Protection for business owners

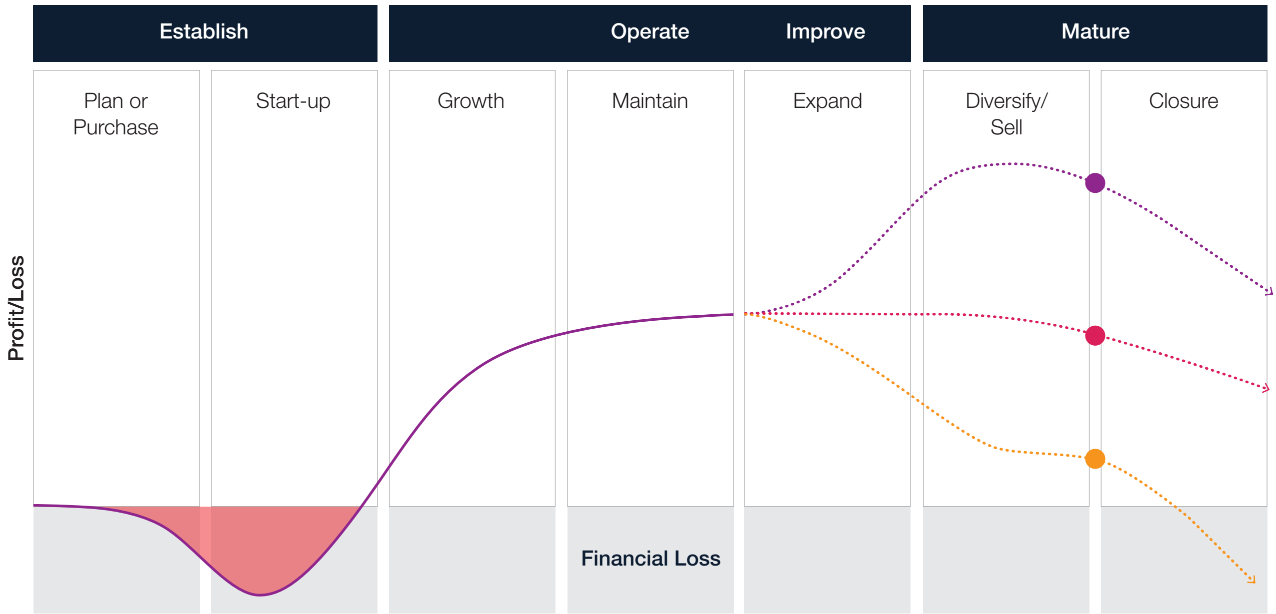
BT Insurance

Contents

The business lifecycle

Businesses and their needs change over time. Often, start-ups experience a financial loss in their first few years, but if all goes well, they will move into the growth phase, where profit is generated.

As the business matures, you may reassess the level at which you participate in the business, and depending on the decision made, you may sell your share, pass the management or ownership of the business to a family member, or close the business. Here is an example below:



Challenges within the business lifecycle

Plan or purchase	Start-up	Growth	Expand	Diversify/sell/close
Getting finance is the biggest challenge, and cautious with spending as no revenue yet. The focus is on go, no-go decision.	Cash flow is unpredictable and sourcing additional funding is still challenging. The focus is on new customers and sales.	The business has strong revenue growth. The focus is on profitability and investing in efficiencies and marketing/sales to grow.	The business is now more competitive. The focus is on grow market share and developing new markets.	The business needs to look for new ways to grow, or business owners must look for a way to successfully exit the business. Some owners may be looking to retire.

Plan or purchase	Start-up	Growth	Expand	Diversify/sell/close
Business challenges: – Obtaining financing – Unknown future profitability – No cash flow/ negative cash flow – Cautious with spending as no revenue yet – Often use personal credit cards, unsecured personal loans and home equity to finance the venture – May continue to work in existing role – No value in business.	**Business challenges:** – Insufficient working capital – Low/no profit – Late payments from creditors – Cash flow is unpredictable and sourcing additional funding is still challenging and expensive – Building customer base and market penetration – Single asset exposure.	**Business challenges:** – The business has strong revenue growth and increased revenue protection needs – Cash flow is more stable but still needs to be carefully managed – Increased funding needed - credit management/risk of overleverage – Stock control – Building the right culture – Single asset exposure – Employee attrition and recruitment.	**Business challenges:** – Maintaining competitiveness – Increased and more complex funding opportunities – capital versus debt funding, short term versus long term – Stock control – Cash flow and credit management – Being able to cover lost revenue and repay business debts in the event of departure, death, disability or critical illness.	**Business challenges:** – Potential Initial Public Offer – Private sale to external or internal parties – Shutdown – Slowing sales growth/margin squeeze – Intergenerational transfer of business ownership.

