Chapter 8

Estate Planning for Business Owners

Chapter Objectives

On completion of this chapter you should have a basic knowledge on:

- Understanding the Various Business Organisations and their Structures.
- The Issues that Arise on the Death of Business Owners in Soleproprietorships, Partnerships and Companies
- The Estate Planning Solutions to Provide Continuity to Business Owners and Organisations.
- Important Features of Buy-Sell Agreements and Key Person insurance Used by Business Organisations.

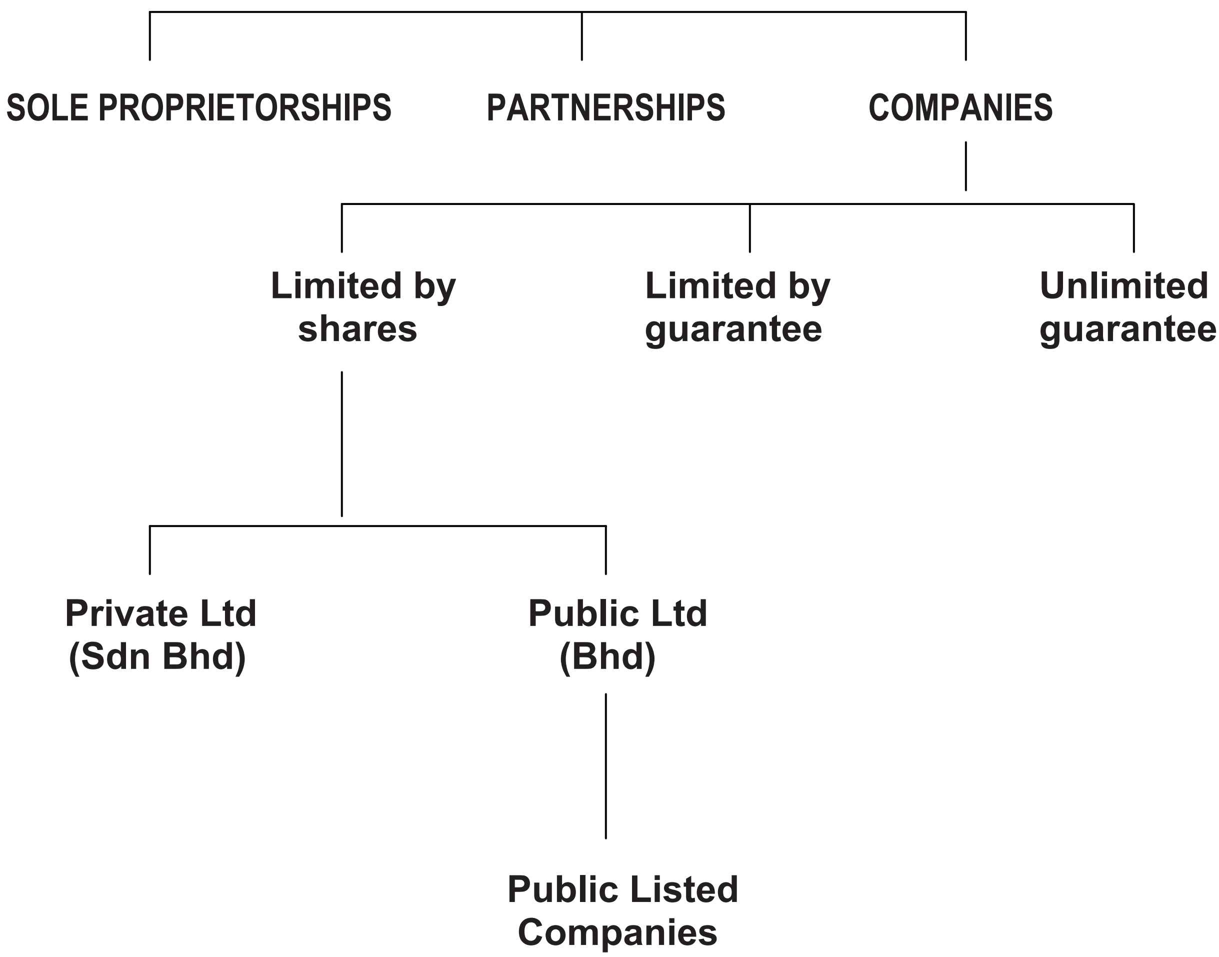
Chapter 8

Estate Planning for Business Owners

Introduction

In understanding estate planning issues for business owners we must take into consideration the laws and regulations that are binding on business organisations in this country. The issues that confront the individuals who are business owners are related to those legal rules that influence businesses and the effect of these when these owners pass away. Business organisations in Malaysia can be broadly divided into 3 categories, namely soleproprietorships, partnerships and companies. The chart below will allow us to see these organisations in a clear perspective.

