

The background of the entire page is a photograph of a middle-aged couple sitting at an outdoor table. The woman, on the left, has blonde hair and is wearing a light-colored cardigan over a grey top. She is smiling warmly at the man, with her chin resting on her hand. The man, on the right, has grey hair and is wearing a light-colored shirt. They are both looking at each other. In the background, there is a blurred view of a city street with buildings and a fountain. The overall tone is warm and positive.

Smart strategies for protecting business owners

2013/14

What are the risks?

Many business owners don't hesitate to insure physical assets such as motor vehicles, plant and equipment.

However, they often overlook the importance of insuring themselves (and other key people in the business) in the event of death, disability, illness or injury.

This can be a very risky oversight, as the long term absence or loss of a key person can have a dramatic impact on a business and each owners' interest in the business.

In this booklet we explain how insurance can provide an injection of cash to:

- protect personal and business assets
- offset a reduction in business revenue
- fund an orderly transfer of business ownership, and
- meet a range of other objectives.

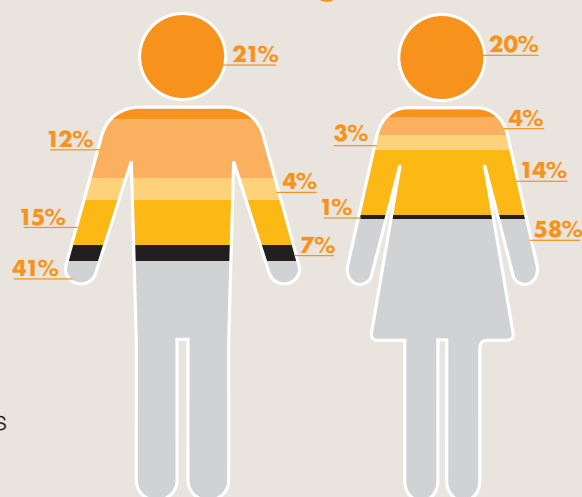
Insurance is the cornerstone of a comprehensive financial plan and can help to minimise the financial impact of events beyond your control.

The key to good protection is to ensure the right amount of cash is paid to the right people at the right time.

To find out which strategies in this booklet suit your needs and circumstances, we recommend you speak to a financial adviser who specialises in business insurance.

You may also need to consider a range of other protection strategies that are outlined in our 'Smart strategies for protecting you and your family' guide. To obtain a copy, speak to your financial adviser or call MLC on **132 652**.

Before the age of 70¹...



Statistically, before the age of 70:

- Will be diagnosed with cancer
- Will have a heart attack
- Will suffer a stroke
- Will suffer from another critical illness
- Will die from something other than a critical illness
- Will not have suffered a critical illness

Source: Munich Reinsurance Group in Australasia, 2009.

¹ This is general population data based on those who are currently 30.

Important information

The information and strategies provided are based on our interpretation of relevant taxation and superannuation laws as at 1 July 2013. Because the laws are complex and change frequently, you should obtain advice specific to your own personal circumstances, financial needs and investment objectives before you decide to implement any of these strategies.

Disclaimer: MLC is not a registered tax agent. If you wish to rely on the general tax information contained in this guide to determine your personal tax obligations, we recommend that you seek professional advice from a registered tax agent.

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What types of insurance are available?

There are five main types of insurance that can be used to provide financial protection for business owners.

The table below summarises these types of insurance and what they can provide in the event of a claim. For information on the tax treatment, see FAQs on pages 22 to 25.

Life insurance	Life insurance can provide a lump sum payment ¹ if you (or a key person in your business) pass away.
Total and Permanent Disability (TPD) insurance	TPD insurance can provide a lump sum payment ¹ if you (or a key person in your business) suffer a total and permanent disability and are unable to work again.
Critical Illness insurance	<p>Critical Illness insurance can pay a lump sum if you (or a key person in your business) suffer or contract a critical condition specified in the policy (eg cancer, a heart attack or a stroke).</p> <p>Note: While many people aren't aware of this type of insurance, its importance cannot be over-emphasised. This is because Australian males and females between age 25 and 40 are, for example, three and five times respectively more likely to become critically ill than die².</p>
Income Protection insurance	Income Protection insurance can provide a monthly payment of up to 75% of your income if you are temporarily unable to work due to illness or injury.
Business Expenses insurance	Business Expenses insurance can reimburse up to 100% of your share of eligible business overheads if you are temporarily unable to work due to illness or injury.

Note: These insurances are all subject to terms, conditions and exclusions. You should refer to the relevant product disclosure or policy document for the full terms and conditions of the insurance cover provided by the product.

How do you best protect your business' future?

A financial adviser, specialising in business insurance, can help you better protect your business by undertaking a business needs analysis and then delivering advice relevant to your business.

¹ If the insurance cover is held within a super fund, the benefit may also be paid in the form of an income stream.

² Based on MLC's claims experience.

Strategies at a glance

Strategy	Suitable for	Key benefits	Page
1 Protect your assets	People who have used debt to start-up or grow a business	<ul style="list-style-type: none"> • Provide funds to reduce or repay debts • Protect personal or business assets used as loan security 	04
2 Protect your business' revenue	Growing businesses that depend on a key person for its revenue	<ul style="list-style-type: none"> • Provide funds to offset a reduction in business revenue • Cover the costs associated with finding and training a suitable replacement 	06
3 Protect your business ownership	People with equity in a business they own with other people	<ul style="list-style-type: none"> • Help ensure orderly business succession if you (or another owner) are disabled or die • Provide funds to compensate you or your beneficiaries for the transfer of your equity in the business to the remaining owners in the event you become disabled or die 	08
4 Protect your income	People who are self-employed or run their business through a company or trust	<ul style="list-style-type: none"> • Receive an income if unable to work due to illness or injury • Ensure that business resources do not have to be used to fund your income 	10
5 Meet your business expenses	Small business owners	<ul style="list-style-type: none"> • Keep up-to-date with your fixed business expenses • Maintain your business as a viable entity during a period of illness or injury 	12
6 Treat your beneficiaries equitably	Family business owners	<ul style="list-style-type: none"> • Provide additional funds to equalise your estate • Ensure all your beneficiaries receive sufficient assets to achieve your estate planning objectives 	14
7 Purchase Life and TPD insurance tax-effectively	People who: <ul style="list-style-type: none"> • are self-employed, or • are eligible to make salary sacrifice contributions 	<ul style="list-style-type: none"> • Reduce the cost of insurance premiums • Enable certain beneficiaries to receive the death or TPD benefit as a tax-effective income stream 	16
8 Reduce the long-term cost of your insurance	People considering insurance	<ul style="list-style-type: none"> • Pay a lower average premium • Make your cover more affordable when older 	18

Strategy 1

Protect your assets

If you've used debt to start-up or grow your business, you should ensure you and other key people¹ have suitable insurance cover.

What are the benefits?

If something happens to you or another key person¹, the insurance payment could be used to:

- reduce or repay debts, and
- protect any personal or business assets used as loan security.

How does the strategy work?

Most businesses use debt to start up and grow their operations. Examples can include:

- loans sourced from a lending institution (eg a bank) that are secured by personal assets (such as the family home) or business assets (such as business real property)
- proprietor loan accounts²
- unsecured loans provided by a relative (eg a spouse or a parent) or an associated entity (such as a family trust or company), and
- significant trade creditors.

While few businesses could exist without entering into these types of arrangements, problems can arise if you (or another key person) are lost to the business temporarily or permanently.

Your business could have difficulty meeting its loan commitments. The lender could have concerns regarding the business' cashflow and credit position and may require the outstanding loan to be repaid immediately.

The lender may even have to sell the personal or business assets used as security so the debts can be cleared.

One way to reduce these risks is to insure yourself and other key people in the event of death, total and permanent disability and critical illness.

If any of these events should occur, the lump sum insurance payment can be used to:

- reduce or pay off the debts
- release any loan guarantee or security provided
- protect your personal and business assets, and
- ensure the business can continue as a viable operation.

Note: This strategy is particularly important for highly geared businesses, but less important for businesses with lower debt-to-equity ratios.

To find out the types and amounts of cover you may need to protect your assets, you should speak to a financial adviser who specialises in business insurance. A financial adviser can also review your insurance needs over time to make sure you remain suitably covered.