Plan or purchase	Start-up	Growth	Expand	Diversify/sell/close
Personal challenges for the business owner: – Supporting and protecting dependents – Protecting existing personal income and ability to pay for normal household expenses – Being able to repay personal debts and cover additional household expenses in the event of death, disability or critical illness. – Maintaining good credit rating to ensure future ability to borrow.	**Personal challenges for the business owner:** – Supporting and protecting dependents – Replacing lost personal income due to the business owner ceasing their previous role – Being able to repay personal debts and cover additional expenses in the event of death, disability or critical illness – Ensuring that a fair value is received for the sale of a business share, upon exiting due to death, disability or critical illness – Investment of proceeds from the sale of business share due to death, disability or critical illness.	**Personal challenges for the business owner:** – Supporting and protecting dependents – Improving lifestyle and work/life balance – Drawing increased income (dividends/ wages) from the business – Being able to repay personal debts and cover additional expenses in the event of death, disability or critical illness – Ensuring that a fair value is received for the sale of a business share, upon exiting due to death, disability or critical illness – Investment of proceeds from the sale of business share due to death, disability or critical illness.	**Personal challenges for the business owner:** – Supporting and protecting dependents – Improving lifestyle given an increase in income, but also increasing dependency – Being able to repay personal debts and cover additional expenses in the event of death, disability or critical illness – Ensuring that a fair value is received for the sale of a business share, upon exiting due to death, disability or critical illness – Investment of proceeds from the sale of business share due to death, disability or critical illness.	**Personal challenges for the business owner:** – Retirement – Being able to repay personal debts and cover additional household expenses in the event of departure, death, disability or critical illness – Investment of proceeds from the sale of business share.

Minimising risks to your business

The survival and success of your business is critical throughout the entire lifecycle, as it is likely to be your main source of income and may play a big part in whether you meet your retirement goals.

Out of all reported corporate insolvencies in 2015/16[1]:

- 79% < 20 people
- 65% debts < $500,000
- The top reasons:
  - inadequate cash flow or high cash use (46%);
  - poor strategic management (46%);
  - and poor financial control, including lack of financial records (34%).

Protecting your interests

To give your business its best chance to survive over the long term, and succeed, you need to get smart about protection. No matter how small or large your business, or how it is structured, each business will face a number of risks. These risks could relate to the economy, competition, or changing consumer behaviour and can be hard to control.

Protection is not just about guarding the financial health of your business, it's also about protecting the ownership of your business – that is, helping to achieve a smooth transfer of business ownership should one of the business owners suddenly exit due to sickness, injury or death.

We all want to avoid thinking about illness, injury and early death. Here are some facts and figures to remind you of just how risky life can be – and why protection is an important consideration.

- A 35 year old male has a 40% chance of suffering from an accident (12%) or illness (28%) that lasts three months or longer[2]
- Around 54,000 Australians suffer a heart attack each year[3]
- 1 in 2 Australian men and women are expected to be diagnosed with cancer before the age of 85[4]
- It is estimated that more than 44,000 people died from cancer in 2015[5]
- Almost 2 million adults aged between 25-64 have had a disability[5]

There are a number of different ways that you can reduce the impact that these risks may have on your business. In this booklet, we discuss 7 ways that you can use insurance to help you mitigate these risks.

Discuss them with your financial adviser today, or call BT on 1300 553 764.

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1 Summary of key data from ASIC REP 507: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-436mr-asic-reports-on-corporate-insolvencies-2015-16/

2 IRESS Life Risk Calculator, accessed 10 July 2017.

3 Heart Foundation, statistics (https://www.heartfoundation.org.au/about-us/what-we-do/heart-disease-in-australia

4 Cancer Council Facts and Figures (http://www.cancer.org.au/about-cancer/what-is-cancer/facts-and-figures.html)

5 AIHW 2011. Australia's welfare 2011. Australia's welfare no. 10. Cat. no. AUS 142. Canberra: AIHW.

BT Protection Plans can help you and your business prepare for the unexpected

Below is a summary of the different ways that BT Protection Plans can help to provide solutions to business owners. To see how these solutions work, refer to the page numbers indicated.

Solution 1:

Protecting your business assets
Enable your business to pay back certain loans, such as a business loan or capital facility, in the event that a key person or guarantor dies, or becomes disabled.

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Solution 2:

Ensuring your business can continue to pay its fixed expenses
Enable your business to continue to pay certain day-to-day expenses for up to one year, if one of the business owners cannot work at their full capacity due to sickness or injury.

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Solution 3:

Protection for transfers of ownership
If your business has more than one owner, it is important that the owners agree on how the business will be transferred if one of the owners dies or becomes disabled. We explain how insurance can be used to help facilitate this transfer.

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Solution 4:

Protecting your household
Protecting your business is important, but it is also important to protect your household if you become sick, injured or die.

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Solution 5:

Using insurance to provide a more equitable estate
You may want to pass your business to certain beneficiaries, but still want all of your beneficiaries to share in the value of your estate. We explain how insurance can help.

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These strategies are examples of how insurance can help you plan for and protect your small business. There may be a number of additional or alternative strategies that you can use to protect your business against potential risks. You should discuss your options with your financial, legal and professional tax adviser.

The information provided in this booklet is a brief overview only, is general in nature and does not take into account your personal circumstances.

Insurance policies explained

In this booklet we use certain terms which describe some of the different types of life insurance policies available within BT Protection Plans. A brief explanation of these is provided below.

