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Business Succession Planning: FAQs

Introduction

When working in the business succession planning area you may come across some issues to which answers are not immediately obvious - we address some of the more common ones in this review.

I am putting a business succession plan in place but one of the business partners can't get TPD or Trauma Insurance - what should I do?

Let's assume there are 3 equal partners in a business - Alan, Bob and Chris, but Chris can't get TPD insurance.

You can proceed with Life, Trauma and TPD policies for Alan and Bob and for Chris, a Life and Trauma policy only.

If any of them dies or suffers a trauma then the Buy Sell Agreement can be implemented to transfer the shareholding to the other two equally. If, on the other hand, Alan or Bob suffer a TPD then the insurance proceeds are received and all of their shares are transferred to the other ie Alan's shares would transfer to Bob and vice versa. Chris does not receive any shares in this circumstance.

If Chris suffered a TPD however, he would not receive any insurance proceeds. Without an agreement transferring ownership, Alan and Bob would still have to pay him his share of the profit even though he is not able to work in the business.

One solution is to put a Exit Agreement in place. This would ensure that if Chris could never work again that his shares would transfer automatically to Alan and Bob. In return for that however, they would have to pay him an agreed amount as he does not have insurance cover.

Commonly, most partners agree that this amount will be based on a discount of 80% of the value of the business at the time. So let's say the business was worth \$1.5 million, Chris would receive 80% of \$500K ie \$400K from Alan and Bob. Payment terms are also usually put in place eg the \$400K could be paid over 3 or 4 years.

So when insurance funding is not available for one partner, a Exit Agreement can provide a solution to a problem that can have severe consequences for all parties.

I can't get enough insurance to cover the client's share in the business. What can I do?

You can still go ahead and put the cover in place as the Buy Sell agreement can cater for the excess in another way - if that's what the client wants eg they may wish to stipulate that a "top-up" payment is payable by the other partners.

For example, David and Ellen were equal partners in a business worth \$3 million but could only get \$1 million of cover each. They wanted to ensure they (or their estate) received the full value. (Assume there are no tax issues in this example).

The Buy Sell Agreement can stipulate that the remaining partner must pay the top-up amount. In this instance, if

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David died his estate receives \$1m in insurance proceeds and Ellen would be required to pay the extra \$500K over say, the next 4 years. She could do this out of the additional cashflow she receives from owning 100% of the business.

Importantly, these agreements are always tailored to the clients - there is no such thing as a "one size fits all" agreement. In this example, David and Ellen may decide only \$400,000 of the top-up needs to be paid and perhaps it will be payable over two years, not four.

The client wants trauma cover but is worried about being forced out of the business even though they recover. How do we deal with that?

Often if trauma insurance is taken out, the Buy Sell Agreement is drafted to provide a "window" for recovery.

This can allow say 6 or 12 months lead time before the surviving partners can force an ill partner out of the business. This gives people time for example, to recover from a heart attack or mild stroke and get back to work.

This is a common inclusion - most people are happy to "carry" a partner for a period of time but want a safety net in case the recovery takes too long.

How does Irongroup's Business Succession Planning service work?

Here's what usually happens...

1. Once you have obtained the clients' agreement to proceed with the insurance applications (they don't need to be finalised), you contact us with their name and phone number. We then call to arrange a meeting, usually at their premises.

You are more than welcome to attend that meeting. It's not necessary to invite their accountant although they are also welcome.

2. During the meeting we explain how the agreement

works and discuss their various obligations and options such as top-up funding, handling debt owed to the business on departure, responsibility for premium payments etc.

The key terms of the agreement are usually resolved during this meeting. We also obtain their accountant's details so we can confirm key elements such as ownership structure etc and to keep them informed.

Our drafting work then commences with possible additional client follow-up required through that process.

3. Once the insurance schedules are completed we are able to finalise the Buy Sell Agreement. We then phone the clients to advise them and send it out for signing.

If your clients are not yet sure if they want to proceed we can also meet with them to help identify solutions for their particular issues. If the client proceeds with the Buy Sell Agreement this meeting is included in the fixed price. If not, we will charge them an hourly rate for that meeting.

Need advice?

If you have a query regarding business succession planning please call us on 03 8621 9000.

With our depth of experience, fixed prices and on-site appointments, we can help you look after your clients' business succession planning needs.

More information?

For a copy of our "11 Common and Costly Business Succession Planning Traps" send an email to info@irongroup.com.