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WEALTH MANAGEMENT

KEY GUIDE I JULY 2025

Business succession planning

Introduction

BE PREPARED

If you are a business owner, succession planning and insurance are important. Business succession planning is simply the process of planning for what you want to happen if you (or your co-owner, if you have one) were to die or fall seriously ill.

If this happens, family and business partners can be left in a complex situation. In some instances, the business ends up in the wrong hands, or in worst cases can fail. These situations can befall sole traders, partners and shareholders in limited companies, although they can all be avoided with sensible business succession planning.

Please note that all scenarios and examples included in this guide are fictitious.

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Planning for your business

The legal position on the death of a business owner will depend on the type of business entity.

- **A sole trader business automatically comes to an end.** The business may still have a value – stock, buildings, or assets such as equipment and vehicles and goodwill, but the business itself will cease to exist legally.

- **A partnership may come to an end** if the partnership agreement does not set out that the business should continue.

- **A limited company continues** but the owner's shares will pass to the beneficiaries of their estate in line with their will, or the intestacy rules if no will is in place.

IF YOU'RE A SOLE TRADER

When a sole trader dies, their business dies with them, legally speaking. The business's assets will form part of the sole trader's estate and pass to their beneficiaries under the terms of their will.

The issues

If the sole trader had not made a will, the intestacy rules apply; in effect, the state decides who the estate should pass to. If there is a spouse/civil partner but no children, the situation may be reasonably straightforward, with the spouse/civil partner inheriting everything. However, where there is no surviving spouse/civil partner, or there are children involved, things can become considerably more complicated.

If the estate is large enough and is not left to a spouse/civil partner, inheritance tax (IHT) can be payable on all assets above the nil rate band (£325,000 is the standard amount in 2025/26, and frozen at this level until 2030), meaning that the government can become one of the largest beneficiaries of the estate.

Currently most businesses are usually exempt from IHT due to business relief which gives 100% IHT exemption after at least two years of ownership. However this is changing from April 2026 (see below, Future changes to business relief) .

Several issues can arise:

- Paying the IHT bill if the business does not qualify for the normal 100% business relief;

- Passing on the business – perhaps to an employee or to a family member;

- Paying any liabilities the business has incurred. These could include outstanding rent on premises, unpaid tax, an overdraft or business loan.

The solution

In each of these instances, the basic requirement is to create a capital sum, preferably outside the estate to minimise IHT.

This can be achieved with the help of a suitable life insurance policy. Generally, we recommend that sole traders in this position take out life insurance policies on their own lives and put the policy into a trust that will receive the proceeds on their death and pay them out to the intended beneficiaries at the right time. It is often said that the benefits of a trust lie in ensuring that the 'right money' ends up in the 'right hands' at the 'right time'.

The exact solution depends on several factors, but here are a few examples:

Scenario	Action taken
James, who has no close family, wants to pass his engineering business to his production manager, Ken, when he dies. Ken would not be able to buy the business's assets on death, nor could he afford to pay the life insurance premiums.	James takes out a policy on his own life, in trust for Ken. On James' death, Ken has a lump sum to enable him to buy the business assets and continue running the business. Having this arrangement also gives Ken a strong incentive to remain with the business, and is valuable as a succession planning tool.
Melanie plans to leave her shop to her daughter Sam, but calculates that on her death, IHT of around £200,000 would be payable on the rest of her estate. She is concerned that Sam would have to sell or mortgage the shop to pay the IHT bill.	To counter her concerns about her daughter settling the IHT liability, Melanie takes out a life insurance policy on her own life and assigns it to Sam. Sam then pays the premiums and, on her mother's death, has a sum of money she can use to pay the IHT bill.
Peter has a sole trader business on which the overdraft increases to £50,000 at certain times of the year. He reckons that other liabilities at any time might amount to another £35,000. He thinks that the rest of his estate would be spoken for and he does not wish to leave his wife (who is his legatee) with liabilities and worries about paying these amounts to creditors.	In this case, Peter could take out a life insurance policy on his life written in trust for his wife. This would provide her with funds in the event of his death which she could use to settle any potential liabilities.

Planning point

You can create a capital sum with the help of a suitable life insurance policy.

IF YOU'RE IN A PARTNERSHIP

A partnership is a business owned by at least two people. Unless there is a specific provision in the partnership agreement (and many partnerships have no formal agreement), a partnership ceases when a partner dies.

