

VitalityLife Business Protection

Case Study – Key Person Cover Life – Buttonit Ltd

At VitalityLife, we recognise that Business Protection can seem complicated. This case study involves a set of circumstances that may be similar to many of your clients' and explains the choices to be made when placing their VitalityLife Relevant Life Policy into trust. Also available on our website is a completed Relevant Life Policy Trust form using the facts of this case study as an example of how to fill in the Relevant Life Policy Trust deed.

1. Background

Buttonit Ltd is a successful button manufacturer. Pre-tax profits are £300,000. It relies heavily on the manufacture and supply of its new blazer button. The man in charge of the production line (with unique knowledge of how to maximise production and minimise cost) is Roy Fastener. If something happened to Roy, the business would suffer severe disruption with consequent significant financial loss. This loss would arise for a number of reasons. In particular, there would be:

- (a) A reduction in profits because of the loss of Roy's experience on the production line.
- (b) The cost of finding, hiring and training a replacement for Roy.

The company wishes to implement an arrangement under which it can ensure that, in the event of Roy suffering a serious illness or even dying, Buttonit Ltd will have sufficient cash to see it through any financial crisis that may ensue.

2. Dealing with the financial needs

Buttonit Ltd would need to set up a key person cover arrangement to cover against the financial loss that could occur. This could be achieved by effecting a Business Protection Plan on Roy's Life. There is no need for a trust form to be completed as the company will be the owner of the policy and the proceeds will be paid directly to the company.

Two important issues arise in respect of this:

- The amount of cover.
- The tax treatment of the arrangement.

(i) Amount of cover

- Buttonit Ltd calculates that Roy's death (or serious illness) would cause it to lose about 50% of its profits (ie. £150,000) each year for three years. The cost of finding, hiring and training a replacement for Roy would be about £110,000.

It therefore sets up a Business Protection Plan with a death benefit of £700,000 on Roy's life on a life of another basis (so that the net proceeds after corporation tax will meet the key person needs).

(ii) Taxation

Roy is not a significant shareholder in Buttonit Ltd, the policy is a temporary assurance

- It is being set up to cover a loss of revenue profits (rather than a capital loss).
- Premium payments are likely to be a deductible expense for corporation tax purposes.
- Should the sum assured be payable, it is likely to be taxed as a trade receipt for corporation tax purposes.

3. The Plan in action

- Two days after Roy's 45th birthday he dies after suffering from a heart attack.
- £700,000 is paid to Buttonit Ltd. This is fully subject to corporation tax at 20% leaving Buttonit Ltd with £560,000.
- Buttonit Ltd uses the £560,000 to:
 - (a) Cover against the loss of profits caused by Roy's death (£450,000); and
 - (b) Hire and train Sam to replace Roy (cost £110,000).