¹ For the purpose of this strategy, a key person must have an interest in the debt and will usually be an owner, loan guarantor or third party who has left money to the business.

² Proprietor loan accounts generally arise when a shareholder or director of a company lends money to the business, or the trustee of a trust distributes income to beneficiaries on paper and retains the cash to fund operations or expand the business.

Case study

Adam, aged 40, is married to Kylie, aged 35. They have a young family and own a home worth \$600,000.

Adam wants to expand his dry-cleaning business and to do this he'll need to raise some capital. After assessing his options, he borrows \$200,000 from a bank and, as part of the loan agreement, he signs a guarantee using the family home as security.

One of the conditions of the loan is that the debt must be repaid immediately if he dies or becomes totally and permanently disabled.

His financial adviser explains that should either of these events occur, the only way he'll be able to repay the loan is to sell either the business or the family home, and both these options would have significant drawbacks.

Selling the business assumes there'll be a willing buyer prepared to pay a reasonable price. Selling the family home can present similar challenges, compounded by Adam's family having to find somewhere else to live.

Adam could also face problems if he suffers a critical illness. In this scenario, he could struggle to meet the loan repayments – particularly if he takes a while to recover or is unable to return to work.

After assessing Adam's goals and financial situation, his adviser recommends he take out \$200,000 in Life, TPD and Critical Illness insurance. If the unthinkable happens, he (or his estate) will receive the necessary cash to repay the loan and extinguish the guarantee.

Note: This case study highlights the importance of speaking to a financial adviser about protecting assets that have been used to secure business debts in case you (or another key person) die, become totally and permanently disabled or suffer a critical illness. A financial adviser can also address a range of potential issues and identify other suitable protection strategies – see Tips and traps.

Tips and traps

- It's important to update your insurance cover in line with the changing value of your debts, as failing to do this may lead to underinsurance.
- If you (or the entity through which your business is run) own an insurance policy taken out for the purpose of repaying a debt, the premiums paid by you (or the entity) will not be tax-deductible.
- If you take out the Life or TPD insurance through a super fund, you could benefit from upfront tax concessions generally not available when insuring outside super (see Strategy 7). However restrictions do apply to who can be nominated as a beneficiary and taxation liabilities may apply to certain eligible persons when a death benefit (including insurance proceeds) is paid in the form of a lump sum, pension or a combination of both from a super fund.
- Insurance cover purchased through a super fund is owned by the fund trustee, who is responsible for paying benefits subject to relevant legislation and fund rules (see 'Restrictions on non-death benefits' in the Glossary). When insuring in super you should be clear on the powers and obligations of the relevant trustee when paying benefits.
- It may be more cost-effective over the longer term if you pay level premiums, rather than stepped premiums that increase each year with age (see Strategy 8).
- Insurance can also be used to protect your business revenue if you (or another key person) die, become disabled or suffer a critical illness (see Strategy 2).
- If you're in business with other people, you should consider establishing a Buy Sell agreement funded by insurance (see Strategy 3).

Strategy 2

Protect your business' revenue

As your business grows, you should consider insuring the people who play a key role in the ongoing success and profitability of your business.

What are the benefits?

If something was to happen to you or another key person (such as a key employee¹), the insurance payment could be used to:

- offset a reduction in revenue, and
- cover the costs associated with finding and training a suitable replacement.

How does the strategy work?

Many growing and established businesses still depend heavily on the skills and intellectual property provided by the owners and other key people.

Where this is the case, the temporary or permanent loss of a key person could have a detrimental impact on revenue and profits.

Also, if another suitable person isn't available within the business, considerable costs can be incurred recruiting and training a replacement.

A cost-effective solution is to insure the key people in your business in the event of death, total and permanent disability and critical illness.

If any of these events should occur, the insurance payment can provide a much needed injection of cash to stabilise and protect the business.

While it may be possible to absorb the reduction in revenue into your business' current year profits, or accumulate a reserve, insuring the key people in your business can be a less expensive and more convenient alternative.

Note: This strategy is usually less important for businesses with limited or erratic revenue sources, as well as those that are less reliant on the contribution of key people.

To find out the types and amounts of cover you may need to protect your business' revenue and who should be insured, you should speak to a financial adviser who specialises in business insurance. A financial adviser can also review your insurance needs over time to make sure you remain suitably covered.

¹ For the purpose of this strategy, a key employee could include, for example, a company director, sales manager, financial controller, or IT manager or developer.

Case study

Charlotte, aged 42, has owned and operated a large and successful garden nursery for many years.

Wanting to maintain ownership while freeing up some time to concentrate on other commitments, she employed Gretel to manage the day-to-day operations.

Gretel's management and sales skills, as well as her extensive horticultural knowledge, greatly increased the nursery's gross revenue and customer base. But when she was diagnosed with cancer, her doctor advised her to retire.

This resulted in an immediate reduction in business revenue and Charlotte incurred significant costs recruiting and training a suitable replacement.

Fortunately, Charlotte had spoken to a financial adviser and, as a result, had taken out a Life, Total and Permanent Disability and Critical Illness policy on Gretel's life before she was diagnosed with cancer.

As a result, Charlotte received a Critical Illness benefit and was able to use the money to find a suitable replacement and offset the drop in revenue and profits experienced during this period of upheaval.

Note: This case study highlights the importance of speaking to a financial adviser about protecting your business' revenue in the event that you (or another key person) die, become totally and permanently disabled or suffer a critical illness. A financial adviser can also address a range of potential issues and identify other suitable protection strategies – see Tips and traps.

Tips and traps

- Term Life insurance policies used to protect against a loss of revenue are tax-deductible and any benefits received are assessable as income.
- The Australian Taxation Office does not recognise a policy as having a revenue protection purpose if the death or disablement of the insured person is likely to result in the closure of the business.
- It may be more cost-effective over the longer term if you pay level premiums, rather than stepped premiums that increase each year with age (see Strategy 8).
- If you're in business with other people, you should consider establishing a Buy Sell agreement funded by insurance (see Strategy 3).
- It's also important to protect your living expenses (see Strategy 4) and your business expenses (see Strategy 5) if you are temporarily unable to work due to illness or injury.
- You should also make sure you have enough personal insurance to protect yourself and your family if something happens to you. To find out more about using insurance for personal protection purposes, see our 'Smart strategies for protecting you and your family' guide.

Strategy 3

Protect your business ownership

If you have some equity in a business you own with other people, you should consider establishing a Buy Sell agreement funded by insurance.

What are the benefits?

By using this strategy, you could:

- enable the remaining owners to acquire your interest in the business in an orderly manner if you die or become disabled, and
- ensure you (or your estate/dependants) receive adequate financial compensation.

How does the strategy work?

If a business owner dies, in the absence of any specific arrangement, their interest is likely to be:

- distributed in accordance with their Will (eg to their surviving spouse), or
- otherwise controlled by their beneficiaries (eg if the interest is owned via a family trust).

As the new part-owner of the business, the spouse (or beneficiaries) would then be entitled to the same management and financial rights as the deceased owner.

But the remaining owners may not be happy admitting the deceased owner's spouse (or beneficiaries) into the business and ownership disputes could arise.

The deceased owner's spouse (or beneficiaries) might not have the necessary skills to assist in running the business, or even want to be involved.

Furthermore, the remaining owners may not be able to raise enough money to buy the departing owner's equity in the business, nor agree on the price.

Potential problems can also occur if a business owner becomes disabled and is unable to work in the business again.

To protect the business and ensure an orderly transfer of ownership, a Buy Sell agreement should be considered as part of the broader succession planning process.

A Buy Sell agreement is a legal contract between business owners that usually comprises two components:

- **a transfer agreement¹** that outlines what will happen to each owner's business interest if certain events occur and how the interests will be valued, and
- **a funding agreement** that outlines how the money will be raised to finance the ownership transfer and who will receive it.

There are a number of ways a Buy Sell agreement can be funded. For example, the remaining owners may be able to buy out the departing owner's interest using their own capital or borrowed money.

However, when it comes to death and disability, insurance is usually considered the most cost-effective and efficient way to raise sufficient capital.

Note: While a Buy Sell agreement will be less important for businesses in which little equity is held, it's still important that the owners of such businesses establish a broader succession plan.