The issues

When this happens, the deceased partner's estate becomes entitled to their share of the business. This can mean a choice for the surviving partner(s). They could:

- Pay the deceased partner's estate a sum of money that they all agree to be the value of the deceased partner's share.
- Carry on in business together with the deceased partner's spouse/civil partner or other beneficiary – even if the new partner has little to contribute to the success of the business.

EXAMPLE
Legacy tensions from a partnership

John and Jane are in partnership and Jane dies. Jane's sole beneficiary, her daughter Kylie, is keen for the business to continue, and so is John, who could not afford to buy out Kylie's interest anyway. Unfortunately, Kylie is unable to play any active part in the business and John resents having to split the partnership's income with a sleeping partner who contributes nothing other than capital to the business.

The solution

John and Jane could have done some succession planning.

Two main options are available to meet such needs and are illustrated below. Other options are available, but they are generally not as attractive.

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A double option agreement (also known as a cross option agreement)	This is a legal contract that outlines the options for buying and selling shares in businesses upon death or critical illness. The surviving partner has the option to buy the share in the business from the deceased partner's estate. In other words, they can force the estate to sell the share in the business. The deceased partner's estate can also exercise the option to force the surviving partner to buy. (In other words, when one party exercises their right to sell or buy, the other party must comply). Generally, the partners take out life policies on their own lives, which are written under a special business trust to benefit the other partner. So, when Jane died, John would have been able to afford to buy out Jane's share from the proceeds of the policy on her life. Kylie would have received appropriate financial compensation and John would have control of the business. The valuation of a partnership business can be difficult and so there should be a formal agreement which sets out an agreed basis for a valuation.
Automatic accrual	This is an agreement which does not involve an actual sale or purchase. Instead the surviving partner(s) inherits the business, but the family receives the proceeds of a life policy. On Jane's death, the business passes automatically to John. No buyout is involved. Instead Kylie is compensated from the proceeds of a life insurance policy Jane took out on her own life, written in trust for her.

The result of both solutions is that John, the remaining partner continues to run the business and Kylie, the deceased partner's beneficiary, receives a fair price. Without these arrangements, the business could be in danger and the beneficiaries might receive little or nothing.

There may also be a need to insure the lives of all the partners to cover potential liabilities that might arise on their death – perhaps to pay off an overdraft or other creditors.

Events such as Covid-19, and the current cost-of-living crisis cause significant disruption for many small businesses with higher operating costs as well as dealing with the difficulty of customers with reduced spending ability. These events are stark reminders to ensure that where a partnership agreement exists it is both current and relevant.