BUSINESS ORGANISATIONS



Sole Proprietors

Sole-proprietors may be those who are members of the various professional bodies or registered business owners. Professionals such as lawyers, doctors and others are regulated by statutory law and they must comply with all the rules that are specified by their respective professional bodies. For example, lawyers are regulated by the Legal Profession Act and one the several requirements is that they must renew their practising certificate annually.

Other business owners who are not classified as professionals by law, must register with Registrar of Businesses under the Companies Commission of Malaysia. They are regulated by the Registration of Business Act 1956 and the Registration of Business Rules 1957.

The assets and liabilities of a soleproprietor are that of the individual himself. There is no distinction in law as to whether assets are held in the name of the business or in the personal name of the sole-proprietor. Similarly, debts and liabilities of the business are also deemed personal to him, hence the common phrase “unlimited personal liability’. Upon his death, the assets and liabilities of the business are that of his personal estate. As a consequence of this, a sole proprietor can make provisions in his Will as to the manner he wants to deal with his business or its assets and liabilities. Naturally, if he does not intend to burden his beneficiaries, he should also make arrangements to settle all outstanding business debts in the most suitable manner possible. For example, if he wants to leave the business to a son, he should declare his intentions clearly in a Will and also make provisions to settle outstanding liabilities, so that the succession can be a “smooth take over”.

Possibilities for the Heirs when a Sole Proprietor Dies

There are more than one settlement-possibilities of dealing with the business for the heirs when a sole proprietor dies. The five common and identifiable ones are listed below:

1) The estate executor or administrator liquidates the business and distributes the net proceeds;

2) Family members carry on the business immediately.

3) The business passes through the probate process to the heirs;

4) The estate executor or administrator carries on the business until it can be sold to an interested third-party; and

5) The business is sold at a prearranged price to a buyer through a buy-sell agreement.

Each of the five possibilities poses different problems or consequences for the heirs. The planer has to understand these problems so that he can recommend steps for the owners to modify their consequences.

Partnerships

Partnerships, like sole proprietors, may consist of professional practices or registered businesses, hence the same principles apply accordingly. However, all partnerships in Malaysia are also regulated by the **Partnership Act 1961** and some of the provisions contained therein are very important for estate planning purposes.

A partnership is defined in the Act as "*the relation which subsists between persons carrying on business in common with a view of profit*". The significant word here is "relation" which refers to an existence of a relationship between one or more persons. A partnership may thus be identified as a business entity but the assets, liabilities, and legal responsibilities that are part and parcel of the business, are effectively that of the individual partners. It is therefore commonly said that a partnership is "not a separate legal entity" as compared to a company (which we shall see later).

Many partnerships do not operate their business with a written agreement amongst the partners. This is because most partners usually trust each other when starting their business (this may not be the situation, if differences arise later!). The profits and assets of a partnership are deemed to be that of individual partners, in whatever proportion that is agreed amongst themselves. The liabilities of the partnership are however, no reflection of the profit sharing arrangement between the partners. The partners are said to be "**jointly and severally liable**" for the debts of the partnership. The means that any one partner may be liable to the full debt, and if he were to pass away, his estate will be liable for it.

For purposes of estate planning, we need to be aware of the consequences of death occurring to a partner. Towards this objective, we must be aware of the relevant provisions of the Partnership Act. **Section 35(1)** of the Act states "*subject to any agreement among the partners, every partnership is dissolved as regards all the partners by the death or bankruptcy of any partner*." This, in simple language and for estate planning purposes means, if there is no agreement among the partners making appropriate arrangements for the business to carry on, the death of a partner, would cause the partnership to dissolve. The legal position of dissolving a partnership is specified in **Section 41 of the Act** which states under the heading "**Rights of Partners as to Application of Partnership Property**" as follows:

On the dissolution of a partnership, every partner is entitled, as against the other partners in the firm and all persons claiming through them in respect of their interest as partners, to have the property of the partnership applied in payment of the debts and liabilities of the firm, and to have the surplus assets after such payment applied in payment of what may be due to the partners respectively, after deducting what may be due from them as partners to the firm; and for that purpose any partner or his representatives may, on the termination of the partnership, apply to the court to wind up the business and affairs of the firm.