To find out whether you need a Buy Sell agreement and the best way to fund it, you should speak to a financial adviser who specialises in business insurance. A financial adviser can also review your insurance needs over time to make sure you remain suitably covered.

¹ The business interest can also be transferred through the partnership agreement, unitholders' agreement or shareholders' agreement.

Case study

Alex and Bill each owned 50% of the shares in a successful engineering business when Bill died suddenly.

Bill's shares were inherited by his wife Lynn via his Will and, because there was no Buy Sell agreement in place, Lynn is not obliged to sell the shares to Alex and Alex is not obliged to buy the shares from Lynn. Furthermore:

- there was no agreed price or timeframe for the transfer of Bill's shares
- there was no insurance in place to enable Alex to buy the shares, and
- Alex doesn't have enough funds to buy out Lynn and doesn't have the capacity to borrow the money.

To further complicate matters, Lynn is entitled to the same management rights and share of profits as her deceased husband, while Alex is doing 100% of the work and only receiving 50% of the profits.

This outcome could have been avoided if Bill and Alex had sought financial advice and executed a Buy Sell agreement, funded by insurance. By using this strategy, Lynn would have received the insurance proceeds in exchange for handing over her interest in the business to Alex².

As a result, Lynn would have been fully compensated, while Alex would have taken ownership of 100% of the business and received 100% of the profits.

Note: This case study highlights the importance of speaking to a financial adviser about establishing a Buy Sell agreement funded by insurance. A financial adviser can also address a range of potential issues and identify other suitable protection strategies – see Tips and traps.

Tips and traps

- Because a Buy Sell agreement affects your legal rights, it should always be prepared by a solicitor (preferably one that specialises in this area).
- There are a number of ways to structure the ownership of insurance policies used to fund a Buy Sell agreement. As each ownership method will have different legal, tax and stamp duty implications, the ownership should be reviewed by the advising solicitor.
- There may be some considerations in taking out the Life and TPD insurance in a super fund (see Strategy 7). However restrictions do apply to who can be nominated as a beneficiary and taxation liabilities may apply to certain eligible persons when a death benefit (including insurance proceeds) is paid in the form of a lump sum, pension or a combination of both from a super fund.
- Insurance cover purchased through a super fund is owned by the fund trustee, who is responsible for paying benefits subject to relevant legislation and fund rules (see 'Restrictions on non-death benefits' in the Glossary). When insuring in super you should be clear on the powers and obligations of the relevant trustee when paying benefits.
- It may be more cost-effective over the longer term if you pay level premiums, rather than stepped premiums that increase each year with age (see Strategy 8).
- You should consider using insurance to protect your assets and business revenue (see Strategies 1 and 2).

² In this example, the insurance proceeds would be paid directly to Lynn. However, different payment arrangements may be preferable for businesses set up under certain ownership structures, or due to the preferences of your solicitor and/or accountant.

Strategy 4

Protect your income

If you're self-employed or run your business through a company or trust, you should consider Income Protection insurance.

What are the benefits?

By using this strategy, you could:

- receive up to 75% of your pre-tax income if you are unable to work due to illness or injury, and
- ensure that business resources do not have to be used to fund your income.

How does the strategy work?

In strategies 1 to 3, we explained why you should consider using Life, Total and Permanent Disability and Critical Illness insurance for Asset (debt), Revenue and Ownership protection purposes. However, it's also important to protect your ability to earn an income.

Think about it this way. If you are unable to work for an extended period due to illness or injury, how will you meet your mortgage repayments and other bills and expenses? Without an income, you could run down your savings very quickly and face financial difficulty.

Rather than putting your family's lifestyle at risk, by taking out Income Protection insurance, you could receive a monthly benefit of up to 75% of your income to replace your lost earnings while you recover.

During this period, Income Protection insurance can ensure that business resources do not have to be used to fund your income while you are not contributing to the business.

A financial adviser can help you determine whether you need Income Protection insurance. They can also review your insurance needs over time to make sure you remain suitably covered.

What is your future earning capacity?

If you're in any doubt about the importance of protecting your income, the table below shows how much you could earn by the time you reach age 65.

For example, if you are currently 35 and earn \$80,000 pa, you could earn around \$3.8 million before you turn 65. Isn't that worth protecting?

To estimate your future earnings capacity, a calculator can be accessed at [mlc.com.au](https://www.mlc.com.au)

How much will you earn by age 65?

Current income (pa)	Age now			
	25	35	45	55
\$40,000	\$3,020,000	\$1,900,000	\$1,070,000	\$460,000
\$60,000	\$4,520,000	\$2,850,000	\$1,610,000	\$690,000
\$80,000	\$6,030,000	\$3,810,000	\$2,150,000	\$920,000
\$100,000	\$7,540,000	\$4,760,000	\$2,690,000	\$1,150,000

Assumptions: Income increases by 3% pa. No employment breaks. Figures rounded to nearest \$10,000.

Case study

Harriett is a self-employed architect and receives an income from her business of \$120,000 pa. She owns a home worth \$500,000 and has a mortgage of \$350,000. If she is unable to work due to illness or injury, she wants to be able to meet her living expenses and mortgage repayments without having to eat into her limited savings.

After assessing her goals and financial situation, her adviser recommends she take out Income Protection insurance to cover 75% of her monthly income. Shortly after taking out the insurance, Harriett is involved in a bad car accident and is unable to work for six months.

Because Harriett had Income Protection insurance, she receives the full benefit of \$7,500 per month for five months after her initial one month waiting period. As a result, she receives a total income of \$37,500 during the six months she spends recovering.

If Harriett had not taken out Income Protection insurance, she would have received little (if any) income during this period and would have struggled to meet her living expenses, mortgage repayments and out-of-pocket medical costs.

Note: This case study highlights the importance of speaking to a financial adviser about protecting your income in the event of illness or injury. A financial adviser can also address a range of potential issues and identify other suitable protection strategies – see Tips and traps.



Tips and traps

- Most Income Protection policies offer a range of waiting periods before you start receiving your insurance benefit (with options normally between 14 days and two years).
- You can also choose from a range of benefit payment periods, with maximum cover generally available up to age 65.
- As a general rule, the longer the waiting period and the shorter the benefit payment period, the less Income Protection insurance will cost.
- It may be more cost-effective over the longer term if you pay level premiums, rather than stepped premiums that increase each year with age (see Strategy 8).
- If you take out Income Protection insurance in a super fund, you can arrange to have the premiums deducted from your investment balance without making additional contributions to cover the cost. This can help you afford insurance if you don't have sufficient cashflow to pay for it outside super.
- If you're self-employed or in a small partnership, you should consider using Business Expenses insurance to cover 100% of your eligible business overheads if you are unable to work due to illness or injury (see Strategy 5).
- You should also make sure you have enough personal insurance to protect yourself and your family if something happens to you. To find out more about using insurance for personal protection purposes, see our 'Smart strategies for protecting you and your family' guide.

Strategy 5

Meet your business expenses

If you are a small business owner, you should consider Business Expenses insurance.

What are the benefits?

By using this strategy, you could:

- keep on top of your business expenses if you are unable to work due to illness or injury, and
- ensure you have a saleable asset if you are unable to return to work.

How does the strategy work?

In the previous strategy, we explained how Income Protection insurance can replace up to 75% of your pre-tax income if you are unable to work due to illness or injury.

But what if you are a small business owner (eg you are self-employed, in a small partnership or operate your small business through a company)?

While Income Protection insurance should still be considered, it's also important to protect the very thing that generates your income – your business.

By taking out Business Expenses insurance, you can cover 100% of your share of eligible business overheads, should an illness or injury prevent you from working.

This can help keep your business afloat and ensure that, in the worst case scenario, there is still a business to sell should the need arise.

Expenses that can be covered typically include, amongst other things, office rent and loan payments, equipment or vehicle leasing costs and utility bills such as electricity, heating and water.

The maximum benefit payment period is usually limited to 12 months. After this period, you can reasonably determine (with guidance from your doctor) whether you will be able to return to work.

You can also choose a waiting period before the policy will start reimbursing your business expenses – typically 14 days or a month.

A financial adviser can help you determine whether you need Business Expenses insurance. They can also review your insurance needs over time to make sure you remain suitably covered.

Case study

Tony and his business partner Andrew run a successful veterinary practice.