Planning point

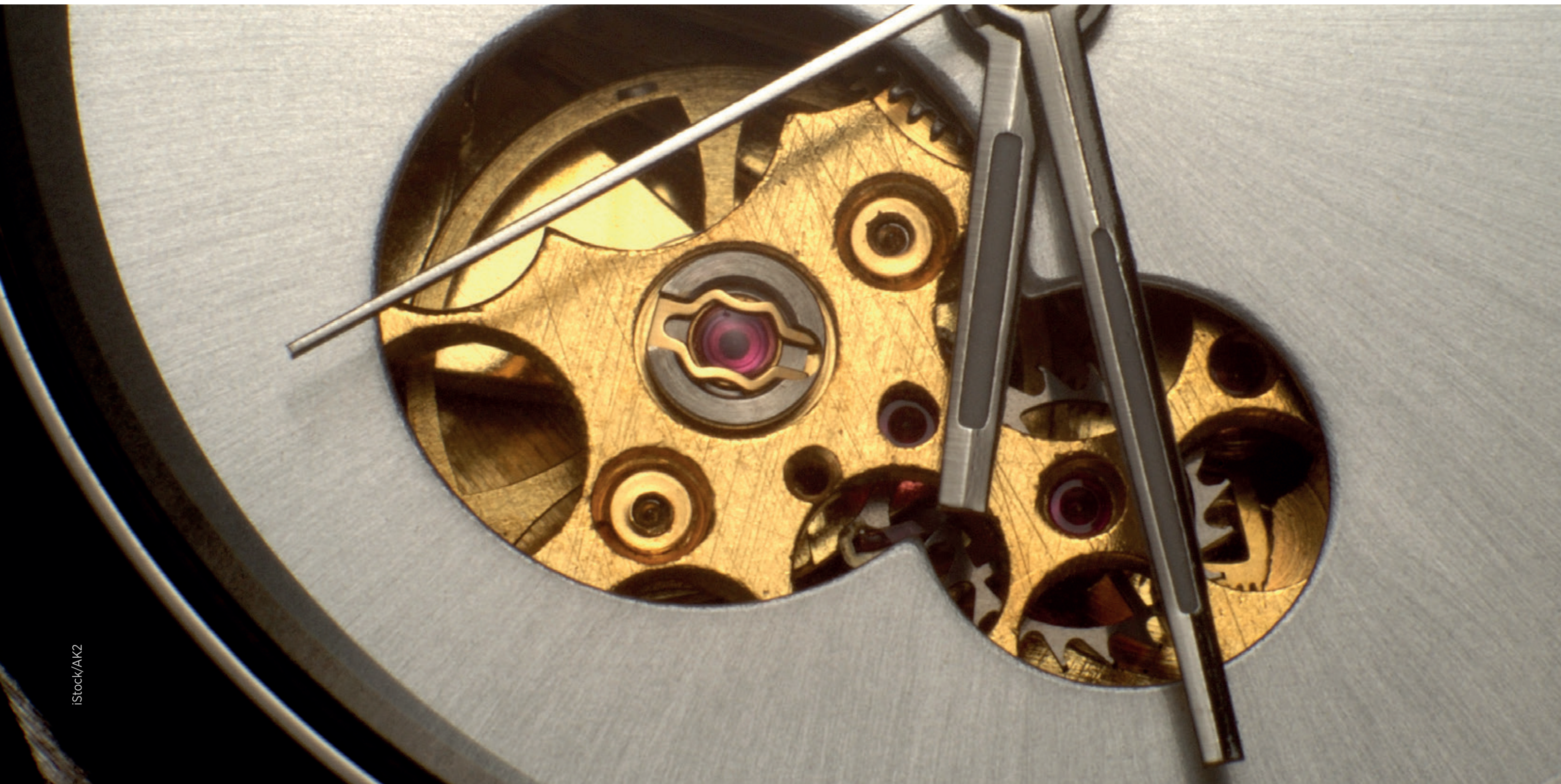
Generally, the best options for succession planning are a double option agreement (also known as a cross option agreement) or automatic accrual.

IF YOUR BUSINESS IS SET UP AS A LIMITED COMPANY

Although companies continue after a shareholder's death, the basic succession issues are similar to those facing a partnership. The key is to ensure the shares end up with the surviving shareholders and the deceased shareholder's family receives compensation.

The issues

Generally, the deceased shareholder's beneficiaries will want financial compensation in return for their shares, assuming



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they do not plan to continue in the business. There may also be the need to pay off creditors on an owner-director's death and this should be dealt with separately.

If we return to the earlier example of Jane and John and assume that rather than being in partnership, they were co-owners of a limited company, we can see the same issues apply. John would probably still want to be able to run the business without having to worry about Kylie being involved, and Kylie would want to be compensated for giving up the share of the business she inherited.

The solution

A double option or cross option agreement is often used for company shareholder succession planning. If a shareholder dies, their beneficiaries can require the remaining shareholders to buy them out or the remaining shareholders can require the beneficiaries to sell their shares.

This means that John could insist that Kylie sells him the shares she inherited from Jane. It also means that Kylie could insist that John buys her shares. If neither of them exercises this option, however, the business continues to run with John and Kylie now being joint owners.

One advantage of a double option agreement is that it does not affect entitlement to IHT business relief. So, the deceased person's shares in a trading business can usually pass down to the beneficiaries currently completely free of IHT – unlike most other assets.

To provide the funds, each shareholder takes out an own life policy written under a special business trust to benefit the other shareholders.

> **Planning point**
> Take expert advice as soon as possible. Planning for the unexpected now can help you work out what you want to happen to your business after your death.

SERIOUS ILLNESS

Of course, it is not just the death of a business owner that can stop a business. If a business owner suffers a critical illness such as a heart attack or cancer, it may not be possible for them to continue in the business, either temporarily or permanently. Good planning can ensure that, should serious illness strike, the needs of the ill business owner, their family, business partners and co-shareholders can all be protected.

