Planning for the future:

protecting your business and shareholders

The problem

It's important that business owners plan for the future, and that includes considering what happens to their shareholdings in the event of any changes – be that a financial downturn, or more unexpectedly, if they die or become critically ill. If they fail to do so, then it may lead to difficult outcomes for them and their loved ones, as well as surviving shareholders and the company.

In this guide we've outlined a range of solutions which might be worth considering – to protect your legal and financial interests in any eventuality.

Roxburgh Milkins Limited regularly work with Aspire Financial Planning to help business owners on matters like these as financial and life planning situations should be considered together (for shareholders, and the company).

Possible solutions

Retention of shares: the shares of deceased shareholder transfer to estate.

Implications

- **The deceased' shareholders family won't receive any immediate value for their shareholding.** If the family need the money to live or funds to pay for care then this could be problematic.
- Whoever ultimately inherits the shares may not wish to be involved (and is quite possibly not experienced) in running the business.
- If the other shareholders work in the business and receive dividends as part of their remuneration, they may not want dividends being paid out to a deceased shareholder's estate.

Variations

- Agree that shareholders can only will their shares to specified people (e.g. immediate adult family members).
- Voting rights can automatically be removed from shares on the death or incapacity of a shareholder, ensuring that beneficiaries cannot interfere in the decision making of company.
- Dividend rights can automatically be removed from shares on death or incapacity so that only shareholders working in a business can receive dividends.

> *"Roxburgh Milkins were very clear and straight forward in their support for TCA, and for me as a shareholder. They understood the commercial considerations - and as well as being efficient in what needed to be done immediately, they thought ahead to future proof our documents too. It gives us confidence that we have everything in place for any other questions that may come up."*
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> **Rich Emerson, The Climbing Academy**

Put and call option between shareholders: the estate of a deceased/critically ill shareholder can require the other shareholders to purchase their shares (the put option) and the remaining shareholders can require the estate/ill shareholder to sell their shares (the call option).

Implications

- The shareholder's estate/critically ill shareholder will receive immediate value for their shareholding (but won't benefit from any future increase in value in the company).
- The remaining shareholders will need to have the funds to cover the purchase price (but will own 100% of the shares, control the company and benefit from any future increase in value).

Variations

The price at which shares can be bought or sold can either be:

- fixed
- calculated on a formula (e.g. a specified multiple of profits)
- at fair value (as agreed at the time of death or illness or by an independent valuer)

Having a fixed price or calculated formula will provide more certainty BUT it may result in shares being transferred at less or more than their actual value.

To give the remaining shareholders time to fund the purchase, it can be specified that the purchase and/or the payment of the purchase price will be delayed or staged.

Company purchase of shares: similar to the put and call option described above but rather than the shares being bought by the other shareholders they are purchased by the company.

Implications

- To purchase its own shares a company must have: the cash, necessary accounting reserves and shareholder approval. A company will not know at the outset whether these requirements will be satisfied, so there is more uncertainty in this option.
- Otherwise, the implications are similar to put and call option above.

The role of insurance: if a put and call / company purchase option is chosen, insurance can be put in place to ensure that the funds are available to finance the purchase.

Implications

- Unless the purchase price (and matching assured sum) is fixed, the insurance policy should be regularly reviewed to ensure it is in line with the current valuation of the shares.
- Insurance premiums will need to be paid for by either the shareholder or the company. If the premiums are paid for by the company there may be corporation tax/income tax/PAYE implications.

Variations

If the proceeds of the insurance policy are less than the value of the shares it can be agreed that:

- the price at which the shares are purchased will be higher or (i) fair value and (ii) an amount equal to the insured sum; and
- if the purchase price is higher than the insured sum then the purchase price covered by insurance is paid immediately with the balance to paid in stages.

Mix and match: many groups of shareholders chose a mixture of the above. For example:

- that the estates of deceased shareholders can retain a percentage of their shares, so they get some benefit from future increases in value but that the rest of the shares are subject to a put and call option arrangement.
- where the cost of insurance is not economic, it may only be put in place to fund only part of the purchase price.

Considerations

- Be aware of what the current position is. Even if shareholders have never considered this issue before, the company's articles of association will govern what can happen in these scenarios - so be aware of what they say. Are you happy with the potential outcome for all involved?
- Shareholders should consider whether their wills need updating and whether lasting powers of attorney need to be put in place to further protect your (and your family's) interests.
- These issues should be considered holistically as part of the financial and life planning for both shareholders AND the company. You should consider whether to take financial advice as well as legal advice. There may be tax implications or other financial considerations.

What next?

Future planning often falls down the 'to do' list. But we all know that things can change in unexpected ways – and fast. The risks of not thinking ahead in this case are that your business, colleagues and family may not be catered for in the way you intended.

By spending a small amount of time agreeing your plans now, you can save money, time and complications in the future.

Roxburgh Milkins and Aspire Financial Planning have put this guide together to help shareholders and companies plan for their future - contact us to find out more about what these issues might mean for you.

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