They each generate a pre-tax income of \$20,000 per month and are jointly responsible for meeting the total business expenses of \$16,000. This leaves them \$12,000 each to draw as income every month.

	For the practice (per month)	Per partner (per month)
Pre-tax income	\$40,000	\$20,000
Less ongoing business expenses	(\$16,000)	(\$8,000)
Pre-tax income (after business expenses)	\$24,000	\$12,000

They have both used Income Protection insurance to protect 75% of their respective incomes (see Strategy 4). Tony has also taken out Business Expenses insurance for \$8,000 a month, which represents his share of the practice's business overheads.

The table below outlines what could potentially happen if either Andrew or Tony became disabled.

	Andrew – Protection plan without Business Expenses insurance (per month)	Tony – Protection plan with Business Expenses insurance (per month)
Income Protection insurance benefit	\$9,000	\$9,000
Business Expenses insurance benefit	Nil	\$8,000
Total insurance benefits	\$9,000	\$17,000
Less share of ongoing business expenses	(\$8,000)	(\$8,000)
Pre-tax income (after business expenses)	\$1,000	\$9,000

Andrew's Income Protection policy would provide a monthly benefit of \$9,000, which represents 75% of his income, net of expenses, but before tax. However, because he doesn't have Business Expenses insurance, he'll have to fund the business expenses out of his own pocket – potentially from his Income Protection policy. As a result, he's left with \$1,000 each month, which won't be enough to cover his personal expenses, medical expenses and tax liability.

Conversely, Tony, who also insured 100% of his share of the practice's business expenses, will not need to use any of his Income Protection benefit (or any of his personal savings) to meet his ongoing business expenses.

Note: This case study highlights the importance of speaking to a financial adviser about protecting your share of business overheads if you can't work due to illness or injury. A financial adviser can also address a range of potential issues and identify other suitable protection strategies – see Tips and traps.

Tips and traps

- Premiums for Business Expenses insurance are tax-deductible and benefits received will be assessable as income, to either the business or the business owner.
- Insurance contracts differ, so check the policy document to ensure you understand exactly what the Business Expenses insurance provides, including what are defined as eligible business expenses.
- You should consider insurance policies that allow you to automatically increase your cover in line with increases in the Consumer Price Index, ensuring the benefit keeps pace with the rising cost of living.
- It may be more cost-effective over the longer term if you pay level premiums, rather than stepped premiums that increase each year with age (see Strategy 8).
- Some other strategies to consider include using insurance to protect your assets (see Strategy 1), offset a reduction in business revenue (see Strategy 2) and fund an orderly transfer of business ownership (see Strategy 3).
- You should also make sure you have enough personal insurance to protect yourself and your family if something happens to you. To find out more about using insurance for personal protection purposes, see our 'Smart strategies for protecting you and your family' guide.

Strategy 6

Treat your beneficiaries equitably

If you have a family business, you should consider using Life insurance as part of your broader succession planning.

What are the benefits?

By using this strategy, you could:

- provide additional funds to equalise your estate in the event of your death, and
- ensure your beneficiaries receive sufficient assets to achieve your estate planning objectives.

How does the strategy work?

When planning the distribution of their wealth, some parents want to leave the family business to one or more of their children.

But problems could arise if you cater for certain children in this way and your other children feel they have not been treated fairly.

Your Will could be contested and, if the challenge is successful, the business or other assets may need to be sold to distribute the proceeds, often with an accompanying Capital Gains Tax (CGT) bill.

To prevent family arguments and reduce the risk of your Will being challenged, you could consider taking out an appropriate amount of Life insurance cover.

In the event of your death:

- the farm or family business could be passed on to one or more of your children, and
- the proceeds from the Life insurance policy could be used to provide an asset of equivalent value to your other children.

Because the law can vary in each state, you should seek professional legal advice before using this strategy.

The taxation consequences of estate planning are complicated and it is recommended that you seek professional advice from a registered tax agent.

You should also ask your tax agent to value the farm or family business and determine how much CGT would be payable if the asset was to be sold by the beneficiaries who inherit it.

This will help you determine how much Life cover you should take out to equalise your estate and treat your beneficiaries equitably.

A financial adviser can also help you determine how much life insurance you may require and can review your insurance needs over time to make sure you remain suitably covered.

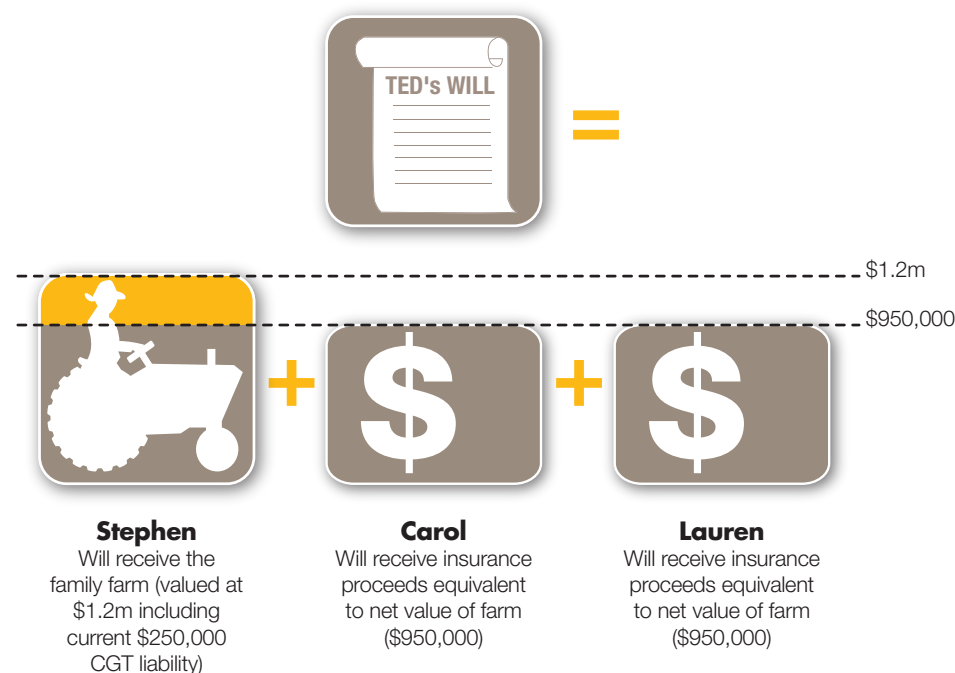
Case study

Ted, a third generation farmer and widower, has worked on the family farm his whole life and intends for his son, Stephen, to take ownership when he dies. The farm is worth \$1.2 million and the net value is \$950,000 (after allowing for CGT that would be payable if the asset was sold).

He also has two daughters (Carol and Lauren) who he would like to share equally in his wealth in the event of his death. But the problem he faces is he doesn't have any other significant assets he could pass on to them to ensure they are treated fairly.

To achieve his estate planning objectives, Ted decides to speak to a financial adviser. After assessing his goals and financial situation, his adviser recommends he take out \$1.9 million in Life insurance and make arrangements so that the benefit is split equally between Carol and Lauren.

By using this strategy, Ted ensures that Carol and Lauren would receive \$950,000 each and all three children would receive an asset of equivalent value.



Note: This case study highlights the importance of speaking to a financial adviser about using Life insurance to equalise your estate. A financial adviser can also address a range of potential issues and identify other suitable protection strategies – see Tips and traps. The taxation (including CGT) consequences in this example are for illustrative purposes only and may not reflect the actual income tax liability. It is recommended that you consult a registered tax agent to confirm the taxation consequences applicable to your personal situation.

Tips and traps

- There are a number of ways to ensure the Life insurance proceeds are received by your intended beneficiaries. Some of these include having the intended beneficiary as the policy owner, nominating them as a beneficiary of the policy or distributing the money via your Will. Each alternative may have different implications which you should consider before choosing a particular option.
- There may be some advantages in taking out the Life insurance in a super fund (see Strategy 7). However restrictions do apply to who can be nominated as a beneficiary and taxation liabilities may apply to certain eligible persons when a death benefit (including insurance proceeds) is paid in the form of a lump sum, pension or a combination of both from a super fund.
- Insurance cover purchased through a super fund is owned by the fund trustee, who is responsible for paying benefits subject to relevant legislation and fund rules (see 'Restrictions on non-death benefits' in the Glossary). When insuring in super you should be clear on the powers and obligations of the relevant trustee when paying benefits.
- It may be more cost-effective over the longer term if you pay level premiums, rather than stepped premiums that increase each year with age (see Strategy 8).
- To ensure your wishes are carried out upon your death, you should consider your entire estate planning position, including which assets will (and won't) be dealt with by your Will. The best way to do this is to seek professional estate planning advice.

