Business Financial Planning
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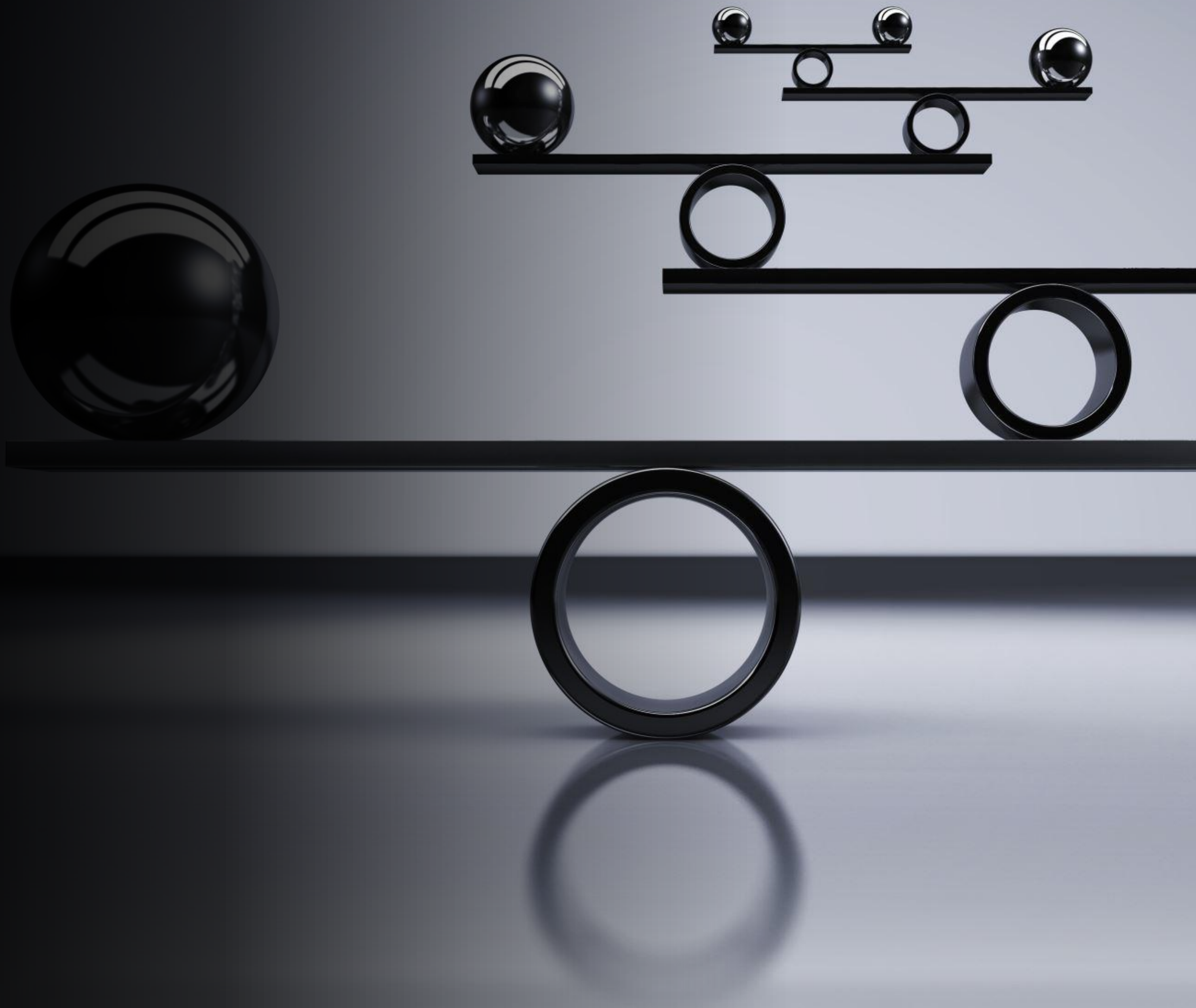
The Trinity

The investment value of life policies in Business Financial Planning - Deceased Estates and Trusts. The trinity of BFP application analyzed and evaluated, i.e. Keyperson, Surety and Buy/Sell structures.