Type of policy	What does it pay	What the benefit could be used for
Lump sum benefits		
Term Life	Pays a lump sum in the event of the death of an Insured Person or if the Insured Person is diagnosed with a terminal illness.	– Protect your business in the event of death of the owner.
Total and Permanent Disablement (TPD)	Pays a lump sum in the event that the Insured Person is, depending on the TPD definition selected, unlikely to work again or suffers a loss of ability due to a permanent disability.	– Protect your business in the event that the owner permanently exits the business due to total and permanent disablement.
Living insurance	Pays a lump sum in the event the Insured Person suffers from a specified medical event such as cancer, a heart attack or stroke. This type of insurance is sometimes referred to as trauma or critical illness insurance.	– Protect your business in the event that the owner is unable to work due to a specified medical event.
Monthly benefits		
Income Protection	Pays a monthly benefit to replace a portion of the Insured Person's monthly earnings if they're unable to work due to sickness or injury.	– Cover your expenses while you're unable to work. – Pay for medical expenses. – Provide financial support for day to day living costs such as rent or mortgage repayments. – Provide for yourself and your family's financial needs such as your children's education.
Business Overheads	Pays a monthly benefit if the Insured Person is unable to work due to sickness or injury, to help keep their business running.	– Cover day to day business expenses such as rent, utility bills or insurance premiums. – Keep your business running if you cannot work.

Note: Cover under BT Protection Plans is subject to limits and exclusions. You should refer to the BT Protection Plans Product Disclosure Statement (PDS) for the full terms and conditions which apply to each type of policy. The PDS is available from your financial adviser, by calling 1300 553 764, or by visiting our website bt.com.au.

1. Protecting your business assets

At some point, many businesses will borrow money from a financial institution or a director – this may be to provide a business with capital for a major purchase or improvement, or simply to provide a source of working capital.

Such loans could include:

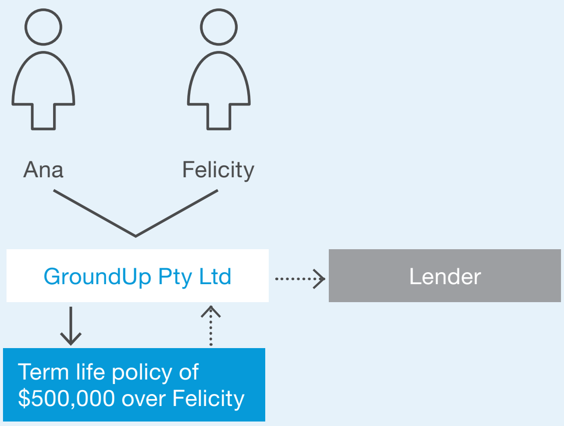
- a business overdraft
- a secured loan from a bank
- a loan from a Director.

On the death or permanent disability of a key person, a business could experience financial difficulty and may find it hard to continue meeting all of its loan repayments – a default on loan repayments could result in a demand for a loan to be repaid in full. Alternatively, the lender may call in a loan if the key person was a guarantor, or was specified in the loan agreement. Such events could force a business to sell some of its assets in order to repay the loan at short notice.

Insurance in action – Hypothetical Example[1]

Protecting your own interests

Ana and Felicity are owners of GroundUp, a popular city cafe.
The business has recently borrowed $500,000 to purchase another cafe as part of its expansion plans and Felicity is guarantor for the loan. GroundUp establishes a term life policy providing $500,000 cover. The company owns the policy and Felicity is the life insured. A number of years later, Felicity dies and the lender requires the loan to be repaid.



Outcome

The proceeds from the life insurance policy allow GroundUp to repay the loan immediately, without having to sell the new property or any other significant assets.

1 This scenario is hypothetical only and is not based on any real life scenario. It demonstrates how BT Protection Plans may be able to aid you in times of need. Your financial adviser will be able to assist you in determining the appropriate cover for you.

How much insurance will you need?

The amount of insurance you need will depend on both your requirements, and the requirements of the lender. When you take out a loan through your business, it is important to understand the terms and conditions of the loan contract. For example, the lender may require a personal guarantee, and on the death of this guarantor (if there is no substitute), the loan may need to be repaid in full.

You will also need to consider the ability of the business to continue servicing the loan on the death or permanent disability of a key person.

You can generally choose to cover either the whole loan facility amount, or only the amount of the facility drawn down. It is important to note however that the availability of insurance cover will be dependent on the level of the debt, and the credit rating of those debts.

Finally, Capital Gains Tax (CGT)[2] may be payable on the insurance proceeds (see below). In these circumstances you may want to consider increasing your insurance policy to allow your business to pay this tax liability.

Insurance in action – Hypothetical Example[1]

Protecting your own interests

Bob and Judy have spent the last 40 years on their cattle farm. They would like to take a step back from the day-to-day running of the business and fulfil their life-long dream of travelling through the south of France for 6 months.

The business has enjoyed much success over the years, but has progressed to a point where market share and growth has stabilised. They have decided to hand over the management of the business to their son, Patrick, whilst retaining ownership of all the farm's assets and loans. Patrick has recently developed relationships with contacts in Europe and America, who supply Wagyu beef to their local market, and he would like to explore this as a potential target market.

Due to some land acquisitions over recent years and the purchase of new equipment, Bob and Judy have a total of $1.5 million in outstanding loans. Their bank has required Patrick to provide a personal guarantee for these loans.