Strategy 7

Purchase Life and TPD insurance tax-effectively

When taking out Life and Total and Permanent Disability (TPD) insurance for certain business purposes, you may want to arrange the cover in a super fund rather than outside super.

What are the benefits?

By using this strategy, you could:

- reduce the premium costs, and
- enable certain beneficiaries to receive the death or TPD benefit as a tax-effective income stream.

How does the strategy work?

There are a range of situations in which you could use Life and TPD insurance to protect your business and the interest you have in it.

In some of these cases, it may also be worthwhile taking out the insurance in a super fund³, rather than outside super. These could include to:

- repay business debts, or release a loan guarantee or security (see Strategy 1)
- fund a Buy Sell agreement (see Strategy 3), or
- equalise your estate (see Strategy 6).

One of the key reasons for holding the cover in a super fund is that you could benefit from a range of upfront tax concessions generally not available when insuring outside super. For example:

- **If you earn less than 10% of your income¹ from eligible employment (eg you're self-employed),** you can generally claim your super contributions as a personal tax deduction – regardless of whether they are used in the fund to purchase investments or insurance.²
- **If you run your business through a company or trust and you sacrifice some of your salary into super,** you can purchase insurance in your fund with pre-tax dollars (see case study).²

These tax concessions can make it cheaper to insure through a super fund. This will usually also be the case if the sum insured is increased to make a provision for any lump sum tax that is payable on TPD and death benefits in certain circumstances (see FAQs on pages 22 and 23).

Another benefit of insuring in super is that you (or certain eligible dependants) have the option to receive the TPD (or death) benefit as an income stream, rather than a lump sum payment. Where this is done:

- because lump sum tax won't be payable when the income stream is commenced, there is no need to increase the sum insured, and
- the income payments will be concessional tax (see FAQs on pages 22 and 23).

An income stream generally won't suit when the purpose of the insurance is to repay business debts or release a loan guarantee or security. This is because, to achieve this objective, the money will need to be received as a lump sum payment.

However, when the insurance is used to fund a Buy Sell agreement or equalise your estate, the beneficiary(ies) may prefer to receive the proceeds as a regular and tax-effective income to meet ongoing living expenses.

A financial adviser can help you determine whether you could benefit from insuring in super. They can also review your insurance needs over time to make sure you remain suitably covered.

Note: Any contributions made to a super fund including contributions made to cover the cost of insurance premiums, will count towards the contribution caps. If these caps are exceeded an excess contribution tax will be payable.

¹ Includes assessable income, less business deductions, reportable fringe benefits and reportable employer super contributions.

² From 1 July 2012, an additional 15% tax will apply to certain concessional contributions of individuals whose income and concessional contributions exceed \$300,000. The tax will only apply to those contributions in excess of the \$300,000 threshold and will be assessed to the individual. This measure could reduce the attractiveness of insuring inside super.

³ Restrictions apply to who can be nominated as a beneficiary and taxation liabilities may apply to certain eligible persons when a death benefit (including insurance proceeds) is paid in the form of a lump sum, pension or a combination of both from a super fund.

Case study

Tom and Harry are both aged 50 and each own 50% of a concreting business valued at \$1 million. The business is run through a company from which they draw a salary, and they both pay tax at a marginal rate of 38.5%³.

To protect their respective interests in the business, their financial adviser recommends they:

- execute a Buy Sell agreement (see Strategy 3), and
- fund the agreement by each taking out \$500,000 in Life insurance, where the premium for both of them will be \$1,128⁴ in the first year.

Their adviser also explains that it will be more cost-effective if they take out the insurance in super. This is because if they arrange for their company to sacrifice \$1,128 of their respective salaries into super, they will be able to pay the premiums with pre-tax dollars⁵.

Conversely, if they purchase the insurance outside super and pay the premiums themselves from their after-tax salaries, the pre-tax cost would be \$1,835 after taking into account their marginal tax rate (ie \$1,835 less tax at 38.5% [\$707] equals \$1,128).

By insuring in super, they could both make a pre-tax saving of \$707 on the first year's premiums and an after-tax saving of \$434, after taking into account their marginal rate of 38.5%.

For both Tom and Harry	Insurance purchased outside super (with after-tax salary)	Insurance purchased inside super (via salary sacrifice)
Premium (pa)	\$1,128	\$1,128
Plus tax at marginal rate of 38.5% ³	\$707	N/A
Pre-tax salary received or sacrificed	\$1,835	\$1,128
Pre-tax saving	N/A	\$707
After-tax saving	N/A	\$434

Let's now assume they continue this cover for 15 years and the amount of insurance increased by 5% pa, to ensure the benefit payable keeps pace with inflation. Over this period, the after-tax savings for Tom and Harry could amount to \$22,845 each (in today's dollars). So insuring in super could be significantly cheaper over a long time period.

Note: This case study highlights the importance of speaking to a financial adviser about the benefits of taking out insurance in a super fund. A financial adviser can also address a range of potential issues and identify other suitable protection strategies – see Tips and traps.

Tips and traps

- Insurance cover purchased through a super fund is owned by the fund trustee, who is responsible for paying benefits subject to relevant legislation and the fund rules (see 'Restrictions on non-death benefits' in the Glossary). When insuring in super, you should be clear on the powers and obligations of the relevant trustee when paying benefits.
- When making salary sacrifice or personal deductible contributions to fund insurance premiums in a super fund, you should take into account the concessional contribution cap (see Glossary).
- When insuring in super, you can usually arrange to have the premiums deducted from your account balance without making additional contributions to cover the cost. This can enable you to get the cover you need without reducing your cashflow.
- While Critical Illness insurance is generally not available within super, it is possible to purchase Income Protection (or Salary Continuance) insurance in super with a choice of benefit payment periods up to age 65. To find out more about the tax implications, see FAQs on page 25.
- It may be even more cost-effective over the longer term if you pay level premiums, rather than stepped premiums that increase each year with age (see Strategy 8).

³ Includes a Medicare levy of 1.5%.

⁴ For simplicity purposes, we have assumed they both pay the same premiums. These premiums are based on MLC Limited's standard premium rates as at 28 June 2013 for non-smoking males aged 50, with \$500,000 in Life Cover that increases by 5% each year and includes a policy fee. In reality, they may pay different premiums based on factors such as their age, health and the amount of insurance each of them requires to protect their respective business interests.

⁵ Because super funds generally receive a tax deduction for death and disability premiums, no tax is deducted from the salary sacrifice super contributions (see FAQ's on page 23). From 1 July 2012, an additional 15% tax will apply to certain concessional contributions of individuals whose income and concessional contributions exceed \$300,000. The tax will only apply to those contributions in excess of the \$300,000 threshold and will be assessed to the individual. This additional tax will affect these individuals in this income bracket only. A contribution cap of \$25,000 (2013/14) applies to those 59 and younger and \$35,000 (2013/14) for those 59 and over as at 30 June 2013. If an individual's contribution exceeds their respective cap the ATO will make a determination on the excess concessional contributions and the amount will be added to individual's assessable income for the same financial year the excess contribution was made. Contributions that are salary sacrificed must be formally agreed with your employer in an effective salary sacrifice agreement. A financial adviser or registered tax agent can ensure this is set up properly for you.

Strategy 8

Reduce the long-term cost of your insurance

When taking out insurances, you should consider paying level rather than stepped premiums.

What are the benefits?

By using this strategy, you could:

- pay a lower average premium over the life of the policy, and
- make your cover more affordable at a time when you need it most.

How does the strategy work?

When you take out insurance within or outside super, there are generally two ways you can pay your premiums.

You can opt for a **stepped premium** that is calculated each year in line with your age.

Or you can choose a **level premium** that is calculated each year based on your age when the cover commenced.

Level premiums are usually higher than stepped premiums at the start (as the graph below reveals).

However, over time, as stepped premiums increase, level premiums can end up cheaper – often at the stage in life when you need the cover most.