Agenda

- Business Financial Planning or Business Assurance
- Risk Profiling
- Risk profiling and taxes
- Key person
- Contingent liability
- Buy/Sell agreement

A bird’s eye view

A Logical versus Dogmatic approach

Meal Leftovers

The Terrific Trio

The professionals

- **Lawyer** (Agreements)
- **Accountant** (Tax and cashflows)
- **Financial Planners** (Insurance and FAIS)

Business financial planning

- Key person
- Contingent liability
- Buy/sell structures

Marketing Material and Advice

Marketing is puffing up – targets the emotional	Makes it personal
Advice – targets the logical	It is just business – nothing personal

Advice

- Factual advice
- Opinionated advice

Risk profiling – Business versus Personal

Risk profiling –Risk profiling – Business versus Personal Business versus Personal

Personal	Business
• Asset and liabilities • Budget • Cash flow • Breadwinner and heirs • Journey through life • Last Will and Testament	• Balance sheet • Income statement • Cash flow • Shareholders and Trusts • **Sureties?** • Succession planning – The "Will"

Two Types of policies

Company-owned life policies

Individual-owned life policies

Two Types of policies

Business Assurance policies all have the same feature in that the life assured is not the same as the owner of the policy.

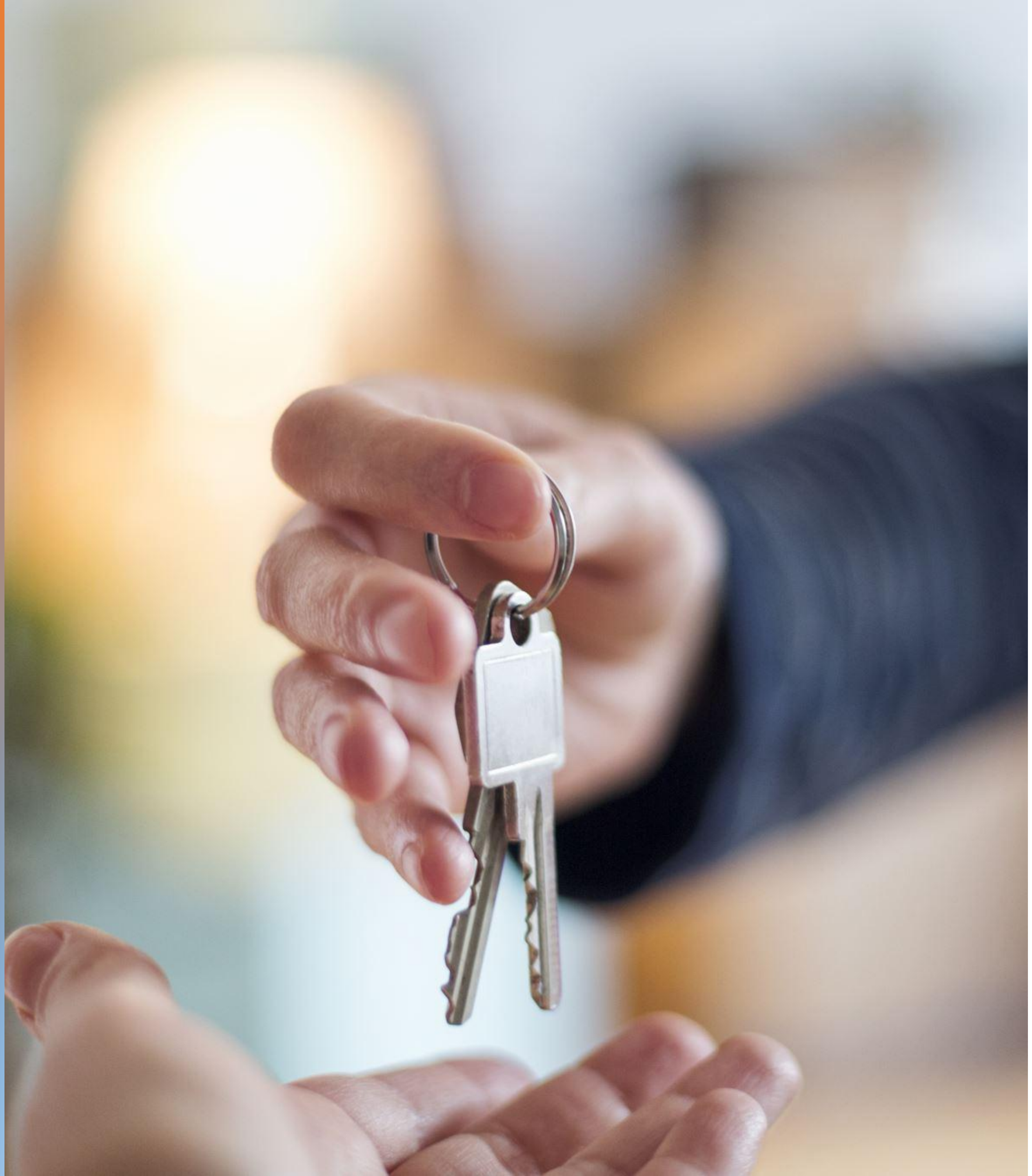
Taxes applicable
(The Terrific Trio)

