use only

Signed and Delivered as a Deed by the said
Full name of Grantee **JOHN SPENCER**
Signature of Grantee *John Spencer*
Witness's signature and address
D Smith 27 THE PARADE, HORSHAM, SUSSEX

Signed and Delivered as a Deed by the said
Full name of first Additional Trustee **STEPHEN YOUNG**
Signature of first Additional Trustee *S Young*
Witness's signature and address
D Smith 27 THE PARADE, HORSHAM, SUSSEX

Signed and Delivered as a Deed by the said
Full name of second Additional Trustee **MARK JONES**
Signature of second Additional Trustee *Mark Jones*
Witness's signature and address
D Smith 27 THE PARADE, HORSHAM, SUSSEX

Signed and Delivered as a Deed by the said
Full name of third Additional Trustee _____
Signature of third Additional Trustee _____
Witness's signature and address _____

Signed and Delivered as a Deed by the said
Full name of fourth Additional Trustee _____
Signature of fourth Additional Trustee _____
Witness's signature and address _____

Note:

This guide has been prepared according to our interpretation of current tax law and HMRC practice. Tax law and tax rates may change in the future.

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