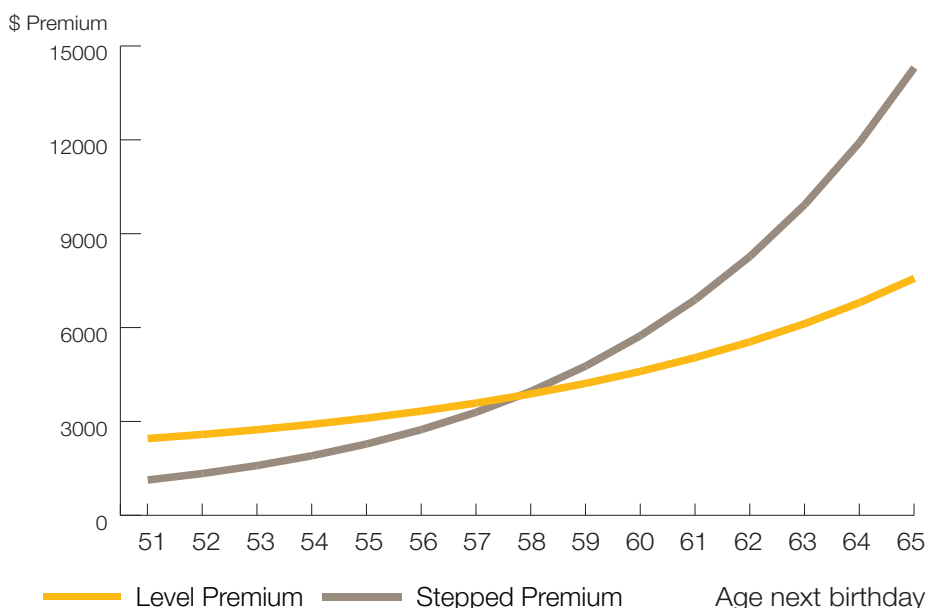
The premium savings in the later years can also make up for the additional payments in the earlier years, saving you money over the life of the policy.

The case study on the opposite page provides an example of the long-term savings that choosing level premiums could provide.

To find out whether you could benefit from paying level premiums, you should seek financial advice. A financial adviser can also help you determine the types and amounts of insurance you require and can review your needs over time to make sure you remain suitably covered.

Note: Choosing a level premium does not mean your premiums are guaranteed or will not change in the future. Level premium rates may increase due to rate increases, CPI increases and policy fee increases. However, unlike stepped premiums, level premiums don't go up by age-related increases.

Level vs stepped premiums



Insurance assumptions: Age 50, male, non-smoker, \$500,000 in Life Cover increased by 5% each year. Based on MLC Limited's standard premium rates as at 28 June 2013 and excludes policy fee.

Case study

Tom and Harry (from Strategy 7) are both aged 50 and each own 50% of a concreting business valued at \$1 million.

To protect their respective interests in the business, their financial adviser has recommended they execute a Buy Sell agreement (see Strategy 3) and fund the agreement by each taking out \$500,000 in Life insurance in their super funds, where they could both make an after-tax saving of \$434 on the first year's premiums and \$22,845 over a 15 year period.

Their adviser also explains it will be even more cost-effective over the longer term if they pay level rather than stepped premiums. This is because, over the next 15 years, they'll both pay level premiums totalling \$64,488 compared to a total of \$78,973 if they choose stepped premiums.

Level premiums could therefore save them both a total of \$14,485 over the next 15 years (or \$8,655 in today's dollars¹). This is in addition to the savings they could make by holding the insurance in super.

For both Tom and Harry	Level premiums	Stepped premiums	Difference
Total premiums over 15 years	\$64,488	\$78,973	\$14,485
Saving (in today's dollars) ¹			\$8,655

However, if Tom and Harry only needed insurance for a shorter time period (eg five years), it may be more cost-effective if they opt for stepped rather than level premiums.

Furthermore, if they both pay level premiums, the cost in year 15 (for example) will be \$7,573 each, compared to \$14,030 with stepped premiums. In other words, level premiums could be significantly lower in the later years, when the cover is needed most.

Insurance assumptions: For simplicity purposes, we've assumed Tom and Harry pay the same premiums. These premiums are based on MLC Limited's standard premium rates as at 28 June 2013 for non-smoking males, aged 50 with \$500,000 in Life Cover increased by 5% each year and includes a policy fee. In reality, they may pay different premiums based on factors such as their age, health and the amount of insurance each of them requires to protect their respective business interests. However, they are both likely to save money over the longer term if they select level rather than stepped premiums.

Note: This case study highlights the importance of speaking to a financial adviser about the best premium payment option when taking out insurance. A financial adviser can also address a range of potential issues and identify other suitable protection strategies – see Tips and traps.

Tips and traps

- You may want to take out part of your insurance using stepped premiums and use level premiums for the rest. This way, the premium in the earlier years will be lower than if you opt entirely for level premiums. Over time, you can then reduce your stepped premium cover as you build up more assets and potentially need less insurance. As a result, you could end up paying level premiums on most (if not all) of your insurance in the later years, and benefit from the lower premium costs associated with level premiums at that time.
- The earlier you lock in the level premium, the greater the potential long-term savings. This is because level premiums are based on your age when the policy commences and are generally lower if you take out the cover at a younger age. However, as you approach age 65, the difference between the two premium structures diminishes for new policies.
- Level premiums can make budgeting easier, because you have a greater degree of certainty regarding what your insurance is going to cost when compared to stepped premiums.
- It can also be more cost-effective over the longer term if you pay level rather than stepped premiums when using insurance for personal (ie non-business) purposes. To find out more about this and other personal protection strategies, see our 'Smart strategies for protecting you and your family' guide.

¹ Assumes an inflation rate of 3% pa.

One Minute Insurance Check

Complete the One Minute Insurance Check below to assess your insurance needs.

Your business needs

If a business owner (or another key person) dies or becomes disabled, have sufficient insurances been taken out to protect your business from a decline in revenue/profits and enable it to meet its ongoing financial commitments (eg loans, overdrafts, creditors or leases)?

- ☐ Yes
☐ No
☐ Unsure

If one of the owners was to die or become disabled, have business succession arrangements (with sufficient funding) been made to ensure an orderly transition of ownership?

- ☐ Yes
☐ No
☐ Unsure

If you were unable to work in your business for a year, could you continue to pay your ongoing business expenses (eg loan repayments or rent, leasing costs, utility bills)?

- ☐ Yes
☐ No
☐ Unsure

Your personal needs

Would your current insurances, including those within super funds, be enough to pay off your personal debts (eg mortgage, car loan, credit card) and keep your family comfortable for the rest of their lives?

- ☐ Yes
☐ No
☐ Unsure

If something unexpected happened to your spouse, could you afford a housekeeper or nanny to look after any children?

- ☐ Yes
☐ No
☐ Unsure
☐ N/A

If you were unable to work for three months, or longer, because of an accident or illness, could you meet your lifestyle expenses (eg loan repayments, rent, food, education, clothing, entertainment) without a regular income?

- ☐ Yes
☐ No
☐ Unsure

Other needs

Are you aware it can be more tax-effective to buy insurance in a super fund?

- ☐ Yes
☐ No
☐ Unsure

Are you aware that choosing to pay level rather than stepped premiums could reduce the cost of insurance over the long term?

- ☐ Yes
☐ No
☐ Unsure

Want some help?

If you answered no or unsure to any of these questions, it could be time you considered talking to an expert about protecting your business and your family.

If you do not have an adviser, contact MLC on **132 652** or go to **mlc.com.au**

Keep your insurance going in tough times

During tough economic times, you may look for ways to cut your expenses. However, when reviewing your budget, insurance should be one of the last items examined.

If the unthinkable were to happen and you didn't have adequate insurance, the financial impact on you and your business could be quite dramatic.

Regardless of whether you're feeling the squeeze right now or looking for ways to reduce your expenses, there are a number of ways many of us can make insurance cover more affordable.

Buy your insurance in super

If you buy your insurance through a super fund, you may be able to take advantage of a range of tax concessions generally not available when insuring outside super (see Strategy 7).

Alternatively, you could arrange to have your premiums deducted from your existing superannuation account balance without making additional contributions to cover the cost. This can make your insurance affordable if you don't have sufficient cashflow to fund the premiums.