The practical consequence of this provision is as follows:

Upon the death of a partner, the surviving partners do the necessary to wind-up the business. All debts must be paid, outstanding payments to the partnership must be collected and all assets converted into cash. This may lead to a situation of a forced sale which would result in a lower valuation of assets. All net proceeds are then apportioned to the various partners' interest. The deceased partner's estate must be provided with an accounting of all the transactions. The heirs of the deceased partner are legally entitled to get cash for the deceased's interest in the business.

Surviving partners cannot obtain loans on the credit or assets of the business. All business transactions or contracts which were initiated before the death of the partner must be completed. New contracts may only be entered into on the personal liability of the surviving partners. Profits made in such transactions must be divided accordingly with the deceased partner's estate but any loss must be borne by the surviving partners only. These then, are circumstances that will prevail should the partnership business be wound-up. It is obvious that neither the surviving partners nor the estate of the deceased partner will benefit form the winding-up process.

We have noted above, that most partnerships do not have a written agreement among the partners, and for those who have, they may not make any provision or arrangements should death occur to a partner. The question to be asked is "Do most businesses wind-up upon the death of a partner?" The answer to this is, "no", because most businesses seem to carry on even upon the death of a partner. How is this so? Let us see what really happens in situations such as these.

In most cases, where a partner passes away, the surviving partner or partners, after a "negotiation process" offer compensation to the next-of-kin of the deceased. The family members of the deceased partner are usually not in an advantageous or strong bargaining position to negotiate favorable terms of compensation and therefore eventually accept whatever amount is offered to them. Once the terms are agreed upon, the appropriate "paperwork" must be executed to effect the transfer of ownership. For example, the wife of the deceased, must consent to transfer the deceased's interest to the surviving partners and complete the necessary documentation work with the Companies Commission of Malaysia (or Registrar of Businesses). In professional firms or practices the respective professional bodies have to be notified and the appropriate arrangements completed to effect the change of ownership.

On the matter of fair compensation to the estate upon the death of a partner, many do not realise that this is a serious matter which needs to be attended to from an estate planning perspective. The most effective way to avoid this problem of disputes and to make arrangements for a smooth process of "business continuation" upon the death of a partner is to ensure that the partners enter into an agreement to make the necessary and appropriate arrangements. If it is the desire of all the partners, that upon death to any one of them, the remaining partner(s) should be allowed to carry on the business, then a "Buy-Sell Agreement" is to be recommended among the partners. The main features of such an agreement will be highlighted below.

Companies

The owners of companies are its shareholders. From the table shown earlier in this chapter, companies in Malaysia are broadly divided into 4 categories. Although a detailed discussion is not necessary for the purpose of this course, it must be noted for estate planning purposes, companies limited by shares, is the category which is most important for our understanding and knowledge. We need to know the consequences of death to a shareholder and the implications of this to other shareholders of the company.

Towards this objective we need to have a basic understanding of the various aspects of a company and a convenient way to do this is to become familiar with the following terminology, features and legalities of a company.

1) The main statute governing companies in Malaysia is the ***Companies Act 1965***. The Registrar of Companies (ROC) in the Companies Commission of Malaysia (CCM) is the regulatory authority.

2) Companies limited by shares may be divided into 2 categories viz. ***Private Limited Companies*** (Sdn. Bhd) and ***Public Limited Companies*** (Bhd). Public Limited Companies who qualify may apply to be “listed” and if so, are classified as Public Listed companies.

3) ***Shareholders*** are “part owners” of a company. There must be a minimum of 2 shareholders and for a private limited company, the maximum is 50. For a public company there is no maximum number of shareholders.

4) ***Directors*** are individuals, who may usually be shareholders, and are responsible for the day-to-day management of the company. They are appointed by the shareholders. There should a minimum of 2 directors at all times for every company.

5) The ***Paid-Up capital*** is the amount of a company’s capital which has been subscribed by shareholders.

6) The ***Authorised capital*** is the amount of a capital which a company is permitted to raise.

7) The ***Memorandum and Articles of Association*** *(M & A)* is one of the documents that must be submitted to the ROC for the purposes of incorporating a company. The Memorandum specifies the company’s name, registered office, objectives, share capital and the liability of the shareholders (members) in the event of winding-up. The Articles of Association contain various provisions that govern the management and administration of the company as well as the rights of the shareholders.

8) The ***Annual General Meeting (AGM)*** is a mandatory yearly meeting of a company for the purposes of receiving the **directors’** report and **statement of accounts** for that particular year, declaring a **dividend**, **electing directors** and **auditors** and for determining the auditors remuneration.

9) ***Limited liability*** – Limited companies are formed on the basis of having the liability of its shareholders being limited. In the event that the company becomes insolvent or is wound-up,

the liability of the shareholders is limited to their investment in the company. This concept and rules are one of the main reasons individuals are agreeable to be involved in a company as a shareholder.