To ensure that they can repay the loans should Patrick die or become permanently disabled, Bob and Judy establish a life and TPD policy over Patrick for $1.5 million.

Outcome

Bob and Judy can travel overseas, with the peace-of-mind that comes with appropriate financial protection. If Patrick died or became permanently disabled, Bob and Judy would be emotionally devastated. However, the financial impact would be minimised. Rather than selling farm assets, the proceeds from the insurance claim could be used to satisfy outstanding loans.

Important points

- Where the purpose of the insurance is to protect the capital of the business, such as to pay out an outstanding loan, the premiums will generally not be tax deductible and the proceeds will not be treated as assessable income, although CGT may apply to the proceeds.
- Under this strategy, CGT will generally apply on Total and Permanent Disablement and Living insurance proceeds paid to a business entity, such as a company. You should always speak to your financial adviser and accountant about the tax treatment and structuring of insurance policies.
- Generally the owner of an insurance policy for asset protection purposes is the business entity, however it may be the insured person. If this is the case, there may be tax implications. The ownership of the policy and payment of premiums can be complex and you should always seek professional tax advice.
- If you need to insure the same person for a different purpose, eg revenue protection (see strategies 1 and 2), for simplicity and clarity, you could consider establishing a separate policy for each purpose – the premiums for revenue protection policies are generally tax deductible.

Depending on the type of your policy, you may be able to increase the sum insured if your loan increases, without further underwriting – speak to your financial adviser for more information.

Note: The individual situation of policy owners may differ and you should seek independent professional tax advice on the strategy.

1 This scenario is hypothetical only and is not based on any real life scenario. It demonstrates how BT Protection Plans may be able to aid you in times of need. Your financial adviser will be able to assist you in determining the appropriate cover for you.

2. Capital Gains Tax may differ depending on how your policy is structured. You should always seek professional tax advice.

2. Ensuring your business can continue to pay its fixed expenses

As a business owner, you may be concerned about your business being able to continue to pay its fixed expenses if you or one of the other business owners becomes sick or injured.

Business Overheads cover pays a monthly benefit for the day to day costs of running a business for up to 12 months if the insured person is disabled because of sickness or injury and is unable to work in the business at their full capacity. It could mean the difference between the business surviving or collapsing.

A Business Overheads policy can help you to pay certain business expenses, such as:[1]

- accountants' and auditors' fees
- advertising costs
- cleaning, electricity, gas, heating, laundry, telephone and water
- leasing costs of equipment and vehicles
- mortgage interest payments
- property rates and taxes
- rent
- salaries of non income producing employees
- subscriptions to professional bodies and publications
- net costs of employing a locum after the insured person becomes totally disabled.

Important points

- Insurance policies to cover business overheads are generally owned by the business entity, sole trader or partners (in the case of a partnership).
- The premiums for business overheads policies are generally tax deductible, and the proceeds treated as assessable income.

Note: The individual situation of policy owners may differ and you should seek independent professional tax advice on the strategy.

Insurance in action – Hypothetical Example[2]

Ensuring your business stays afloat

David has 15 years of experience as an architect, and decided 18 months ago that he would start his own company. During the following 12 months, he acquired the necessary funding from the bank, researched where his office space should be, arranged a long-term commercial lease, purchased computers and other office equipment, recruited an office manager, set up accounting and banking systems, and advertised in a number of real estate magazines. All this hard work paid off, as David was able to open the doors six months ago.

Unfortunately, David was subsequently involved in a serious car accident where he broke his right collar bone and arm, rendering him unable to work.

His duties within the business were the hands on production of drawings and documents for construction plans, physical site inspections and driving to councils, sites and clients.

Following David's injury, the income that his business received reduced dramatically, but the expenses continued. Fortunately his business was able to survive as David was able to claim on his Business Overheads Policy.

Outcome

The proceeds from David's claim helped him to pay for a locum architect to keep things running whilst he recovered. His clients continued to be serviced through his company, maintaining his professional status.

1. Please refer to the the BT Protection Plans Product Disclosure Statement (PDS) for the full list of allowable business expenses.
2. This scenario is hypothetical only and is not based on any real life scenario. It demonstrates how BT Protection Plans may be able to aid you in times of need. Your financial adviser will be able to assist you in determining the appropriate cover for you.

3. Protection for transfers of ownership

You may share the ownership of your business with one or more people – if you do, it may be important to consider what would happen to the ownership of the business if one of the owners died, became disabled or had to exit.

Business owners will sometimes establish a legal agreement, such as a Buy-Sell agreement in order to provide more certainty if this happens.[1]

A Buy-Sell agreement is a document which commonly sets out the wishes of the business owners should one of them die, become incapacitated or trigger any one of a range of specified events. It can be drafted in a number of ways to suit your circumstances, and those of your business. For example, if your business partner dies, a Buy-Sell agreement can be structured to give you the legal right to buy their share of the business, for a specified amount. The agreement could also give you (or your beneficiaries) the right to sell your share of the business to the other business owner(s), should one of these events happen to you. The purchase can be funded by life insurance policies, taken out on the lives of each owner.

