Don’t skimp on business continuity costs

We are frequently requested to assist small-business clients in their financial structuring at all levels, whether it is with regard to the acquisition of another company, the employment of a key individual or the evaluation of a proposed buyout.

The question is always asked as to the need or otherwise of the seemingly expensive business assurance policies in place.

I will focus my attention on these specific business needs.

**Small business - loans and liabilities**

If your business has insufficient liquid investment capital to cover all overdrafts, long-term loan facilities and potential liabilities, life assurance to cover the life of surety holders is essential.

This type of cover is called ‘contingency liability cover’.

If you have stood surety for an overdraft or other debt, your death may result in the bank demanding repayment and collecting this from your deceased estate. This can have dire consequences for surviving dependants.

Surety cover can prevent this eventuality.

**Tax implications**

The policy can be structured in such a way as to be either conforming or non-conforming in terms of the Income Tax Act. If the policy is conforming, the cost of the related premiums will be deductible expenses for tax purposes, but the proceeds of the policy will be taxable in the hands of the business and therefore allowance would have to be made for tax.

If the policy is non-conforming premiums will not be deductible but the proceeds will be free of tax.

The decision to make the policy conforming or non-conforming is based on whether the expense that must be met is tax deductible or not.

**Small business - finance for key individuals**

Many small companies have one or two key individuals around whom much of the business revolves.

- This could be a technical or financial person on whom much of the business and its future income and profits rely.
- Key individuals normally have good relationships with customers or suppliers.
- It would be a large setback to the company to lose even one of these individuals suddenly.

In these instances, we advocate the use of Key Person insurance. The company takes out life insurance cover on the key person, the sole purpose of which is to finance the search and replacement of the key individual.

Should there be insufficient capital within the business to fund the replacement of a key individual – which could run into millions – or should it be difficult to find a suitable replacement candidate on the market, key person insurance is essential.

**Tax implications**
Again, if the requirements of the Income Tax Act are met, the premiums will be tax deductible. Should the premiums be deductible, the proceeds will be taxable and provision for tax must be made.

**Small business - finance to purchase shares**

One of the most important areas of small business assurance is the financing of the purchase of shares from a deceased estate in terms of the Buy and Sell Agreement between shareholders in a private company or members in a close corporation or partners in a traditional partnership.

A Buy and Sell Agreement should always exist within any business agreement with two or more parties, but the *financing* of the agreement is where problems may arise.

A properly structured Buy and Sell Agreement has the following benefits:

- The estates of deceased shareholders/members/partners are paid timeously for their share or part share of the business, which benefits the heirs.
- The remaining shareholders take control of the shares from the deceased estate.
- The death of a shareholder does not affect the decision making of the company.
- Business valuations can be certain.
- A disability planning scenario is usually included because if one of the shareholders/members/partners is permanently disabled, this will have an effect on the business similar to the death of one of these persons.

If the shareholders/members/partners all have sufficient personal capital, available at all times, to pay for the purchase of shares that would become available in terms of a buy and sell agreement on the demise or disability of any or all partners; then life assurance and disability cover may not be required on the lives of the partners. It goes without saying that this is a highly unlikely scenario.

**Tax implications**

There is no income tax deduction on the premium paid by members of the close corporation and the policy proceeds will not attract tax. Provided the policies are correctly structured the proceeds will be exempt from estate duty.
The importance of perspective

Most small business owners would not consider foregoing short-term insurance cover on the productive capacity of their enterprises. Vehicle, factory, machinery, even public and product liability insurance is considered essential.

However, often the very people who enable the business to produce wealth for shareholders are not properly protected.

Shareholders and business owners need to protect themselves as their businesses’ most important assets.

The need for business assurance cannot be underestimated.

Consult with your financial planner to determine the merits of business assurance within your business. Visit the FPI website on www.fpi.co.za to select a qualified CERTIFIED FINANCIAL PLANNER®.