Partnership share purchase - commerciality and premium equalisation

Synopsis: How to achieve commerciality by equalising premium payments.

Date published: 15.02.2023

To ensure that the share purchase arrangement (including life policies in trust) between partners is commercial and therefore has no adverse inheritance tax (IHT) implications (even though currently there is 100% business relief meaning that problems, such as they are, should be minimal), premiums payable by the partners should (in most cases) be 'equalised'.

This means that premiums are apportioned in such a way that each pays a 'commercial' amount relative to the benefit he may receive from the arrangement.

The IHT gifts with reservation of benefit provisions do not apply to pension policies and in any event premiums under pension policies are payable in a different manner and so the following is not relevant where the policy in question is a temporary assurance issued as part of a personal pension arrangement.

How equalisation can be done is shown by the following example.

Three partners are equally entitled to benefit under each others' policies.

Premium	A	£600
	B	£450
	C	£720
		£1,770

The following are the methods of equalisation that are likely to be commercially acceptable.

'Life of another simulation'

One of the easiest and most commercially accepted methods of equalising premiums is to use the "life of another" method, e.g. in an equal sharing partnership how much would each partner have to pay if the policies were effected on a life of another basis with two partners paying one half of the premium on the policy on the third life.

The policies are however actually effected on an "own life/in trust" basis.

Life	Total premium paid	Premiums paid by		
		A	B	C
	£	**£**	**£**	**£**
A	600	-	300	300
B	450	225	-	225
C	720	360	360	-
Total	1770	585	660	525

So in this case although A, B and C would pay the premiums, payments would need to be made between them to ensure that each only paid an amount equal to the benefit to which they were entitled.

The same method can, of course, be used where the shares are unequal - each will then pay a proportion reflecting their share of the business, ignoring the share of the life assured under each policy.

An alternative

Is to add up all the premiums, i.e. in our example	£1,770
and divide this in the profit-sharing ratios, i.e. equally =	£590

In both cases the premiums could be paid by the partnership and the post-tax profit share/capital accounts or loan accounts of the individual partners debited.

Topping up with actual life of another policies

Here trust policies are effected with each partner paying the same premium for different levels of cover and topping up the balance needed by life of another policies - this is likely to be very difficult to administer and would cause considerable problems on changes of partners.

Adjusting cover levels under flexible unit linked whole of life policies for the same premium

Here, effectively those with the 'more expensive' sums assured, will be paying for the extra cover in the form of reduced surrender values.

The 'life of another' simulation is considered to be the easiest to administer.

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