A Buy-Sell agreement, coupled with an insurance policy, can be useful for a number of reasons:

- If an owner dies, you may not want to work with their spouse or partner, but you may have no choice if he or she inherits the deceased owner's share of the business and wants to manage the business with you.
- Alternatively you may want to buy that owner's share of the business on their death or disablement, but may not be able to afford it. The spouse may then sell the business share to a third party who you may not want to work with either.
- The agreement can also set out a business valuation, helping you to avoid arguments about the value of the exiting owner's share.
- The insurance policy can be structured so it provides the funding that allows the surviving owner(s) to purchase the exiting owner's share and retain 100% ownership of the business.

Note: It is important to understand all of the implications of entering into a Buy-Sell agreement, including that the agreement may compel you, or your estate, to sell your share of the business. You should always seek professional legal and tax advice.

Who owns the insurance policy?

The insurance policy under a Buy-Sell agreement can be owned in a number of ways. Below is a brief description of the most common ownership methods.

Self Ownership

Self ownership involves each owner holding an insurance policy over their own life – the premium expense can either be shared, or each owner can pay their own premium. When an owner dies or becomes disabled, the Buy-Sell agreement can be structured so as to reduce the amount that the surviving owner must pay to acquire the departing owner's share, by the insurance proceeds paid from the departing owner's policy. This helps the surviving owner to afford the purchase of the departing owner's share – the transaction will be partially or wholly funded by the insurance policy.

Cross Ownership

Cross ownership involves the business owners holding an insurance policy over each other's lives. The Buy-Sell agreement can be structured so that the insurance proceeds are used to help fund the transfer of business ownership. This structure is not as common as self ownership because Capital Gains Tax (CGT) is generally payable on any Total and Permanent Disablement or Living insurance proceeds, unless the owners are defined relatives (see Taxation section)

1. Other legal agreements, such as a Partnership Agreement may also deal with a transfer of business equity on the departure of a business owner, however many do not include a valuation of the business.

Superannuation Ownership

Under superannuation ownership the life insurance policy is held through a superannuation fund.

Funding a superannuation-owned policy can potentially be tax effective but it can also create complexity, due to limits on contributions and restrictions on payments. There may also be tax consequences at the time of claim, especially where death benefits are paid to non-dependant beneficiaries such as adult children.

If buy/sell insurance is being considered inside an SMSF, a private ruling should be obtained from the ATO prior to implementation.

Company Ownership

Under this ownership structure, CGT is generally payable by the company on the proceeds from TPD or Living insurance policies.

When the insurance policy is owned by a company, the proceeds from a death, TPD or Living insurance claim may be used by the company to buy back the departing owner's shares. The result is that the remaining owners will hold a greater percentage of equity in the business without actually purchasing additional shares. This may create a greater tax liability upon the eventual sale of their existing shares.

Trust Ownership

As an alternative to the above options, the insurance policy could be owned through a discretionary trust. The trustee will then distribute any insurance proceeds in accordance with the trust deed. Trust-owned insurance proceeds will be taxed in the same manner as proceeds of directly-owned policies. Trust-ownership may be useful when policies for other purposes are owned in the same trust, or where proceeds from a single policy are to be used for multiple purposes. Trust ownership is complex and therefore professional taxation and legal advice is essential.

Legal and taxation advice is critical when deciding on ownership as each structure will have different tax, stamp duty and legal implications.

Insurance in action – Hypothetical Example[1]

Protecting transfers of ownership

Jen and Laura are co-owners of Lilies, a thriving florist business located in the CBD of Melbourne. They have been operating the business for a number of years and work very well together, each complementing the other's unique talents. They have recently started a new initiative, where they offer a 'bouquet of the day' based on the flowers available each morning at the flower markets. This is provided at a reduced price in comparison to a bespoke floral arrangement, and can be purchased online with ease, and delivered anywhere in Melbourne in less than two hours.

Jen and Laura can see that the business will continue to grow in the years to come, and want to ensure that if either of them were to die or become disabled, they would like to have the option of purchasing the other's share of the business, however neither would be able to afford to do this at short notice.

Whilst Jen is single and has no dependants, Laura has a husband, Leo and two children. If Laura died, all of her assets would pass to Leo under her will, including her share of Lilies. Jen is deeply concerned about this. Leo works as an IT consultant and has no experience in running a business, let alone a florist. In addition, Jen and Leo have very different personality types and do not have a great deal in common.

First, their adviser arranges for the business to be valued by an independent valuer – and a business value of $1.2 million is established – Laura and Jen each own 50%. Next, their adviser recommends that Laura and Jen each establish a life and TPD insurance policy of $600,000 – this is to ensure that each will have enough money to purchase the other's share of the business. Finally, their lawyer drafts a Buy-Sell agreement, giving both Jen and Laura the right to purchase the other's share of Lilies should a 'trigger' event, such as death or disability occur.

The diagram above illustrates what happens under this particular Buy-Sell agreement if Laura dies.

The Buy-Sell agreement will give Jen the right to acquire Laura's share of Lilies. The purchase by Jen, of Laura's share of the business could be funded by the proceeds from Laura's insurance policy.

Outcome

In the event that Laura dies, Jen would acquire full ownership of the business, avoiding a potentially disastrous business relationship with Leo. At the same time, Leo receives fair compensation for the business share, which he uses to pay down his mortgage. This allows his to reduce his working hours and focus on his children.