10) ***Separate legal entity* -** A company is said to be a separate legal entity which is independent of the individuals, who own it as shareholders. It is an artificial, legal person created by law and has perpetual succession irrespective of changes in ownership. It may enter into contractual relations with third parties as well as its own shareholders. The death of any shareholder does not affect the existence of the company.

11) ***Ownership and control* -** The shareholders are collectively the owners of a company and elect directors at the AGM (who usually are, but need not be shareholders) to manage the operations of the company. As expected, minority shareholders will usually have limited influence in the management of the company. Major policy decisions are decided by the board of directors who will delegate to a managing director, the authority to manage the company.

Private Limited Companies & Death of a Shareholder

Many businesses operate as private limited companies with a relatively small number of individuals who are shareholders as well as the directors of the company. It is very common to see these companies with 2,3,4 or 5 shareholders who are also the directors. Upon the death of a shareholder, the shares of the company held by him are deemed to be part of the assets of his estate and are subject to the usual administrative procedures. There are also provisions in the Articles of Association of the company that dictates the manner in which the shares are dealt with. The following are the 3 main principles that apply:

i) The personal representative of the deceased shareholder shall be the only person recognised by the company as having the right to deal with the shares. This effectively means the Grant of Probate or Letters of Administration has to be obtained by the legal representative before he is permitted to deal with the deceased's shares.

ii) Beneficiaries of the shares of a deceased shareholder may request that the same be transferred to themselves or may nominate others to receive their shares. In either case, the directors have the right to decline or suspend the registration of shares to anyone accordingly.

iii) The beneficiaries are also entitled to dividends, other advantages and the same rights as the deceased shareholder would have been entitled to if he had not died.

It is very common to find that the beneficiaries of the deceased shareholder are the spouse and immediate family. They may not have adequate knowledge of the business and may not want to hold on or retain the shares. They would most likely prefer to dispose off their shares for an attractive cash settlement. More so, holding on to the minority shares of a private limited company would have very little financial benefits.

It is also most likely that the surviving shareholders / directors would want to purchase the shares of the deceased shareholder from the beneficiaries. This is because it may not be wise to allow shares to be sold to “outsiders” who are unknown or not familiar to them. Of course, as everyone may know, the desire of the beneficiaries to sell their shares at a favorable price is not a mater that can be easily negotiated and resolved. On this matter let us see how businesses may be valued.

Valuation of a Business

The valuation of a company will take into consideration the following three (3) factors:-

The 1st factor is the **Net Tangible Asset Value (NTA)** which is also known as “Liquidation Value”. This refers to the cash generated by dissolving a business and selling its assets separately.

The 2nd factor refers to **Going-Concern Value (GCV)** which is the present worth of expected future cash-flows generated by a business.

And lastly, the 3rd factor takes into consideration **“goodwill value”**, such as a company which is a well known market brand, could be worth hundreds of millions.

There are 4 possible methods to value a business. The following is very brief overview of them.

Method 1

Net Tangible Assets

NTA value comprises the tangible fixed and current assets of the company (excluding the intangible assets, such as goodwill) less the liabilities of the company.

Typically, the NTA method will not take into consideration the value of potential future earnings. Rather it seeks to provide an indication of value based on the company’s historic cost-based financial accounting data. This method does not usually take into consideration revalued or devalued assets and liabilities except in certain circumstances where particular asset classes may be revalued subject to generally accepted accounting principles. Hence, it tends to set a conservative value for businesses with preserved assets.

For example:

Net Tangible Assets = Tangible Fixed Assets + Current Assets – Total Liabilities

or

= Total Equity – Intangible Assets

Method 2

Price to Book Value Ratio

The Book Value is defined as the total assets less total liabilities and less minority interest. The Price to Book Value method seeks to project the value using the price to book ratios of listed companies operating in the same sector as the company being valued, in comparison with the book value of the said company.

The disadvantage of this method is its high sensitivity to the relative age of assets. Certain assets may have no intrinsic value and may lack the availability of suitable comparative data from listed companies. As in the NTA method, this method will not take into consideration the future "earnings potential" of the company being valued.

For example:

Price to Book Value Ratio	=	Book Value Per Common Share
	=	Total Equity ÷ Total Common Shares Outstanding
	=	RM X per share

Method 3

Price Earnings Ratio

Under Price Earnings Ratio ("PER") method, the value of a company's equity is directly related to the profits the business has generated and is expected to generate, taking into account the market's perception of business operations of that nature.

