Business Insurance

ZURICH

Protecting Business by Protecting People

Co-Director Protect

Why purchase Co-Director Insurance?

The directors of a company are often the major shareholders and make all the key decisions for the firm. A successful business depends on the close co-operation and experience of the directors. The death and/or serious illness of one of the directors can have a serious impact on both the surviving directors and the deceased's successor(s).

The remaining directors may be faced with a new shareholder and director who has little business expertise and contacts. If the deceased director owned more than 50% of the business, disagreements may arise if the deceased's successor(s) – who would now be the majority shareholder(s) – has different plans for the future of the business.

Ideally, the remaining shareholders/directors or the company would buy back the deceased's shares but may not have sufficient funds available to do this. The deceased's successor(s), on the other hand, may not wish to become involved in the business and might find it difficult to sell their shareholding. They might indeed welcome a cash sum at this difficult time.

Co-Director Insurance gives the directors of a company the peace of mind that there will be funds available to them, to buy back his/her shareholding from his/her successor(s) should one of them die, thereby maintaining their control of the company.

The Co-Director Insurance policy can also cover the diagnosis of a serious illness of a director.

Forms required

Own Life in Trust (see pages 3 and 6)

- Co-Director Insurance Application Form
- Co-Director Insurance Trust Form
- Co-Director Insurance Double Option Agreement – Own Life in Trust
- Co-Director Insurance Financial Questionnaire

OR

- Life of Another (see page 6)
- Co-Director Insurance Application Form
- Co-Director Insurance Double Option Agreement – Life of Another
- Co-Director Insurance Financial Questionnaire

This guide is designed as a quick reference to the main features of the policy. For full details of any individual cover or any other aspect of the policy, you should consult the Policy Document, which is definitive in all matters of interpretation and entitlement to benefit. In the event of any conflict between this brochure and the Policy Document, the provisions of the latter will prevail.

The structure of a company

A company is a legally separate entity from the shareholders that own it. The shareholders appoint directors to the management board of the company. Where shareholders are actively involved in the company, they generally appoint themselves as directors and in that role make all the important decisions. The death of a director who has a significant shareholding in the company can have serious repercussions for all parties.

The surviving directors

The surviving directors now have a new business partner, the deceased's successor(s), who may not be familiar with the business.

- They may also face loss of control if the deceased director owned more than 50% of the company.
- Their ideal solution would be to buy the deceased director's shareholding.

The successor(s) of the deceased director

- The successor(s) may find themselves with a shareholding for which they have no ready market in a company in which they want no involvement.
- The company's Articles of Association may give the other shareholders the right to block the sale of the shares to an outside party.
- They may also be experiencing cash flow difficulties with the loss of the deceased's salary.

Co-Director Insurance is a means of solving these problems for both the surviving directors and the deceased's successor(s). Co-Director Insurance provides the necessary capital for the surviving directors to buy back the shares of a deceased director.

Setting up Co-Director Insurance

Co-director Insurance is a personal arrangement between the directors themselves. There are two methods of setting up Co-Director Insurance:

- Own Life in Trust, or
- Life of Another.

Own Life in Trust

The steps in setting up an Own Life in Trust arrangement are:

- Each director effects a life insurance policy on his own life, for a sum insured equivalent to the estimated full market value of his or her shareholding.
- The directors pay the premiums. If the company pays the premiums on behalf of the directors, they are deemed to have received a benefit-in-kind equal to the premium paid. Premiums paid by the directors are not tax deductible.
- Each policy is arranged under trust, so that on death, the proceeds are payable directly to the trustees for the benefit of the surviving directors.
- A legal agreement is put in place between the directors using a Double Option Agreement. This gives the surviving directors an option to buy out the deceased director's successor(s). It also gives the successor(s) the option to sell their shareholding to the surviving directors.

  If either party exercises their option, the Agreement obligates the surviving directors to buy the deceased's shareholding at a fair open market value and obligates the deceased director's successor(s) to sell the shareholding back to the surviving directors.