The trade-off with this option is that you will use up some of the money that could otherwise meet your living expenses in retirement.

While this could impact your lifestyle when you are no longer working, think of what could happen to your family's lifestyle in the interim if the worst were to happen.

Without insurance, your family could run down your savings very quickly and face financial difficulty well before your intended retirement date.

Pay level premiums

If you elect to pay level rather than stepped premiums, you could reduce the long-term cost of your insurance considerably (see Strategy 8). This is because, over time, level premiums can end up cheaper, often at a stage in life when you need the cover the most.

Pay your premiums annually

In some cases, you may be eligible for a discount if you pay your premiums annually, rather than monthly.

Consolidate your insurances

Holding all your personal insurances in the one policy could enable you to save on fees. Fee savings could also be made by consolidating the insurances held by yourself, your spouse and other family members (in some cases) into the one policy.

Choose a longer waiting period and shorter benefit payment period for Income Protection

Most Income Protection insurance policies enable you to choose how long you will need to wait before the insurance benefit will start to be paid and how long it will be paid for. Choosing a longer waiting period and a shorter benefit payment period can reduce your premiums, in some cases significantly.

Reduce the sum insured

As a last resort, you could consider insuring yourself for a lower amount. If something were to happen to you, this would clearly be a better option than cancelling your insurance completely.

But you also need to keep in mind that reducing the sum insured could leave you (or your family) without sufficient money to meet your financial goals should the unthinkable happen.

To find out how you could make your premiums more affordable, we recommend you speak to a financial adviser.

Frequently Asked Questions

In this section, we summarise the taxation treatment of different types of insurance. The tax implications can vary, depending on the reason the insurance is purchased and the person (or the entity) who owns the policy.

What are the tax implications of Life insurance?

Scenario	What tax concessions are available?	Are the benefits assessed as income?	Are the benefits subject to Capital Gains Tax?
Where an individual owns the policy on their own life and the premiums are paid by the individual for personal protection purposes	None	No	No, unless the recipient is not the original beneficial owner and acquired the policy for consideration ¹
Where an individual owns the policy on their own life and the premiums are paid by the individual's employer	The employer may be able to claim the premiums and related fringe benefits tax (FBT) as a tax deduction.	No	(No as above)
Where a company, trustee of a trust, partners in a partnership or sole trader owns the policy for Revenue protection purposes	The company, trustee of a trust, partnership or sole trader may be able to claim the premiums as a tax deduction (provided a term insurance policy is used) ¹³	Yes – the benefits are assessable to the company, trustee of a trust, partnership or sole trader at the applicable tax rate (provided a term insurance policy is used)	No
Where a company, trustee of a trust, partners in a partnership or sole trader owns the policy for Asset (debt) protection purposes	None	No	No, unless the recipient is not the original beneficial owner and acquired the policy for consideration ¹
Where the trustee of a superannuation fund owns a policy on the life of a fund member	<p>The Trustee may be able to claim the premium as a tax deduction.</p> <p>At the fund member level:</p> <ul style="list-style-type: none"> Self-employed³ and other eligible people can claim their personal super contributions as a tax deduction. Employees can arrange to make pre-tax (salary sacrifice) super contributions. <p>Note: These super contributions will count towards the member's concessional contribution cap (see page 26).</p>	<p>If paid as a lump sum:</p> <ul style="list-style-type: none"> Dependants for tax purposes⁴ can receive unlimited tax-free amounts. Payments to non-dependants will be subject to tax as follows: <ul style="list-style-type: none"> no tax is payable on the tax free component the taxed element of the taxable component is taxed at 16.5%⁵ the untaxed element of the taxable component is taxed at 31.5%⁵. <p>If paid as an income stream, the income payments will be tax-free if the deceased (or the recipient) is aged 60 or over. Otherwise, the income payments less any tax free component will be taxable at the recipient's marginal rate (less a 15% pension tax offset) until they reach age 60 from which time they will be tax-free.</p> <p>Note: Only certain dependants are able to receive a death benefit as an income stream. These include a spouse, children under age 18, financially dependent children aged between 18 and 25, other financial dependants (excluding children), disabled children and people in an interdependency relationship with the deceased fund member.</p>	No

Note: This taxation information is based on MLC's understanding of current legislation and Australian Taxation Office practice as at 1 July 2013. Our comments are general only. The taxation treatment may vary according to your individual circumstances and may not apply in all cases. You should therefore seek professional advice regarding your own taxation position.

What are the tax implications of Total and Permanent Disability (TPD) insurance?

Scenario	What tax concessions are available?	Are the benefits assessed as income?	Are the benefits subject to Capital Gains Tax?
Where an individual owns the policy on their own life and the premiums are paid by the individual for personal protection purposes	None	No	No, so long as the person receiving the insurance benefit is the life insured or a defined relative ⁷ of the life insured
Where an individual owns the policy on their own life and the premiums are paid by the individual's employer	The employer may be able to claim the premiums and related fringe benefits tax (FBT) as a tax deduction.	No	(No as above)
Where a company, trustee of a trust, partners in a partnership or sole trader owns the policy for Revenue protection purposes	The company, trustee of a trust, partnership or sole trader may be able to claim the premiums as a tax deduction. ¹³	Yes – the benefits are assessable to the company, trustee of a trust, partnership or sole trader at the applicable tax rate	Yes – if the recipient is not the life insured or a defined relative ⁷ of the life insured. However, the capital gain is reduced by the amount included as assessable income ⁸ .
Where a company, trustee of a trust, partners in a partnership or sole trader owns the policy for Asset (debt) protection purposes	None	No	Yes – if the recipient is not the life insured or a defined relative ⁷ of the life insured
Where the trustee of a superannuation fund owns a policy on the life of a fund member	<p>The Trustee may be able to claim a portion of the premium as a tax deduction. In some cases, a deduction of 100% of the premium may be available to the trustee. The portion that is deductible will depend on the terms of the policy and the application of the relevant taxation law.³</p> <p>At the fund member level:</p> <ul style="list-style-type: none"> Self-employed⁴ and other eligible people can claim their personal super contributions as a tax deduction. Employees can arrange to make pre-tax (salary sacrifice) super contributions. <p>Note: These super contributions will count towards the member's concessional contribution cap (see page 26).</p>	<p>If paid as a lump sum:</p> <ul style="list-style-type: none"> No tax is payable on the Tax free component. The taxable component is: <ul style="list-style-type: none"> – taxed at 21.5%⁶ if under age 55 – taxed at 16.5%⁶ on amounts above \$180,000⁹ if aged 55 to 59 – tax-free if aged 60 or over. <p>If paid as an income stream, the income payments will be tax-free if the disabled fund member is aged 60 or over. Otherwise, the income payments less any tax free component will be taxable at the disabled member's marginal rate (less a 15% pension tax offset) until they reach age 60.</p>	No

¹ Consideration may be monetary or otherwise but does not include premiums paid on the policy.

² FBT of 46.5% is payable on the taxable value of the premiums.

³ The government has proposed to ban the provisions of 'own occupation' insurance in all superannuation funds, however at the time of printing this guide this proposal had not yet been legislated.

⁴ To qualify as self-employed for this purpose, you must earn less than 10% of your assessable income, reportable fringe benefits and reportable employer super contributions from eligible employment.

⁵ Includes a spouse (legally married or de facto including same sex), a former spouse, children under age 18, a financial dependant and a person in an interdependency relationship with the deceased.

⁶ Includes a Medicare levy of 1.5%, where not paid via the deceased's estate.

⁷ A defined relative includes:

- the person's spouse, or
- the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of that person, or of that person's spouse, or
- the spouse of a person referred to in paragraph (b).

⁸ It's generally unlikely for a capital gain to be higher than the amount otherwise assessable as income.

⁹ Applies for the 2013/14 financial year (and post-June 1993 components prior to 1 July 2007) when taken as cash from age 55 and under 60.

Frequently Asked Questions

What are the tax implications of Critical Illness insurance (when the benefit is paid as a lump sum)?