Once a prospective maintainable earnings level has been ascertained, the valuer then seeks to establish a prospective PE multiple by which the earnings figure is "capitalised". The PER will be based on a cross-section of a comparable company data and is usually adjusted to reflect:-

- General economic and market conditions prevailing at the valuation date (economic uncertainty, interest rates);
- Industry and market comparisons (type of industry, competition, size of operations);
- Operations of the business on a qualitative basis (management capability, utilisation of equipment etc;) and
- Overall risks attached to the earnings of the business (key markets, access to credit etc).

The prospective PER to be applied should take into consideration the company's standing, growth prospects, the economic sector in which it operates, prevailing market conditions and the nature of products.

The Price Earnings (“PE”) ratio is made up of the market price per share over the earnings per share.

For example:

Earnings Per Share (EPS) = Profit for the period attributable to ordinary shareholders ÷ Number of Shares

Method 4

Discounted Cash Flow (“DCF”)

Modern valuation theory views the value of a company or an asset as a function of the “free” cash which it is able to generate over time after reinvestment of sufficient cash flows to sustain the productive base. Under the DCF approach, the anticipated future cash flows of the Company (“Free Cash Flow to the Company”) are discounted to their net present value (“NPV”) using a discount rate, which is the weighted average cost of capital (“WACC”). The resulting NPV represents the value of the Company as a whole, including debt and equity. The WACC is derived based on the weighted average cost of debt that is applicable to the company and the rate of return on equity that an investor in the Company would reasonably require, based on the debt to equity ratio of the Company. To derive the value of equity, the market value of debt needs to be deducted from the Company NPV.

Discount rates play a central role in the analysis by permitting distinctions to be made between businesses with similar expected cash-flows but different risks. Businesses which carry great risks will carry higher discount rates and therefore, have lower values.

A key advantage of the DCF approach is that it facilitates specific evaluation of revenue stream, expected capital expenditure (both committed and planned) and significant operating costs under various assumptions about market conditions, regulations and business strategies. In the DCF valuation method, it allows the appraiser to model judgements about future regulations, growth, new investments and pricing as well as undertake sensitivity analysis on each of the key variables.

A variation of the DCF approach described above involves calculating the anticipated future cash flows to equity holders, which is essentially its residual income. Under this variation of DCF, free cash flows to the company are adjusted to remove principle repayments, interest payments and borrowings and to reflect future dividend policy. The relevant discount rate will be the cost of equity capital, adjusted on a period by period basis to reflect the changing capital structure of the company.

Buy-Sell Agreements

The concept of using Buy-Sell Agreements as one of the most efficient ways for businesses to be continued upon the death of a business owner has already been mentioned earlier. In practice, it has been observed that this is particularly important for partnerships and private limited companies. This concept or arrangement should be

recommended provided the partners and shareholders **do not** want their family members to be involved in the business but instead, wish to give them a reasonable or fair **compensation** for their interest or share in the business. This primary objective must be established among the owners of a business before a “buy-sell arrangement” can be recommended. Let us look at the main features of such an arrangement to grasp a general understanding of the concept. This is because the application of such arrangements must be “tailor-made” to each business organisation depending on the circumstances of each case. However, one common feature that makes these arrangements acceptable and practical is the use of **life insurance proceeds** as a funding mechanism towards payment of the compensation as stated above.

Main features of a Buy-Sell Agreement using Life Insurance as a funding mechanism

(Note: partners referred here also refer to shareholders of companies)

1) The surviving partners must buy and the deceased partner’s estate must sell the interest of the deceased partner to the surviving partners.

2) The price of the deceased partners interest is specified or may be determined by mutual consent of the partners at the time of execution of the agreement. Provisions must also be made to allow for the revision of this price within the agreement.

3) The partners are to purchase and maintain life insurance in a stated amount in order to finance the purchase of the deceased partner’s interest in the partnership.

4) An outline of the method by which any increase of the purchase price of a deceased’s interest or share is to be paid, if it is in excess of the insurance proceeds, must be stated.

5) The surviving partners will assume all debts of the partnership and release the estate of the deceased from all further obligations.

6) The intention of the partners should permanent disability occur to any one partner must be provided.

7) To provide for the purchase of additional life insurance, should the need arise.

8) The intention of the partners if the partnership is terminated in circumstances other than the death of the partner.

9) An agreement as to the ownership and control of the policies and the manner in which policies on the lives of the surviving partners owned by the estate of the deceased partner are to be disposed off.

10) To provide for the appointment of Trustees, if recommended and acceptable by the partners.

Types of Partnership Insurance "Buy-Sell" Schemes

1.