1. This scenario is hypothetical only and is not based on any real life scenario. It demonstrates how BT Protection Plans may be able to aid you in times of need. Your financial adviser will be able to assist you in determining the appropriate cover for you.

Who pays the premiums?

Generally speaking, the person or entity that owns the insurance policy will pay the premiums, though in some cases the owner and payer will be different. Advice is essential in this area, especially for complex business structures involving multiple entities.

An issue that may need to be considered is how the cost of premiums is allocated where the business owners differ in age and health. Because these factors can affect the cost of insurance premiums, one owner may need to pay significantly more than the other owner, for the same amount of insurance cover.

Example:

Let's revisit Laura and Jen from the previous case study. Due to Laura's age, her premiums are 20% higher than Jen's. Laura and Jen have a number of options for payment, including:

- sharing the cost of the total premiums, and
- each paying their own premium amount.

Advice is critical in this area and you should discuss these options with your financial adviser and professional tax adviser.

Valuing your business

If you were to sell your business today, what price would you ask for it? If you were to buy your business partner's share of the business, how much would you pay?

Valuing your business is an essential part of business succession planning. A proper valuation can reduce the likelihood of potentially awkward or unfair negotiations on price, or even disputes with an exiting business partner or their beneficiaries.

A proper valuation can also give the parties to the agreement, and their beneficiaries, much greater clarity about what their interest in the business is worth and how much they would need to pay to purchase an outgoing owner's share.

Below are two examples of different valuation methods:

- An independent valuation performed by an accountant or qualified valuer – the method used can differ depending on the type of business and also its maturity. For example, a business that has just started will normally be valued in a different way to a business that has been trading for a number of years.
- Agreed value – the business owners agree on a valuation between themselves. For example, you may have a good idea about how much your business is worth, and agree with your business partner on a fixed price you will pay for their share if they exit the business. However, care should be taken with this approach to ensure that the valuation can be commercially justified. Without a proper independent valuation, arguments can still arise between you and the beneficiaries of your business partner.

It is generally a good idea to update the valuation each year, or when the circumstances of the business change. A regularly updated valuation may reduce the risk of disagreements and help enable a smooth transfer.

It is also important that you see your financial adviser regularly, as changes in the valuation of the business will normally require a corresponding change to the amount of cover in your insurance policies. Without this adjustment, there can be a gap between the value of the business to be transferred and the amount of insurance cover to pay for it.

The importance of advice

Strategies to transfer business ownership can be complex and the needs of each business and its owners will be different. It is important that you seek taxation and legal advice from a professional tax adviser and suitably qualified lawyer in relation to your specific needs.

Buy-Sell arrangements can be structured in many different ways and you should always seek advice to ensure the rights and obligations contained in a Buy-Sell agreement reflect the wishes of the parties.

4. Protecting your household

If you own a business, the chances are that it provides you with an income to meet your personal living expenses. If you are unable to work because of sickness or injury, this income could be significantly affected.

While Business Overheads (see strategies 2 and 4), can help protect the income and overheads of your business respectively for up to 12 months, you may still need to protect your personal income (ie the income that the business pays to you).

In addition, you may need to protect your family's lifestyle if you die, suffer from a permanent disability, or critical illness.

Protecting your household income

Income protection is designed to help you avoid the financial stress of selling your assets or taking on more debt if something unexpected were to happen. These payments are designed to replace part or all of your regular pay.

An income protection policy can help you protect your income for a specific period or until a certain age (the maximum age will depend on your occupation and the policy type).

If you are a sole trader, a partner in a business, or an employee of your own company or trust, the amount of income we will allow you to insure is generally based on the following (as a proportion of your share in the business):

- total income generated from the business, less
- expenses incurred in generating that income, plus
- expenses that can be added back.

Examples of expenses that can be added back include:

- your salary,
- personal superannuation contributions (for you and your non-income producing spouse),
- a percentage of motor vehicle lease and expenses,
- director's fees (to the extent that they relate to you),
- depreciation (subject to limits)
- donations, and
- salary for a non-income producing spouse.

You may be able to insure up to 80%[1] of your income, depending on the policy type.

In certain circumstances the business may continue to generate some income for you even though you may no longer be able to work. In assessing your insurable income in these circumstances, consideration will be given to items such as dividends, salary, wages and profit participation.

1. BT Protection Plans Superannuation Contribution Option is an additional option which allows you to insure up to 80% of your income. Without this option, a maximum limit of 75% will normally apply.

Tailoring your policy

There are a number of ways you can tailor your income protection policy, to suit your needs for protection and affordability. Below is a quick guide to some of these choices.

Choosing between agreed value and indemnity: an agreed value policy allows you to protect the level of your income at the time the policy is commenced – this means that if your income fluctuates, and becomes lower than that amount at the time of your claim, you will still be paid the agreed amount. Indemnity policies are generally less expensive, however the benefit paid to you will be limited to a proportion of your income prior to your disability.

Choosing between a standard policy and one with additional benefits: a standard income protection policy will generally cover a percentage of your income and may provide a death benefit if you die whilst receiving a claim. A policy with additional benefits is slightly more expensive, however it can provide extra payments and reimbursements for expenses such as counselling, nursing care, and certain transportation and accommodation costs. BT Protection Plans refer to these policies as Income Protection and Income Protection Plus respectively.