- Income Tax
- Capital gains tax
- Estate duty

The nature of a life policy in business assurance

- To indemnify against a loss
- To settle capital debt
- To act as an investment

The basics of key person insurance



- What is a key person in a family
- What is a key person in a business

Value of key person

Key woman

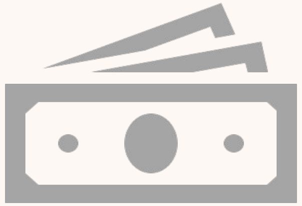
Home management

Caring for children

Home cleaning

Creche

Holidays



Key person

Loss of future profits

Training costs

Calculate the Insurance cover

Home management	15 000 x 12
Caring for children	20 000 x 12
Home cleaning	6 000 x 12
Driver to school	R5 000 x 12
Holidays – Sugar bay	R40 000 x 12
TOTAL	1 032 000
Term of 10 years/inflation + 4%	**R8 786 321**

Calculate the life cover

- Insurable interest at inception
- Train a second person
- Tax deduction on the premiums

Prior to 2012

The CHOICE

- Conforming policies
- Non – conforming policies

The Outcome

- Tax-free
- Taxable
- The intention overlooked, but included in 2012 changes

Post 2012 - Key person and Income Tax

(aa) Insured against any loss due to death, disability, severe illness, on life of director/employee and

(bb) Pure risk policy with no cash/surrender value and

(cc) Employer-owned when the premium is paid *(security cession does not change ownership status)*