Let's consider a couple of examples:

Scenario one – Sanjeev	Scenario two – Anita
Sanjeev is a partner in a small engineering firm. He is diagnosed with cancer and is unable to continue to work. His business partner, Chris, would like to carry on running the business and buy Sanjeev out. Unfortunately, he cannot afford to do this, and they end up with no choice but to dissolve the partnership and split the assets of the business. Sanjeev gets less than he would have hoped for his share of what was previously very much a going concern and Chris is, in effect, left having to start again.	Anita is the managing director of a small retail company. She jointly owns the business with her brother David and sister Jenny. Unfortunately, Anita suffers a heart attack and is strongly advised to work less from now on. She would like to step back from the business and ideally sell her shares to her siblings, but with no arrangements in place there is no mechanism for this to happen. More importantly, David and Jenny have no funds to buy her shares.

In both these situations, a solution was available. Had they taken specialist advice before the event, arrangements could have been made to ensure that both ended up with the outcome they desired.

A suitable critical illness insurance policy would have been the best way to provide protection against the financial consequences of having a serious illness in both cases. These policies pay a tax-free cash lump sum on diagnosis of a specified critical illness or disability. Critical illness policies do not cover everything although the latest version of the Guide to Minimum Standards of Critical Illness Cover published by the ABI states that new policies must cover at least cancer, heart attack and stroke.

Scenario one – solution	Scenario two – solution
Sanjeev and Chris could each have had a critical illness policy in place. Depending on how this had been structured, it could either have allowed Chris to buy out Sanjeev's share of the partnership, or simply provided Sanjeev with a cash lump sum with the business automatically passing to Chris. In either case they would have achieved their desired objective.	Had Anita and her co-directors each had a critical illness policy in place, it would have been possible for Anita to step back from the business without financial disaster for her or her siblings. The business would have ended up in the hands of David and Jenny, whilst Anita would have been left with a cash lump sum to provide for her needs.

When using critical illness insurance in these contexts, the policies are normally written in trust for the other business owners, along with an agreement between them about the circumstances in which the share in the business should be transferred. In this case a 'single option' agreement would allow the unwell owner the option of selling their shares to the others (who would have to buy) but would not allow the others to force the unwell owner to sell.

Businesses should ensure that their shareholder agreement is both current and relevant. In addition there should be a plan in place which sets out how the business will be managed in an emergency situation should owners or key members of staff become ill.

Future changes to business relief

Business relief at the full rate of 100% is currently available to sole traders, partner interests and holdings of shares in unquoted companies after two years of ownership who continue to hold the business on their death.

From 6 April 2026 the full relief at 100% will be subject to a cap of £1 million. This will apply to combined qualifying businesses and agricultural assets.

Any business that has a value of more than £1 million will get 50% relief instead of 100%, resulting in an effective IHT charge of 20% on excess assets, instead of 40%.

The allowance covers property in an estate at death, failed potentially exempt transfers and chargeable lifetime transfers where there is an immediate lifetime charge. The new rules will apply for lifetime transfers on or after 30 October 2024 if the donor dies on or after 6 April 2026 (and within 7 years of making the lifetime transfer).

With these changes on their way, it is more important than ever to consider business succession planning, particularly if the business can be restructured within families to ensure multiple use of the £1 million threshold.

Given the complexity and potential impact of these changes, it is crucial for business owners to take advice to fully understand their position.

The Financial Conduct Authority does not regulate advice on trusts or tax advice including inheritance tax planning.

The value of your investments and income from them may go down and you may not get back the original amount invested. Past performance is not a reliable indicator of future performance. Investing in stocks and shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and your financial circumstances. Tax planning is not regulated by the Financial Conduct Authority.

HOW WE CAN HELP

When we advise clients about business insurance and succession planning, we start by finding out the most important issues in each specific case. Once the structure of your business and your aspirations have been identified and prioritised, we can then recommend a suitable way forward.

In doing so, we can help you to understand:

- The options available and their costs.
- The tax implications.
- The methods of valuing a business.

The death or critical illness of a business owner can lead to unexpected or undesirable consequences for those left behind. Taking the opportunity to plan can help bring into focus what you want to happen to the business after a death or during temporary or permanent incapacity, and to identify how best to ensure that this will actually come about. Contingency plans are vital to protect your business against the long-term impact of unforeseen circumstances.

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