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Corporate Co-Director Insurance

Following on from our TechTalks on Partnership and Co-Director Insurance, we continue with the topic of Share Buyback Insurance, however we highlight the alternative method in setting this up i.e. Corporate Co-Director Insurance, or Corporate Share Buyback.

In this issue, we examine how a company arranges a Share Buy back policy to provide funds to purchase back shares should one of the Directors die. We examine where there is a need for insurance and how the policies of insurance are set up.

The implications of the death of a Director

As in the previous TechTalk article, the shares held pass to the beneficiaries or personal representatives of a deceased Director.

The implications therefore would be identical to those outlined in the Co-Director Insurance Issue, (so there is not much need to go through them again) however the ideal solution in this case is for the company to be in a position to buy out the shareholding.

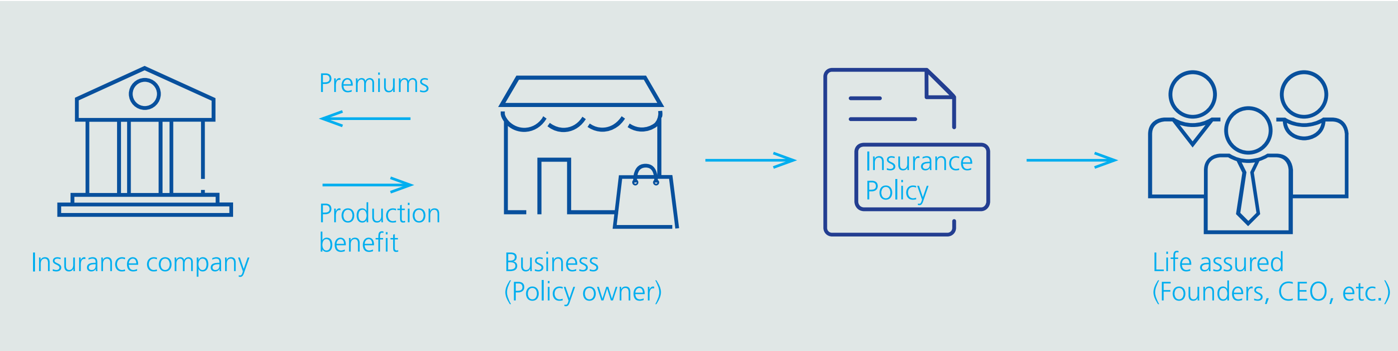
Corporate Co-Director Insurance is a means of solving these problems for both the surviving Directors and the deceased's personal representatives. It provides the necessary capital for the company to buy back the shares from the personal representatives.

Setting Up Corporate Co-Director Insurance

The contract used for Corporate Co-Director Insurance would generally be a level term protection plan, with possibly the addition of a conversion option should the Directors intend working past their intended retirement date.

The policy of insurance is set up on a 'Life of Another' basis i.e. it is the company who will own the policy on the life of a Director.

As the company is policy owner, the protection plan could be either a single life policy on each Director's life, or indeed a dual life policy covering two Directors on the one policy.



The legal power allowing a company to purchase its own shares

The two areas which deter brokers from advising clients on Corporate Co-Director Insurance are the legal aspect and the potential tax liability.

The Companies Act 2014 allows a company to buy back its own shares if certain conditions are satisfied. The relevant conditions, for current purposes, include:

- The buy back must be allowed by either (i) the company's constitution; (ii) rights attaching to the shares; or (iii) a special resolution of the shareholders.
- Where the buy back is to be authorised by a special resolution, the shares to be bought back must not be included in the vote and the contract or the terms of the buy back must be provided to the shareholders (if requested) in advance of the special resolution.
- A public limited company cannot buy back all its own shares, effectively liquidating itself. After the buy back, no less than 10% of the nominal value of the total issued share capital of the company must be owned by shareholders other than the company.
- Only fully paid up shares may be purchased by the company, and, when buying back the shares, they must be paid for in full.
- Companies can only buy back shares out of profits available for distribution, as defined by the section 117 of the Companies Act 2014. If there is currently a negative pool of profits available for distribution, the company may not be able to buy back the deceased Director's shares even if it receives the full benefit of the policy on that Director's life.

This means that even if the company has received the cash to buy the shares, if it has negative revenue reserves per its statutory accounts then company law prohibits it from purchasing its own shares.

As these conditions are based on the requirements of the Companies Act, it is highly advisable to get a solicitor involved to ensure these conditions are satisfied.

The tax treatment where a company may purchase its own shares

Under Section 130 of the Taxes Consolidation Act 1997, the payout by the company in respect of shares is deemed to be a 'distribution' and as it is deemed to be a distribution the company must deduct dividend withholding tax at the standard rate of tax.

The personal representatives of the deceased, who are selling those shares back to the company, are liable to income tax with a credit allowed for the withholding tax already deducted.

However Section 176 of the Taxes Consolidation Act 1997 allows the Buyback of those shares not to be deemed a distribution, if a number of conditions are satisfied. These conditions are as follows:

- The company must be an unquoted trading company and the purchase of the shares must be wholly or mainly for the benefit of a trade carried on by the company.
- The purchase of the shares is to facilitate the disposal of the shares by the successors and does not have the intention of avoiding taking dividends.
- The vendor must have been tax resident and tax ordinarily resident in the State for the year in which the company is purchasing the shares.