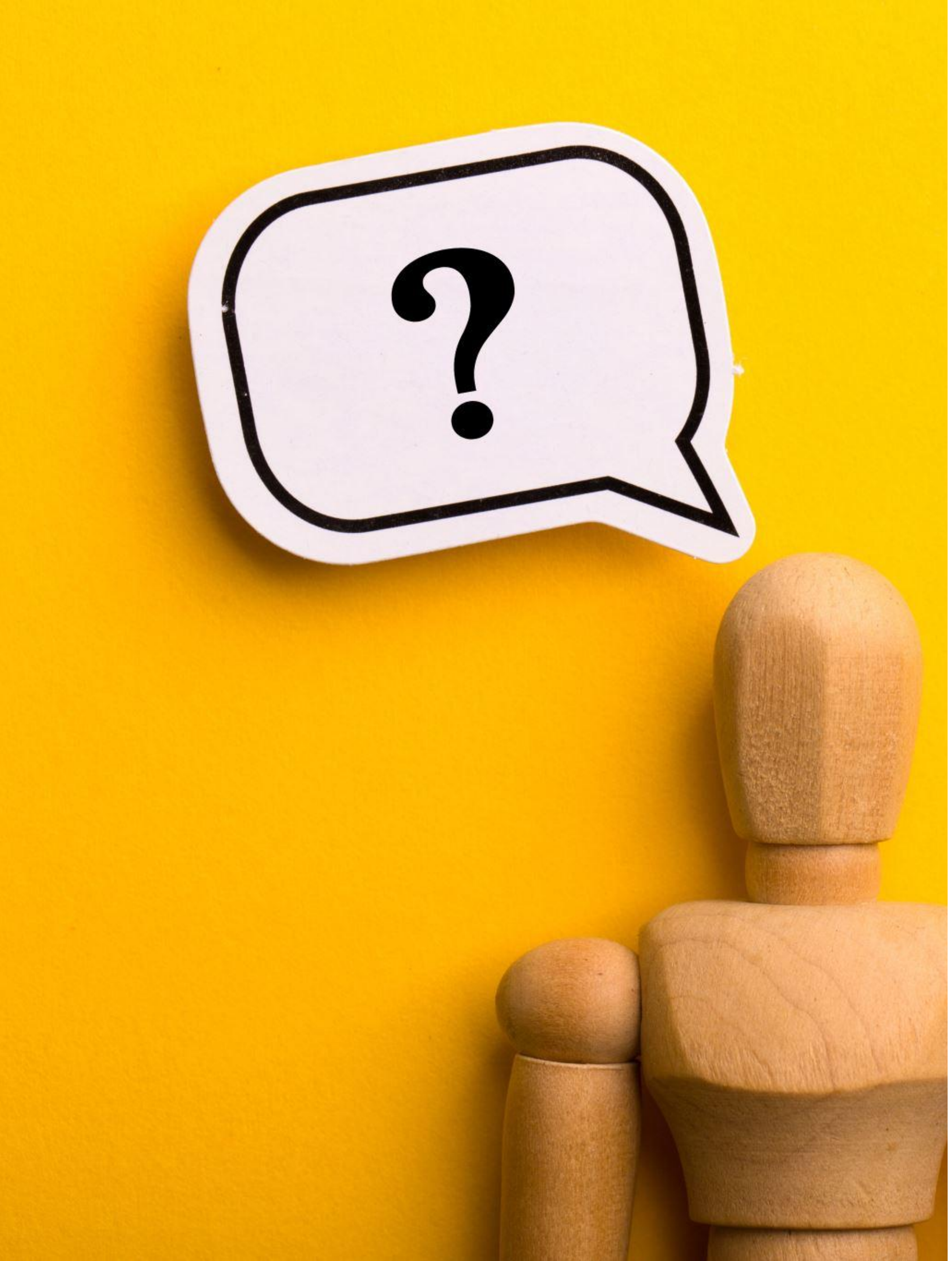
If all the requirements above are met, then the taxpayer has a choice, under (dd), regarding the deductibility status of the premium.

(dd) In respect of a policy entered into:

(A) on or after 1 March 2012, the policy agreement states that this paragraph applies in respect of premiums payable under the policy, or

(B) before 1 March 2012, it is stated in an addendum to the policy agreement by no later than 31 August 2012 that this paragraph applies in respect of premiums payable under the policy.

The basics of contingent liability



What is the problem?

- The creditor – business risk
- The surety – personal risk

Surety

- Student loan – father signs surety
- To stand in for the debts of the business
- Recent court case of surety between other shareholders
- Surety where shares are sold or share buyback.

Common law remedies

- The real problem often missed in a discussion of contingent liability
- The agreement and cession of policy
- The Stoical nature of cash flows
- Estate duty – Yes or no?