Cross – Purchase Concept

Most suitable for a firm with 2 partners. Each partner takes out life insurance on the other partner, becoming purchaser, owner and beneficiary. Alternately, each partner takes out life insurance on his own life and then absolutely assigns the policy to the other partner. The sum insured is an amount equal to a proportionate share of each partner's business interest.

Upon the death of a partner, the surviving partner receives the proceeds and uses it to pay the deceased's estate in exchange for his business interest.

Example:

Partnership valued at RM 500,000

Partner A's interest worth RM 300,000

Partner B's interest worth RM 200,000

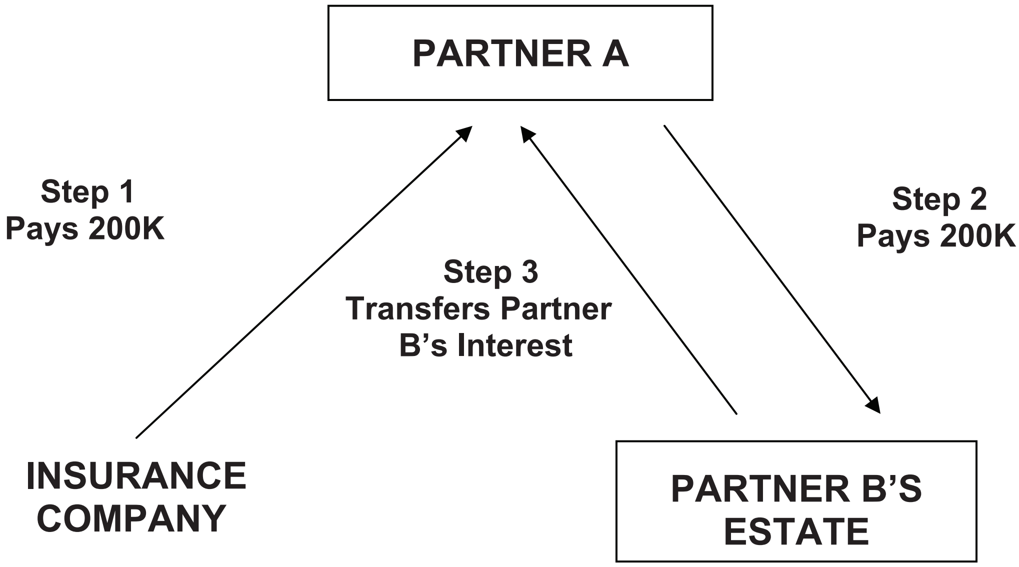
A owns RM 200,000 insurance on B

B owns RM 300,000 insurance on A

Upon the death of B, A receives RM 200,000 from the insurance company and pays it to B's estate in return for his business interest in his partnership

CROSS – PURCHASE PLAN

Upon death of Partner B



2.

Entity Concept

Most suitable for a firm with 3 or more partners. The partnership purchases the life insurance on each partner's life, becoming the policyowner and beneficiary. Alternately, each partner takes out life insurance on his own life and assigns the policy benefits to the partnership. The sum insured is an amount equal to each partner's share of the business (at the time of entering into the agreement).

Upon the death of any one partner, the partnership receives the proceeds of the policy and pays it to the deceased's estate. Each surviving partner's percentage will be adjusted to reflect the proportionate increase in their share of the business.

Example:

Partnership valued at RM 600,000

Partner A's interest worth RM 300,000

Partner B's interest worth RM 200,000

Partner C's interest worth RM 100,000

Life insurance is taken out on each partner's life according to the value of their respective interests.

Should Partner C die.

The partnership receives RM 100,000 from the insurance company and pays it to the representatives of C's estate. C's interest in the partnership will be distributed to the surviving partners.

