LIMITED LIABILITY PARTNERSHIP (LLP) SHARE PROTECTION

WHAT IS LLP SHARE PROTECTION?

LLP Share Protection provides money so that should one member in a business die or suffer from a terminal illness, the remaining member(s) may be able to afford to exercise an option to buy the deceased member's interest from his or her estate. Provision can also be made if a member suffers a critical illness.

KEY ISSUES FOR PARTNERS TO CONSIDER IF NO PROTECTION IS IN PLACE

Where a share of an LLP has passed to the estate of a deceased member, the family has two main options:

1. The family could take over the deceased's position as a member.
2. The family could realise the value of the interest by selling it.

Neither of these avenues is problem-free. Commercial experience, age, qualifications, ability, commitment or other reasons could prevent any members of the deceased's family being capable of becoming a member.

If the family of the deceased wishes to sell their interest in the LLP, the remaining member(s) may find themselves working with an unwelcome new member. Also it may be difficult to find buyers which could lead to financial problems for both the family and the business.

HOW DOES LLP SHARE PROTECTION WORK?

Each member takes out either a life or life and critical illness policy written in trust for the other members. They also enter into an agreement, typically a Cross Option Agreement. On the death, terminal illness or critical illness (if chosen) of a member, the other members then have the money to help buy the member's share.

The individual members can pay the policy premiums, but these would usually come from the business account. Since premiums reflect the age, gender and sums assured of each individual member, the amounts paid on each member do not reflect the benefits each may receive in the event of a claim. However, premiums can be apportioned according to each member's share in the business. This is known as premium equalisation. The sum assured of each policy equals the value of each member's share in the business.

CROSS OPTION AGREEMENT

A written agreement, known as a 'Cross Option Agreement', is a reciprocal arrangement that helps the surviving members to keep control of the business, by giving them the option to buy the interest of any member who dies. Similarly, it also provides the estate of the deceased with the option to sell to the remaining member(s). Such agreements also outline how an interest in the business is to be valued.

TAX

The members will typically pay the life assurance premiums themselves and will not get income tax relief on those premiums. If the business pays the premiums then this will be taxable income on the members. Where the arrangement is on a commercial basis there will be no inheritance tax on the payment of the premiums of the trust policies. Where policies are in trust, any proceeds will not normally form part of the member's estate for inheritance tax.

TRUSTS

Each member may request that the life assurance company issue the policy on their life under trust for the benefit of the other members. Typically, the other members will be appointed as trustees. This way, in the event of the death, terminal illness or critical illness of a partner any proceeds will be paid to the trustees. The other members, as beneficiaries of the trust, will then have the money with which to buy the share of the ill or deceased member.