Estate Duty consequences

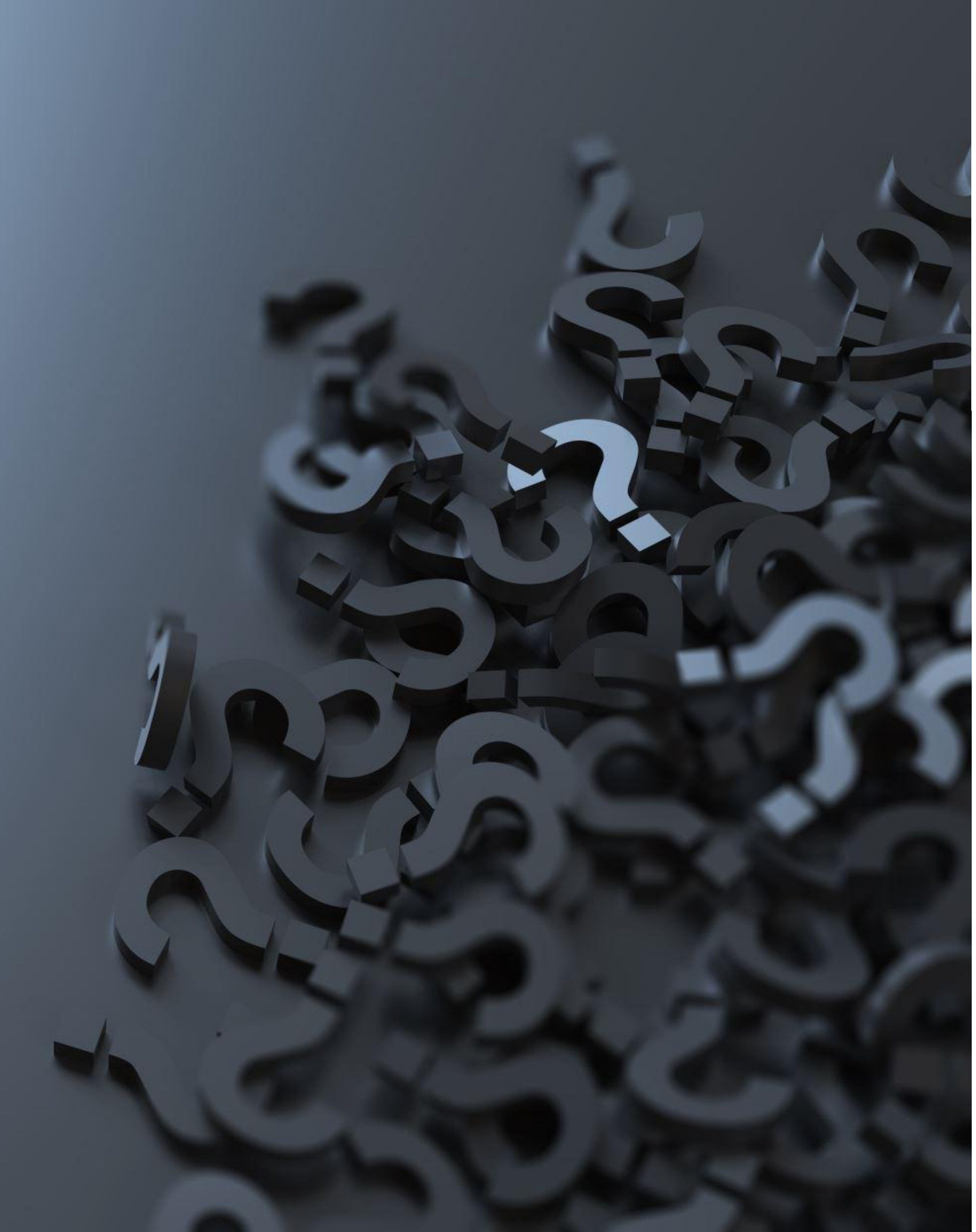
Section 3(3)(a)(ii) of the Estate Duty Act states the requirements to avoid the inclusion of the life policy as deemed property in an estate as the following:

"... the Commissioner is satisfied and remains satisfied that such policy was not effected by or at the instance of the deceased,

that no premium on such policy was paid or borne by the deceased,

that no amount due or recoverable under such policy has been or will be paid into the estate of the deceased

and that no such amount has been or will be paid to, or utilized for the benefit of, any relative of the deceased or any person who was wholly or partly dependent for his maintenance upon the deceased or any company which was at any time a family company in relation to the deceased;."