The ownership will therefore be changed:-

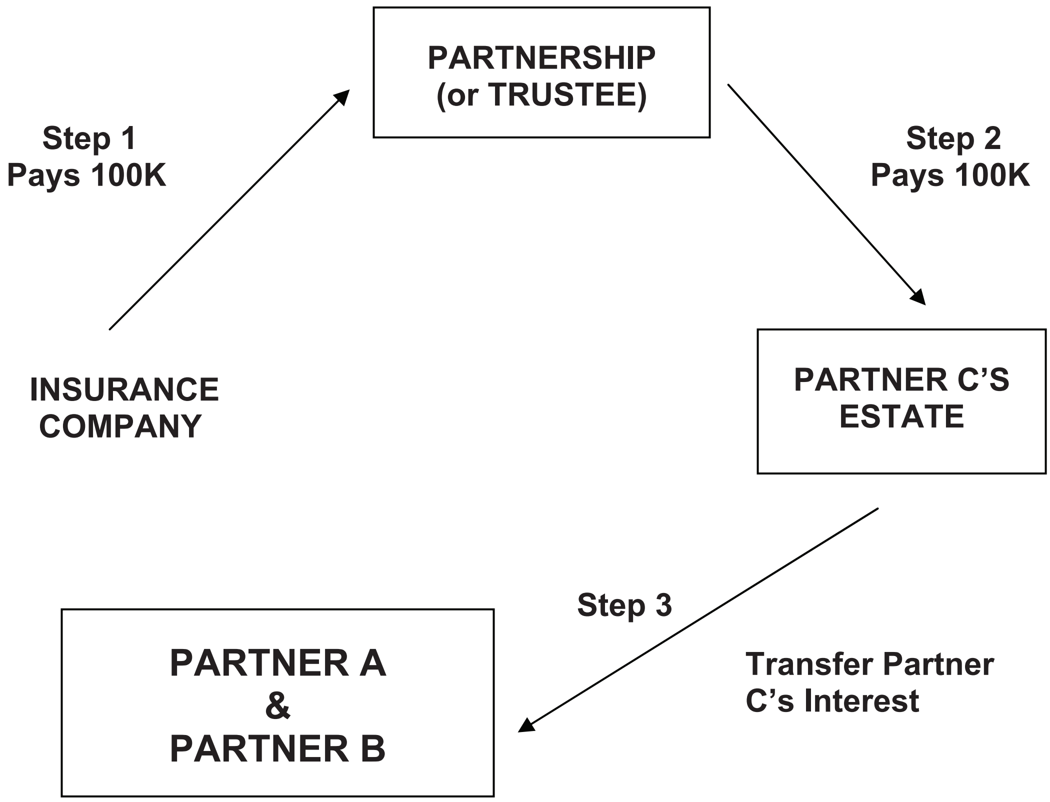
Partner A's interest would now be worth RM 350,000

Partner B's interest would now be worth RM 250,000

(or in any other percentage as determined in the partnership agreement)

ENTITY PLAN

Upon the death of Partner C



The examples shown above i.e. the Cross-Purchase concept and the Entity concept have been illustrated in a simple manner so that the student of this course will grasp the basic principles. In practical situations, there are several details to be considered, including the recommended use of trustees to expedite the arrangements. As there are also several legal issues involved, these agreements must be executed with legal advice.

Key Persons in Private Limited Companies

There are many private limited companies where there are between two to five shareholders who are also directors of the companies. In this "closely held" business, one or two of such directors may be the dominant personalities who would be mainly responsible for the success of the company. Such a person may be the managing or executive director, someone with special skills or knowledge or even one who has that "special goodwill" and influence which brings in business to the company. These are examples of individuals who will determine the growth and success of the company and consequently profit to all the shareholders. Hence, they are labeled as **"Key-persons".** Although these individuals are found in all types of business organisations, for purposes of estate planning issues, the death of key persons in private limited companies has significant implications.

If the key person is crucial for the success of the business, then his sudden death will directly affect the company and consequently the shareholders, and of course the employees. It will definitely be wise to prepare for such adverse consequences that will affect everyone involved in the company. To minimise the financial impact of the loss of a key person, one of the most practical ways is for the company to purchase life insurance on his life for an appropriate amount. If one were to put some thought to it, we would realise that there are several advantages of such an insurance coverage. The primary objective and therefore benefit is to compensate the business organisation for the loss of a key person as a result of his death or permanent disability. The moneys from the insurance policy may also have other advantages. Some of these are as follows:

a) provides a business reserve or contingency fund

b) indemnifies losses that may occur from business transactions

c) prevents cash flow disruptions to the business operations

d) preserves profitability and shareholders confidence

e) enhances credit status of the company

Valuing a Key-Person

The insurance taken on the life of a key person is regarded as loss of profits insurance. A company should try to estimate the loss of profit they would occur in the event of the death of a key person.

The monetary consequences include the costs of finding and training a successor and the loss of business and goodwill which was personal to the key person.

Determining the sum assured of the insurance policy for these purposes may be a very subjective matter. The sum assured must reflect the financial loss that the company would face by the death of the key person. This involves a number of factors which may be difficult to quantify, such as the expected profits of the company in the near future and the extent to which they depend on the key person.

The general computation of the sum assured is by multiplying the company's gross profits with the key person's remuneration and then dividing the total by the company's total remuneration of the employees. (This estimates the contribution of the individual's efforts towards the company's profits.) The figure derived thereof is then multiplied by the duration of the coverage under the said policy.

