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The importance of PROPER SUCCESSION PLANNING for SUCCESSFUL BUSINESS CONTINUITY

Business life policies, such as a keyman policy or a contingent liability policy, are an important aspect of ensuring the long-term survival and continuity of a business.

"A keyman policy is intended to help the business survive the death or disablement of a person key to the ongoing operations of that business. Individual talents are becoming critical to the success of many companies and every business.

"If the policy was not taken out by the deceased, who also did not pay the premiums, and if no amount has been, or will be, paid to or utilised for the benefit of any relative of the deceased or any company which was at any time a family company then the life policy will be exempt from has very valuable employees who contribute significantly to the running and growth of the company. It makes sense to insure against the unfortunate event of their untimely demise," explains fiduciary practitioner, Sarah Love, of Private Client Trust.

"Contingent liability insurance refers to a policy taken out by a business on the life of an employee or director who stands surety for the debts of the business. The amount of cover taken out should be equal to the loan amount adjusted for tax. If the person who stands surety dies before the loan has been settled, contingent liability insurance ensures that the outstanding loan amount is repaid in full, which means that the person who stands surety's estate is absolved from further liability and the business is not placed under undue financial strain."

TAX TREATMENTS

According to Sue Blake, tax practitioner at Private Client Financial, there is a big difference in the tax treatment of business life policies. Blake explains that section 11(w)(ii) of the Income Tax, Act 58 of 1962 allows a company to claim a tax deduction on the insurance premiums paid on the life of an employee so long as the policy certain requirements are met.

"In the event that such a policy pays out, it is necessary to consider whether the proceeds will be subject to income tax or capital gains tax. If a choice was made in terms of section 11(w)(ii) to deduct the premiums for income tax purposes, then the proceeds received are regarded as falling into the definition of gross income and will be subject to income tax in the hands of the company."

"Where the premiums were not deductible or the election in terms of section 11(w)(ii) was not made, the proceeds received will be regarded as being of a capital nature and so not subject to income tax. These capital proceeds are also exempted from capital gains tax so long as there was no cash or surrender value attached to the policy, and the company is the original owner of the policy."

KEYMAN POLICY

In terms of the Estate Duty Act, life policies attract estate duty as a deemed property. However, Love explains that there are a few exceptions, including one for a keyman policy, if certain requirements are met estate duty. As such, a properly set up keyman policy may not attract estate duty. However, a contingent liability policy will attract estate duty and the amount taken out would need to be adjusted for this."

BUSINESS SUCCESSION – THE SHAREHOLDING

According to Love, the second part of astute succession planning is to look at the ownership and assess what you want to happen with your ownership in the business. "There are a few options when it comes to business succession; your heirs inherit your interest/shareholding, the other shareholders/members buy each other out, the business can repurchase your interest/shareholding or your interest/shareholding is sold on the open market.

"The best option depends on the type of business you are involved in and if the business requires active involvement by the shareholders. If you opt for a buy-and-sell or share buyback, there are two elements to consider the obligation on the co-shareholder/business to purchase your interest/shareholding and the funding of the purchase. It is critical that the obligation on the business partner/company exists before finalising the funding, as without this the plan may fail."

ESTATE DUTY CONSIDERATIONS

"Should the purchaser be the business (share buyback) one would need to look at contingent liability cover. Should the purchaser be a co-shareholder one would look at buy-and-sell life policies," says Love.

"A buy-and-sell life policy will be exempt from estate duty if the policy owner and the life assured are business partners; if the policy was taken out to fund the purchase the life assured business interest; and if the life assured did not pay the premium. If any of these conditions are not met, then the life cover would need to be adjusted for estate duty." Love cautions that business succession is not as straightforward as it may seem, and that it is critical to be supported by an independent financial advisor, tax practitioner or accountant and Fiduciary practitioners advise to ensure you fully explore that there is an executable plan in place. ■

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