

Business Ownership Transfer Arrangements

An important aspect of the advice Triplejump provides to its clients is the process and structure for the sale of shares in a closely held company and where there are multiple independent owners i.e. they are not husband and wife or defacto life partners. The principles of this discussion apply equally to Partnerships.

Insurance is often an effective way of creating cash to purchase the shares for certain circumstances such as death or serious disablement.

To achieve the certainty that the clients are wanting i.e. the shares will be available for sale and the cash will be available to buy the shares involves:

- Appropriate insurance policies with correct ownership;
- Ensuring the estate planning especially the wills and enduring powers of attorney are in place and relevant;
- A legal and binding Buy and Sell Deed between the required parties. This may be within the Shareholders Agreement or a new agreement which operates in conjunction with the Shareholders Agreement and Constitution.

Failure to have the complete structure in order is likely to lead to failure of the clients objectives for implementing the insurance in the first place.

Triplejump has developed a best practice process for protecting the owners of businesses where they want to ensure that an effective transfer process is in place. This work has been done in conjunction with John Brown LLB, author of CCH Estate and Trust Guide and an experienced lawyer in Insurance matters.

The objective of this work was to develop a series of templates that we could make available to legal advisers to assist in the structuring of the Buy and Sell agreements and the implementation of a Trustee Company as the owner of the insurance intended for creating the cash to purchase the shares. Peter McKenzie QC has also reviewed the work prepared by John and provided some opinions as to best practice.

Policy Ownership

The purpose of the insurance policies for Business Ownership Protection is to provide the cash that is required by the surviving shareholders to fund the purchase price of shares that they are buying from an exiting shareholder where that shareholder has died or has become seriously disabled.

As there is likely to be a time lag between the event and then the shares being offered up for sale it is important to ensure that the insurance proceeds are safely 'housed' prior to the transfer process.

If the policies are in the name of the other shareholders then the

proceeds are personal property of the owner and could be attacked by Property Relationship claims or could be applied to other purposes especially if there is no binding agreement between the parties.

If the policy is owned by the shareholders company then on claim the funds may be deemed income of the company and the shareholders may be required to withdraw the proceeds as a distribution before using the funds to buy the shares. This may incur tax and is likely to also require the shareholders to confirm the company can pass the solvency test following the distribution.

Creditors of the company may also be able to access the proceeds.

Triplejump has shown that the best practice is for the policies to be held by an independent trustee company. The Trustee Company is party to a legally binding agreement –The Buy and Sell Deed- and is required to apply the funds from the insurance proceed according to the agreement.

Because of the time delays between the application for insurance and the issuance of an in force policy and the appointment of a trustee and the completion of the buy and sell deed, it is critical that interim documentation is completed that details the intention and obligations of the parties. If a claim was made against a policy before all the final agreements were completed the interim documentation would increase that probability that the intentions of the parties could be fulfilled.

The templates Triplejump has had developed enable the legal adviser to progress through the required steps and instructions to appoint the Trustee Company as the owner of the policies. Supporting these are guidelines and a discussion document for establishing the Buy and Sell Deed.

The documents available are:

- Interim Statement of Intent
- Interim Request to Trustee Company
- Declaration of Trust
- Buy and Sell Deed Provision Questionnaire
- Buy and Sell Deed Sections

We believe these tools will give you access to robust templates that will help you to structure appropriate and watertight arrangements for your business clients. If you wish to know more please contact your Triplejump relationship.



Creating Certainty for Business Owners – A ‘Real’ Case Study

Human Capital Risk is a growing concern for business owners; how do you protect the livelihood of a business and meet the needs of business owners and their families should an unforeseen event occur? If you have the correct processes in place you can ensure everything within your control goes to plan.

This article tells the true story of Maree (names have been changed to protect identities) and the failure of her husband and his business partners to put the correct process in place.

The Problem

Maree's husband was one of four 25% shareholder's in a mid-sized business. All four shareholders were actively involved in key roles within the business. They had three young children and Maree provided the primary care role in the household, they also had a reasonably substantial mortgage.

It had been discussed that the shareholders owned substantial policies of \$1.3m on each others lives, based on what Maree's husband had told her the intention was that if one of them was to die the remaining shareholders would buy the shares off the wife and in return pay over the proceeds of the policy.

Tragically at the age of 42 Maree's husband suffered a fatal stroke and passed away during the Christmas period of 2009.

In the wake of her husband's death Maree approached the company seeking purchase of her shares and the payout of the insurance. She was advised that there was no written agreement in place between the shareholders and the insurance funds were not available, the business was also not in a good position. The shareholders made an offer to buy her shares for about a third less than what she understood the value of the policy to be. It was at this stage that Maree sought legal advice to ascertain her rights.

The Cause

The shareholders had taken steps to manage some of the financial risk and had purchased Key Person and Shareholder Protection insurance for each of the four shareholders. The policies had increased throughout the years from \$800,000 to \$1.3m. Notes were occasionally recorded estimating new company value and the rationale for increasing the cover. The policies were originally cross owned amongst the shareholders.

More recently the ownership of the Shareholder Protection policy was changed to the company and the business was paying the premium.

The financial performance of the company had fluctuated and in the final two years was down in revenue by around 30% and the profit was minimal. The company did not have its own Constitution

and there was no Shareholders Agreement or Buy and Sell Deed between the shareholders.

The Problem Compounded

Because the policy was owned by the Company the insurance company only required them to provide the death certificate to pay the proceeds – the estate did not need to have completed probate and Maree did not need to provide approval. The insurance adviser along with the company's lawyer had been advised not to provide any information to Maree.

Maree's lawyer needed to prove beneficial interest in the policy, they required documentation of the intended purpose of the policies. Information was obtained after many months that pointed to the policies being put in place for the purpose of share buy-outs

The Resolution

Many months after Maree's husband's death the parties agreed to go to mediation and a settlement was reached – less than the \$1.3m but a lot more attractive than the original offer.

So what went wrong? There were a number of causes:

- There was no legal and binding agreement between the shareholders to ensure that the shares Maree inherited would have to be bought and for an agreed price
- The policy was owned by the Company and this meant that the shareholders faced some issues getting the proceeds 'out' for personal use without some significant tax implications. It is important to be aware though that cross ownership could also have created problems for Maree - she would have been trying to get hold of the money they now owned personally
- The records of the insurance adviser and the company meeting minutes were scant so it was not hard to prove the intentions.

Avoiding the Problem:

Avoiding the problem requires expertise and collaboration. Expertise of legal advisers to draft an agreement that will work and expertise of insurance advisers to ensure the type of policy implemented suits the needs of the client and that the structure of the insurance will ensure the proceeds end up in the right hands.

This involves:

- Correct identification of the purpose of insurances
- Correct ownership and tax treatment of the policies
- Appropriate documentation regarding the terms on which policies are being held
- Appropriate legal agreements completed to bind all the parties to the required outcomes in the form of the Constitution, Shareholders Agreement and Buy and Sell Deed.

Too many New Zealand business owners would find themselves in the same position as Maree when tragedy strikes. Triplejump is committed to helping you solve these problems for your clients.