  The residence and ordinary residence of the deceased's personal representatives is taken as that of the deceased immediately prior to death.
- The shares must have been owned by the vendor and the deceased Director for a combined period of at least three years when the shares are being bought after the shareholder's death.
- After purchase of shares by the company the next of kin must have reduced their shareholding by 25% at least.
- After purchase of shares by the company the next of kin may no longer be connected with the company.

As these conditions are written into the Taxes Consolidation Act 1997, it is strongly advisable to have the company accountant and/or tax adviser consult on these conditions.

Quantifying the cover

The approach to arranging the life insurance cover and to quantifying the amount of insurance is determined by the value of the company, divided into the number of shares held.

There are several methods as to how a company can be valued, so this information should be sought from the company's accountant who may have the information already to hand.

Tax issues for the personal representatives.

Apart from the possible income tax liability, there may be other tax implications for the personal representatives of the deceased.

(a) Capital Acquisitions Tax may apply however there is a spouse exemption to this tax. If the shares are inherited by anyone other than a spouse, they may have a liability. They may be in a position to avail of Business relief however this could be lost on the disposal of the shares

(b) Capital Gains Tax does not arise on death, but could arise if, over the period between death and the surviving Directors purchasing the shares, the value of the shares increased in value.

The Buy/Sell Agreement

As with Co-Director Insurance, a legal agreement between the company and the Directors to buy and sell the shares should be completed. These Buy/Sell Agreements' come into force on death of a Director and compel the company to buy the shares back from the deceased's personal representatives and the personal representatives to sell that share back to the company.

Steps in setting up Corporate Co-Director insurance

When advising clients on setting up Corporate Co-Director insurance, the following are some suggestions as to how to approach it.

- Check that the Company is legally in a position to purchase back it's own shares, for example ensure the Company's constitution allows the buyback of shares on death. If no provision for this is in place, the company's Directors will need to make provision legally so that in the event of death the shares can be purchased. They should consult with their legal advisor and/or solicitor.
- The company's accountants should have the value of the company already as most lending companies will require this if the Directors required a loan. However in determining the value of a company, the accountant should advise on the value of the company.
- How are the policies to be set up, single life policies or dual life? Whatever best suits the Directors of the company, ultimately it is the Directors who have the final decision as to how the policies are set up
- The application form should be filled out with the Company as the Policy Owner and the Directors are the lives insured, who complete the medical questions.
- The Directors sign the application form as lives insured, a senior figure in the company signs the application for 'for and on behalf of' the company. If a company seal is available, this may be used on the application form.
- Ensure that all the correct documentation accompanies the application form, outlined in the table below.

All of the required forms are available

Life of Another
Application Form
Financial Questionnaire
Double Option Agreement (Life of Another)

for download on Zurichbroker.ie, under the dedicated Business Insurance section.

Type of policy to be used

For Corporate Co-Director Insurance, the policy used is Zurich Life's Guaranteed Term Protection Plan and would be set up on a single life basis, or a Dual Life basis where there is two Directors. The premiums on the policy may be discounted with Zurich Life's discount vouchers of 5%, 10% and 15% for life cover only up to a maximum of €250 per month.

Co-Director Insurance OR Corporate Co-Director Insurance, which arrangement should be used?

One of the common questions is whether Directors should use the personal arrangement of Co-Director Insurance covered in the previous TechTalk, or Corporate Co-Director Insurance.

One of the over-riding issues is the payment of the premiums for the life insurance policy. Under Corporate Co-Director Insurance, the company pays the premiums with no liability to tax for the Directors. However, should the company pay the premiums for the personal Co-Director option, it will generate a Benefit-in-Kind Tax liability which the Directors must submit in their annual tax returns.

The other issue in the three year rule for share ownership. In order to avoid a potential tax liability on the payout from the company to the estate of a deceased Director, there is a requirement for the shares to be held for a minimum of three years. Legislation states that the 'vendor' of the shares is the owner of the shares immediately before the purchase is made, taking into account the period of time the shares were owned by the deceased Director.

Where a Director has not held the shares for the three year period, for example a start-up company, it may be argued that the personal representatives or estate could hold the shares for the balance of years before selling the shares back to the company.

A question therefore to be put to the company's accountant would be that if the sum insured is payable from the policy to the company but it is not used to purchase the shares back until the 3 year period has passed, does the sum insured attract a tax liability as it has not been distributed?

The general view is that for younger start-up companies, the Directors would be better advised to proceed down the personal Co-Director procedure and maybe revisit the policies once they have held the shares for more than three years.

In conclusion

Having Corporate Co-Director Insurance in place makes for sound business sense, as it ensures the continued operation of a company where the company has the funds in place to purchase the shares from the personal representatives of the deceased.

Further information

If you are concerned about any issues raised in this article or if you need to discuss any particular case you may have, contact the TechTalk Team on 01-209 2020.

Next time on Business Insurance TechTalk…

Keyperson Insurance – protecting that Key employee

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