

Share purchase on critical illness/disability

Synopsis: The choice: double and single option agreements.

Date published: 14.03.2024

Share purchase on critical illness or disability of a shareholder requires special consideration. This is because the degree of illness or disability will frequently dictate whether the director wishes to dispose of their shares.

In some situations where a critical illness is diagnosed and a valid claim can be made against the critical illness policy funding the arrangement for share purchase, the condition suffered may not, in fact, be fatal or totally disabling. It is possible that, after a period of convalescence, if required, a director will return to work.

In principle, two forms of option agreement are available to the directors...

Double option agreement for sale / purchase on critical illness / disability

This would be based on the same principles as for purchase on death. In this case, the continuing shareholders would be able to force the critically ill shareholder to sell their shares, even perhaps against the shareholder's will. However, certainty will be provided as to what will happen in the event of a shareholder becoming critically ill or disabled.

It is possible that such certainty may only be needed in certain circumstances, which can be defined to ensure that a shareholder is not forced to sell their shares where they are still capable of continuing to participate in the business but a claim has been made under a policy.

Some certainty may be provided in certain circumstances, for example by closely defining a particular condition, such as total or permanent disability or making a provision that a purchase will take place in the event of the shareholder being unable to carry out certain business activities through illness or disability covered by a critical illness policy, for a period of, say, six months or more. In such a case, effectively, a forced retirement could result with the provision for the purchase of their shareholding by means of a double option agreement.

Single option agreement

In many cases, it will be felt that to force the critically ill shareholder to have to dispose of their shares would be unfair and a fairer solution would be to place the critically ill shareholder in the driving seat, so to speak, i.e. give them control over whether they wish to sell their shares or not.

This will normally be provided by means of a single option agreement. Under such an agreement the critically ill shareholder will alone have the option to sell, with no corresponding option to buy given to the other shareholders. This will remove the possibility of the critically ill shareholder being forced to sell as could be the case with the double option agreement.

Taxation

In either case, it will be necessary, when arranging funding for the purchase through life assurance, to bear in mind the capital gains tax (CGT) that may become due on the share sale following critical illness. There will, of course, be no revaluation for CGT as there is in the case of a purchase following death.

The CGT flat rate of 10% (for basic rate taxpayers) and 20% (for higher and additional rate taxpayers) applies but business asset disposal relief (previously known as entrepreneurs' relief) may reduce this rate to 10% for gains of up to a cumulative (lifetime) total of £1 million of 'qualifying' gains.

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