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Dealing with the death of shareholder

Introduction

In a private limited company the death of a major shareholder can cause a number of issues. Firstly, the deceased s shares may pass to beneficiaries who do not subscribe to the company s business plan and vision and/or who lack business experience. Secondly, even if the remaining shareholders wanted to purchase the deceased s shares, they may not have sufficient funds to do so. Thirdly, the financial welfare of the deceased s beneficiaries may be at risk as the company has no obligation to provide the deceased s beneficiaries with benefits such as income and pensions and an assurance by the shareholders to the now deceased shareholder during his lifetime that his beneficiaries will be looked after upon death is not always sufficient.

Cross-option agreement

Each shareholder can enter into a cross-option agreement which grants the other shareholders a put or call option over his shares in the event of death. The agreement entitles the surviving shareholders to buy the deceaseds shares (a call option) or the deceased representatives to sell the shares (a put option) to the remaining shareholders. In each case it is a right and not an obligation. A cross-option agreement insures that in the event of death, control stays with the remaining shareholders and entitles both sides to trigger a sale of the shares.

Life Assurance Policy

It might be the case that the remaining option holders have insufficient funds to pay for the deceased s shares. Therefore, in conjunction with the cross-option agreement, each shareholder can take out a life assurance policy which will reflect the value of their shares held in the company and will be held on trust for the other option holders. Upon the death of a shareholder, the proceeds of the deceased s life assurance policy can be used by the remaining option holders to purchase the shares under the call or put option.

Business Property Relief

Business Property Relief offers 100% relief from inheritance tax on business property. In order for the deceased s beneficiaries to obtain relief on the deceased s shares, it is important that the cross-option agreement is drafted correctly and not as a binding contract for sale of the deceased s shares on (or immediately prior to) death. The parties must have a right and not an obligation to purchase the shares. If the parties have a contractual obligation it will be deemed a transfer of cash and therefore void for the purpose of Business Property Relief and as such will be subject to inheritance tax.

Protection of beneficiary rights

The cross-option agreement insures the beneficiaries of the deceased can extract value from the sale of the shares in a tax efficient way and the ownership of the company stays with the remaining shareholders.

Conclusion

A correctly drafted cross-option agreement means that the ownership of the company remains with shareholders who subscribe to the company s business plan and vision and have relevant business experience. It also enables family members of the deceased to receive value from the sale of the shares free from inheritance tax. A cross-option agreement is generally entered into in conjunction with a shareholders agreement.

Please contact Michael Buckworth for more information and/or to discuss your shareholders agreement.