  If both parties mutually agree not to exercise their options, this allows the successor(s) to retain their shareholding and come into the company.

  There is an alternative legal agreement available known as a Buy and Sell Agreement whereby the sale transaction must always be carried out.
- In either case the Agreement should be referred to a solicitor for examination

Inheritance/Gift Tax Implications

- Certain Revenue guidelines must be met to ensure that there is no Inheritance Tax or Gift Tax liability on the insurance policy proceeds in the hands of the surviving directors. These include showing the policies are clearly effected as part of a commercial arms length arrangement and are part of a reciprocal agreement between the directors. This agreement can be included as a clause in the Co-Director Double Option Agreement. Any surplus not used by the surviving directors to buy the deceased director's share will be liable for Inheritance Tax or Gift Tax.
- Death is not a necessity – proceeds paid on diagnosis of permanent total disability or serious illness are also exempt from Capital Acquisitions Tax as long as Revenue guidelines are met.

Life of Another

The steps in setting up "Life of Another" arrangement are:

- Under a Life of Another arrangement, each director takes out a policy on each of the other directors' lives. This is generally only feasible where there are a small number of directors and the arrangement is unlikely to change.
- Again the directors pay the premium themsleves, if the company pays the premium it is again deemed to be a Benefit-in-Kind.
- On the death of one of the directors, each of the others receive the proceeds of their policy, which can be used to buy the deceased's shares from his or her successor(s).
- A legal agreement is put in place between the directors using a Double Option Agreement or a Buy and Sell Agreement as previously set out.
- There is no liability to Capital Acquisitions Tax as each director receives the proceeds of the policy for which he or she has personally paid the premiums.

Tax treatment where the buy-back is not treated as a distribution

Capital Gains Tax (CGT) on shareholding

The deceased director does not suffer CGT on his or her shareholding upon death. The shares are deemed to be acquired by the successor(s) at their market value on the date of death. If the successor(s) sell their shares shortly afterwards to the surviving directors, any increase in the value of the shares from the date of acquisition to the date of disposal will be liable to CGT.

Capital Acquisitions Tax (CAT) on shareholding

There is no liability to CAT if the deceased's spouse inherits the shares. The normal rules relating to CAT will apply if someone other than the spouse inherits the shares.

Where a CAT liability has been reduced by Business Relief, the disposal of shares by the successor(s) after inheriting them from the deceased director would result in the loss of this Business Relief. **This may be financially significant and professional advice should be obtained if this scenario is a possibility.**

Serious Illness and Permanent Total Disability cover

Throughout this guide we have focused on insurance cover in the event of the death of a director. The following issues need to be considered if including Serious Illness or Permanent Total Disability cover in a Co-Director Insurance arrangement.

- The precise definition of ill-health would need to be agreed for Serious Illness cover. A director who fully recovers from serious heart surgery may not want his or her shares to be compulsorily purchased by the other directors.
- Where a director is diagnosed as having a serious illness, he or she could face Capital Gains Tax on the disposal of his or her share of the company. If the director is over 55 and certain conditions are met, Retirement Relief may apply thereby reducing his or her Capital Gains Tax bill.
- Where an Own Life in Trust arrangement is used, the proceeds paid under a policy on permanent total disability or a serious illness are also exempt from Capital Acquisitions Tax provided the Revenue guidelines outlined earlier are met. Any surplus not used by the other directors for the purchase of shares will be liable to Capital Acquisitions Tax.

For more information

Talk to your Financial Broker or advisor

Call our Financial Planning Team directly on 0818 202 102

Email us at customerservices@zurich.com

Visit our website at zurich.ie

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The information contained herein is based on Zurich Life's understanding of current Revenue practice as at October 2021 and may change in the future.

Intended for distribution within the Republic of Ireland.

GR: 6252 Print Ref: ZL PB 3 1021 Product Ref: JAS

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