Example: If the total gross profits were RM5 million, the key person's salary is RM250,000 and the total salaries paid by the company is RM2 million, the estimated apportionment of annual profits attributed to him would be

$$\text{RM5,000,000} \times \frac{\text{RM 250,000}}{\text{RM2,000,000}} = \textbf{RM625,000}$$

If the compensation required is equivalent to 3 years of the key-person's contribution, then the sum assured of the insurance policy should be RM 625,000 x 3 = RM1,875,000

Liabilities of Directors

The estate planning arrangements for directors of companies must also take into consideration the personal liabilities by virtue of their position in the companies. Although business liabilities for directors who are shareholders may be limited to their investments in the company, they may however be personally liable for other related aspects of the business. Examples of these are seen when directors are guarantors of loans or income tax and employee provident fund (EPF) liabilities and compliance with statutory requirements of the Companies Commission of Malaysia. These circumstances make the affected directors "jointly and severally" liable. As we also know by now, this also means that if they pass away, their respective estates may then become liable.

If financial institutions offer loan or credit facilities to companies, they usually request the main or active directors to be guarantors to these loans. It is therefore advisable to insure the directors, or at least the key person among them for an appropriate sum. Such insurance should be on this key-person's life for an amount equal to the loan facility given to the company. Popularly known as "**debt cancellation insurance**", the term is self explanatory i.e. upon the director's death, insurance policy moneys are available to pay off, or settle outstanding loans to the lender.

Taxation Aspects of Insurance Policies

In Buy-Sell Agreements, the premiums for the insurance policies are effectively paid by the individual partners on shareholders. If the partnership or company's funds are used, then such sums of moneys are treated as a 'benefit-in-kind' to the individual partner on shareholder. It must be noted that a company may not be the policyowner and even if it is, in such types of arrangements, it cannot claim these premiums as a "deductible business expense". On the other hand, the proceeds of these polices upon the death of an individual are tax free in the hands of the recipients.

In key-person insurance policies, the uncertainty of the tax treatment was resolved by the Inland Revenue Board's Public Ruling No 2/2003 which was issued on 30th Dec 2003. It clearly implies that premiums for only term and personal accident policies (i.e. policies without cash values), on the life of employees, who are not shareholders of the company, are allowable as expenses. If these premiums are claimed as allowable expenses, then the claim proceeds are treated as a taxable.

Conclusion

High net-worth individuals are usually business owners and professionals, people who would greatly benefit from the service of an estate planner. In this chapter, we have understood the main issues that need to be addressed in estate planning for business owners. Although an indepth knowledge would be beyond the scope of this course, estate planners must be confident on legal, tax and other related practical aspects of business organisations and how these affect the business owners in order to be able to provide competent advice and service.

Case Study – Buy-out of Shares in a Private Limited Company

Hisham, Chong and Maniam are the only shareholders and also the executive directors of a private limited company dealing with motor vehicle parts. Their ages are between 4 3 to 48 years and have been successfully involved in this business for more than 15 years. The apportionment of the company's shares among Hisham, Chong and Maniam are 35% : 35% : 30% respectively and they each draw a salary as well as enjoy directors benefits such as use of a company car and other related benefits. Although successful, the company has never paid out dividends, but profits have been utilised as bonuses to the directors. The 3 of them have come to realize that they must provide for a smooth transition of the business should one of them pass away as well as to ensure that their respective families are well compensated from the business, in the event of an untimely death. They have invited you to share some ideas and make a suitable recommendation to meet their desired objectives.

Recommendation and Advice

To meet the objectives of the 3 Shareholders (Directors) we have to first inquire, whether they are willing to give up their shares to the surviving shareholders if one of them were to pass away. Shares of a company, owned by an individual are considered part of his personal estate and as with the rest of the assets will be dealt with accordingly. This will therefore depends whether an individual dies testate or intestate.

If all the 3 shareholders in this case are agreeable to transfer the shares to the surviving shareholders in exchange for cash, then a insurance or Takaful funded "Buy-Sell arrangement should be considered, The benefit of such an arrangement is that upon the death of any one of the shareholders, moneys from the insurance or Takaful plans which are received, shall be utilised as payment to the estate in exchange for the shares. The shares are then divided amongst the surviving shareholders of the company. An appropriately prepared Buy-Sell Agreement would be necessary to facilitate such an arrangement, which would also provide for all the incidental requirements necessary for a smooth execution of the shares. The values of each shareholders interest in the company must be considered as well as future increase in these values must be provided for as well.