Let's consider a case study of how a BT Income Protection Plus policy can work for a business owner.

Important points

Premiums paid on income protection policies may be tax deductible to the policy owner and the proceeds are generally treated as assessable income.

Holding an income protection policy through superannuation may potentially help your cash flow, as the premiums are paid from your superannuation account balance. However you need to be aware that you will not receive the benefit of claiming the policy premiums as a personal tax deduction.

In addition, some income protection policies that offer a more comprehensive range of benefits, may not be able to be held wholly inside super. If an extensive income protection is required, consideration can be given to owning a portion of cover inside super, and a portion of cover outside super.

The individual situation of policy owners may differ and you should seek independent professional tax advice on any strategy.

Insurance in action – Hypothetical Example[2]

Protecting your personal income

Stephen runs his own plumbing business through his company, Clean Pipe Pty Ltd. The promise that he makes to his clients is that someone in his team will be on-site within two hours, seven days a week, 365 days a year; if a problem arises.

He is currently servicing residential properties, but is looking into whether he can secure commercial property contracts. This would require expansion of the company with recruitment of additional employees. The challenge is to ensure that the culture of the company remains intact, and that the service promise to clients can be maintained.

Based on the earnings of the business, he is able to obtain cover of $20,000 per month in an Income Protection Plus policy. Five years later Stephen suffers a severe back injury in a car accident on his way to work and is unable to work for three years. At the time of the accident, his insurable income has fallen to $16,000 per month. He is eligible to claim against the policy as he satisfies all of the policy terms and conditions.

As his policy is 'agreed value', he receives a monthly benefit payment of $20,000, following the end of the waiting period. As Stephen has an Income Protection Plus policy, the Nursing Care Benefit is also payable for the period of his hospitalisation during the waiting period.

Outcome

Stephen and his family can continue to meet their personal living expenses during his time off work.

1. This scenario is hypothetical only and is not based on any real life scenario. It demonstrates how BT Protection Plans may be able to aid you in times of need. Your financial adviser will be able to assist you in determining the appropriate cover for you.

Protecting your family's lifestyle

Cover for critical illness
Trauma (also known as Living) claim proceeds may be used to pay for medical expenses, provide the flexibility to take time off work, or allow you to re-evaluate your future working life through full or partial repayment of existing debt. A payment may be made on the diagnosis or occurrence of a specified medical event such as cancer, heart attack, stroke or coronary artery bypass surgery. Your inability to work has no bearing on whether you will qualify for a Trauma payment.

Cover for permanent disability
The purpose of total and permanent disability (TPD) cover may be to extinguish your personal debt, provide for lost future income and pay for mobility aids or home modifications. Occupation-based TPD policy proceeds will generally be paid if you are no longer able to work on a permanent basis.

There are two main types of TPD insurance – 'own occupation' and 'any occupation'. An own occupation TPD policy definition is more generous than an any occupation definition. However, own occupation TPD premiums are approximately 50% more expensive.

Cover for terminal illness or death
The purpose of Term Life proceeds may be similar to the purpose of TPD cover, but instead of home modifications and mobility aids, final expenses such as funeral costs may be included in the sum insured. Cover may also be for palliative care and life-extending drugs, or discretionary items such as a family holiday, in the case of terminal illness.

Let's consider a case study of how a BT Term Life, TPD and Living policies can work for a business owner to cover their personal needs.

Insurance in action – Hypothetical Example[1]

Protecting your personal needs

Barbara, age 46, owns a house in Erskineville, Sydney. She has one child Nancy, age 18, from a previous marriage. Her new partner Rodney, age 45, is a freelance writer who has been living with Barbara and Nancy for two years.

Barbara works as a marketing manager for a chain of homeware stores but wants to start her own business – "Namaste Candles", making and selling a range of natural organic candles. Her goal is to enable distribution to anywhere in Australia, and eventually anywhere overseas. Barbara would like to borrow to establish her business, rent a factory, purchase equipment and ingredients, and hire one employee; however she is still in the process of sourcing funding.

Barbara has completed a "how to run your own small business" course and has completed extensive market research on her business idea. She has constructed a three-year business plan to establish and grow her business, and has identified potential buyers through her existing network from her current role.

She currently earns $100,000 pa from her marketing role and has no plans to resign from this role in the near future. Barbara has an income protection policy in place, but no other type of protection to ensure that herself/Nancy can continue their current lifestyle, should Barbara die, become permanently disabled or suffer from a critical illness.

Barbara is highly independent and financially disciplined and wants to remain so. She has paid off most of her mortgage over the last eight years, with only $150,000 remaining.

After speaking to a financial adviser, Barbara takes out a Term Life and TPD policy that provides cover of $400,000 to extinguish the remaining mortgage, allow for either home modifications and mobility aids, or final expenses, and tertiary education costs for Nancy.
In addition, Barbara commences a Trauma policy that provides cover of $200,000 to reduce her mortgage, pay for medical expenses, and allow Rodney to take some time off work to provide emotional and physical support.