Scenario	What tax concessions are available?	Are the benefits assessed as income?	Are the benefits subject to Capital Gains Tax?
Where an individual owns the policy on their own life and the premiums are paid by the individual for personal protection purposes	None	No	No, so long as the person receiving the insurance benefit is the life insured or a defined relative ¹⁰ of the life insured
Where an individual owns the policy on their own life and the premiums are paid by the individual's employer	The employer may be able to claim the premiums and related fringe benefits tax (FBT) as a tax deduction.	No	(No as above)
Where a company, trustee of a trust, partners in a partnership or sole trader owns the policy for Revenue protection purposes	The company, trustee of a trust, partnership or sole trader may be able to claim the premiums as a tax deduction. ¹³	Yes – the benefits are assessable to the company, trustee of a trust, partnership or sole trader at the applicable tax rate	Yes – if the recipient is not the life insured or a defined relative ¹⁰ of the life insured. However, the capital gain is reduced by the amount included as assessable income ¹² .
Where a company, trustee of a trust, partners in a partnership or sole trader owns the policy for Asset (debt) protection purposes	None	No	Yes – if the recipient is not the life insured or a defined relative ¹⁰ of the life insured

¹⁰ A defined relative includes:

- a. the person's spouse, or
- b. the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of that person, or of that person's spouse, or
- c. the spouse of a person referred to in paragraph (b).

¹¹ FBT of 46.5% is payable on the taxable value of the premiums.

¹² It's generally unlikely for a capital gain to be higher than the amount otherwise assessable as income.

¹³ The taxation implications for partnerships, trusts and sole traders may vary depending on the individual circumstances. It is recommended that you seek advice from a professional who is a registered tax agent.

What are the tax implications of Income Protection and Business Expenses insurance?

Scenario	What tax concessions are available?	Are the benefits assessed as income?	Are the benefits subject to Capital Gains Tax?
Where an individual owns the policy on their own life and the premiums are paid by the individual for personal protection purposes	The individual may be able to claim the premium as a tax deduction.	Yes – the benefits are assessable to the individual	No
Where an individual owns the policy on their own life and the premiums are paid by the individual's employer	The employer may be able to claim the premiums and related fringe benefits tax (FBT) as a tax deduction. ¹⁴	Yes (as above)	No
Where the trustee of a superannuation fund owns a policy on the life of a fund member (Income Protection insurance only)	<p>The Trustee may be able to claim the premium as a tax deduction. At the fund member level:</p> <ul style="list-style-type: none"> • Self-employed¹⁵ and other eligible people can claim their personal super contributions as a tax deduction. • Employees can arrange to make pre-tax (salary sacrifice) super contributions. <p>Note: These super contributions will count towards the member's concessional contribution cap (see page 26).</p>	Yes (as above)	No

¹⁴ Fringe Benefits Tax is not payable, as the premiums are 'otherwise deductible' to the employee.

¹⁵ To qualify as self-employed for this purpose, you must earn less than 10% of your assessable income, reportable fringe benefits and reportable employer super contributions from eligible employment.

Glossary

A

Account based pension – an account in which you can invest your super savings in exchange for a regular and tax-effective income.

Assessable income – income (including capital gains) you receive before deductions.

C

Capital Gains Tax (CGT) – a tax on the growth in the value of assets generally assessable when the gain is realised. If the assets have been held for more than one year, the capital gain may receive concessional treatment.

Complying super fund – a super fund that qualifies for concessional tax rates. A complying super fund must meet the requirements that are set down by law.

Concessional contribution cap – a cap that applies to certain super contributions. These include, but are not limited to:

- contributions from an employer (including salary sacrifice)
- personal contributions claimed as a tax deduction (where eligible)

A contribution cap of \$25,000 (2013/14) applies to those 59 and younger and \$35,000 (2013/2014) for those 59 and over as at 30 June 2013. If an individual's contribution exceeds their respective cap the ATO will make a determination on the excess concessional contributions and the amount will be added to individual's assessable income for the same financial year the excess contribution was made.

D

Dependant for tax purposes – those people eligible to receive unlimited tax-free lump sum payments from a super fund in the event of your death. Includes a spouse (legally married or de facto including same sex), a former spouse, children under age 18, a financial dependant and a person in an interdependency relationship with the deceased.

E

Eligible employment – broadly any work that classifies you as an employee for Superannuation Guarantee purposes.

Employment Termination Payment (ETP) – a payment made by an employer to an employee on termination of employment. Examples can include a redundancy payment exceeding the tax-free amount, accrued sick leave or an ex gratia payment.

F

Fringe benefit – a benefit provided to an employee by an employer in respect of that employment. Super contributions made by an employer are excluded from the definition of 'fringe benefit' and therefore outside the scope of fringe benefits tax.

Fringe Benefits Tax (FBT) – a tax payable by your employer on the grossed up value of certain fringe benefits that you receive as an employee. The current rate of tax is 46.5%.

M

Marginal tax rate – the stepped rate of tax you pay on your taxable income. The table below summarises the tax rates that apply to residents in 2013/14.

Taxable income range	Tax payable ¹ in 2012/13
\$0 – \$18,200	Nil
\$18,201 – \$37,000	19% on amount over \$18,200
\$37,001 – \$80,000	\$3,572 + 32.5% on amount over \$37,000
\$80,001 – \$180,000	\$17,547 + 37% on amount over \$80,000
Over \$180,000	\$54,547 + 45% on amount over \$180,000

Medicare levy – a levy of 1.5% that is payable on the whole of your taxable income on top of normal marginal tax rates. In 2012/13, if you earn less than \$20,542 pa (\$33,693 pa combined for couples) you are exempt from the levy.

An additional surcharge of up to 1.5% applies to singles with an income in 2013/14 over \$88,000 pa (or couples with a combined income of \$176,000 pa) who don't have private health insurance. If applicable, this Medicare levy surcharge will be payable on top of the base Medicare levy of 1.5%.

¹ Excludes Medicare levy.

P

Pension offset – a tax offset of 15% on the taxable income payments received from an income stream investment purchased with superannuation money between the ages of 55 and 59. The offset is also available before age 55 on death and disability benefits paid as an income stream.

Personal after-tax super contribution – a super contribution made by you from your after-tax pay or savings.

R

Reportable employer super contributions – certain super contributions (including salary sacrifice) that must be identified by an employer and included on an employee's Payment Summary.

Restrictions on non-death benefits from superannuation – Government regulations restricting payments from super funds apply to all non-death benefits paid under the policy. This means the trustee may not pass benefits to you until they have satisfactory proof that you will never be able to work again in any occupation you are reasonably suited to by education, experience or training, or until you satisfy one of the other conditions of release prescribed by law.

If you do not satisfy a condition of release, the trustee of the super fund must preserve the benefit in the fund until they are allowed to release it. Should this situation arise, the trustee of the super fund will write to you, explaining your options in relation to the preserved benefit.

Examples of some conditions of release are as follows:

- you have reached your preservation age (between 55 and 60, depending on your date of birth) and have permanently retired from the workforce
- you stop working for your last employer on or after reaching age 60, or
- you turn 65.

Where you are entitled to receive a non-death benefit, the trustee of the super fund will pay the benefit to you. Alternatively, you may ask for the benefit to be transferred to a roll-over facility of your choice.

S

Salary sacrifice – an arrangement made with an employer where you forgo part of your pre-tax salary in exchange for receiving certain benefits (eg superannuation contributions).

Self-employed – to qualify as self-employed, you need to receive less than 10% of your assessable income, reportable fringe benefits and reportable employer super contributions from eligible employment.

Superannuation Guarantee (SG) contributions – the minimum amount of super contributions an employer is required to make on behalf of eligible employees is 9.25% (2013/14) of ordinary times earning up to the maximum super contribution base limit of \$48,040 (2013/14) per quarter.

T

Taxable component – the remainder of a superannuation benefit after allowing for the tax free component. The amount of tax payable on the taxable component may depend on the age of the recipient, the dependency status of the beneficiary (death benefits only) and the size of the benefit.

Taxable income – income (including capital gains) you receive after allowing for tax deductions.

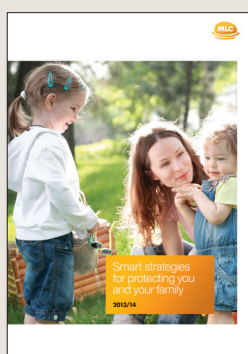
Tax deduction – an amount that is deducted from your assessable income before tax is calculated.

Tax free component – that part of a superannuation benefit that is received tax-free.

Notes

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

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