SARS Reference Guide

3. (iii) A policy will have been 'effected by the deceased' if he was the person who contracted with the insurer for the issue of the policy, whether or not he was the beneficiary under the policy.

4. (iv) 'At the instance' of a person is defined in the dictionaries as 'at the request or suggestion' of a person. A policy will be effected at the instance of the deceased if the proposor would not have effected the policy had he not been requested by the deceased to do so. "

“In cases where the company took out insurance cover on the life of A to enable them to pay the debt as set out in (1) above to his estate, the argument that the policy was not effected by or at the Instance of A would be very difficult to prove as the deceased was directly involved in the negotiations regarding the whole transaction. “

SARS Reference Guide

For the exclusion in terms of section 3(3)(a)(ii) of the Estate Duty Act to be applicable the following circumstances must be considered:

The Commissioner must be <u>'satisfied'</u> that all the requirements of the section are met before the exclusion will be allowed. To enable SARS (on behalf of the Commissioner) to consider whether the proceeds of a policy fall within the ambit of the exclusion, all the relevant documentation pertaining to the case:

Copies of the resolution taken by company to take out such policy,

Application made for the policy and **<u>any other documentation</u>** to **<u>prove</u>** that the proceeds of the policy were not applied to benefit either the estate, any relative of the deceased or any person who was dependent upon the deceased for his/her maintenance or a family company of the deceased as envisaged in the relevant section of the Estate Duty Act.

These documents **<u>must</u>** be submitted together with the Liquidation and Distribution Account to the estate auditor at SARS who will verify the documentation.

The basics of buy/sell agreements

Problem areas

Identifying the wrong risk profile

What can go wrong

- Valuation – from whose perspective
- Neglect company wealth life policies
- Insurance underwriting
- The agreement – (Armitage)

Tax avoidance, Trusts and Life policies

Identifying the wrong risk profile

Estate duty requirements

1. Purpose
2. Was a partner of the deceased – on the date of death
3. Premiums
4. No amount paid to estate

What is the overarching requirement? Personal or Business?

Trust – Buy/Sell agreement

(1) A and B are co-shareholders of a company.

(2) The start-up value of the company in the year 2000, before the introduction of capital gains tax (CGT), was zero. So, the capital profit and the capital gain are the same for ease of illustration.

(3) Ignore any loan accounts and assume they are nil.

(4) Ignore any dividend payments.

(5) The company's value in 2024 has grown to 40 million.

(6) The company secured a loan of R10 000 000 from a financial institution, and **both shareholders signed surety for the total amount.** The company effected life policies on their lives for R10 000 000.

Assets	Base Cost	Market value	Gain	
50% shareholding	0	25 000 000	25 000 000	
40% inclusion rate			10 000 000	
45% marginal rate			4 500 000	

Assets		
50% Shareholding	25 000 000	
Company owned life policy	10 000 000	
Buy/Sell life policy	25 000 000	
Exclude Buy/Sell policy	(25 000 000)	
Gross estate	35 000 000	
CGT (s 4(b))	(4 500 000)	
S 4(p)	(5 000 000)	
Net estate	25 500 000	
X 20%	5 100 000	

Capital gains tax	**4 500 000**	
Estate duty	5 100 000	
TOTAL	9 600 000	
Liquidity ratio	38,4%	

Assets	Base Cost	Market value	Gain
50% Shares	0	25 000 000	25 000 000
80% inclusion rate			20 000 000
45% rate			9 000 000

Assets	
50% Shareholding	0
Company owned life policy	10 000 000
Buy/Sell life policy	25 000 000
Exclude Buy/Sell policy	(0)
Gross estate	35 000 000
CGT (s 4(b))	(0)
S 4(p)	(0)
Net estate	35 000 000
X 20% / 25%	7 250 000

	Retained in Trust	Distributed
Capital gains tax	9 000 000	4 500 000
Estate duty	7 250 000	7 250 000
TOTAL	16 250 000	11 750 000
Liquidity ratio	65%	47%

Thank you