Outcome

Even though Barbara has not yet established her business, and therefore does not have any business loans or revenue (and therefore business insurance is not required), her personal protection needs have been addressed. This will ensure that if something happened to Barbara, Nancy can continue to live in the house that she grew up in, and afford to attend university.

5. Using insurance to provide a more equitable estate

As a business owner, you may want to pass your business to a particular beneficiary, but also treat your other beneficiaries equitably.

Passing a business to the next generation can be tricky – for example, you may have a number of children but only one or two of them may want to take the business on. This is a common scenario, which often creates problems, as the business can be worth considerably more that the rest of the estate.

Without a well considered estate equalisation strategy, a number of poor outcomes could occur, such as:

- The children who are not inheriting the business could be left with a much smaller share of the estate, potentially causing family disputes.
- The business may need to be sold in order to distribute the estate evenly.

Estate equalisation is a strategy which aims to provide your beneficiaries with a more equitable distribution of assets.

One way to achieve this is to establish a life insurance policy over your own life, and the insurance proceeds can be used to make your estate more equitable upon your death.

For example, your will may be set up such that your business may pass to your intended beneficiaries, while your remaining beneficiaries receive the proceeds of your life insurance policy.

Estate planning advice from a suitably qualified lawyer is essential with this strategy. You should also seek professional tax advice to determine the net value of your estate, taking into account any Capital Gains Tax (CGT) payable on your assets.

Your financial adviser can help you determine the amount of insurance you should hold, and review your cover over time.

Insurance in action – Hypothetical Example[1]

Protecting your estate

Matthew is a wheat farmer in Western Australia who is approaching retirement. He has three children, with his son Terence taking care of the day-to-day management of the farm.

Matthew has decided to leave the farm wholly to Terence as his two daughters – Annette and Muriel, have both married and moved to the city. However, Matthew would still like Annette and Muriel to receive a substantial amount from his estate.

The current value of the farm is $1.5 million and Matthew has no other significant assets. This means that if Matthew died today and the farm was sold, all three children would receive an inheritance of approximately $500,000 (assuming no CGT).

With the help of his financial adviser, Matthew establishes a life insurance policy for a total of $1 million, for the equal benefit of Annette and Muriel.

Outcome

If Matthew died today, Annette and Muriel would each inherit $500,000; an amount similar to the value of their inheritance had the farm been sold or evenly split. Terence could continue to run the family farm, with the hope that he can pass it down to his own children when the time comes.

1. This scenario is hypothetical only and is not based on any real life scenario. It demonstrates how BT Protection Plans may be able to aid you in times of need. Your financial adviser will be able to assist you in determining the appropriate cover for you.

Important points

- To ensure the fair distribution of your estate, you should have a proper business valuation done and this should be updated regularly.
- There are a number of options for structuring the insurance policy, eg the beneficiaries could be nominated directly or receive the insurance proceeds through the estate. Alternatively, the intended beneficiaries could own the policy covering the life insured. Your adviser can help you choose the most appropriate ownership option for your circumstances.
- Be aware that when structuring insurance through superannuation, significant tax can apply on superannuation death benefits paid to adult children.

Note: The individual situation of policy owners may differ and you should seek independent professional tax and legal advice on the strategy.

Choosing the right premium structure

There are a number of different ways to structure your insurance premiums depending on your needs, which could lead to considerable cost savings for you and your business. Below is a guide to the premium structures which may be selected.

When paying your insurance premiums, you will generally have a choice of the following premium structures:

- stepped premiums
- level premiums
- a combination of stepped and level premiums.

Stepped premiums

Stepped premiums are generally the least expensive option when you commence your insurance policy, however they generally increase each year as you get older. The increase in the cost reflects the increase (as you age) in the likelihood that you will claim on the policy.

Level premiums

By choosing a level premium structure, you premiums will generally remain the same over time. However, premiums will increase if the sum insured changes, if the policy fee increases, or the underlying assumptions of the insurer change. The insurer's assumptions may change if, for example, the amount of claims made are higher or lower than expected.

Once the specified period of time that level premiums apply ends, the premium reverts to a stepped premium structure. Under BT Protection Plans you can choose when this will occur with the following options:

- age 55 – 'Level 55' premium option
- age 65 – 'Level 65' premium option.

Level premiums may benefit you if you have long-term insurance needs.

Insurance in action – Hypothetical Example[1]

Stuart and James choose a level premium for the insurance taken out as part of their Buy-Sell strategy

Stuart (45) has a successful building business that he has grown over a number of years with his business partner James (43). They put in place a Buy-Sell agreement and each establish life and TPD policies. After considering many factors, they both decide on a 'Level 55' premium structure so that each will have a steady insurance premium until they reach age 55.

By choosing a level premium and paying more in the short term, Stuart and James may be able to save money on their premiums over the longer term. The level premium structure protects them against age related increases in their premiums as they get older, which can be an important part of maintaining a workable Buy-Sell agreement.

1. This scenario is hypothetical only and is not based on any real life scenario. It demonstrates how BT Protection Plans may be able to aid you in times of need. Your financial adviser will be able to assist you in determining the appropriate cover for you.

Buy – Sell

The table below illustrates the taxation treatment that applies when a company, trustee of a trust, or individual owns a policy (and pays the policy premiums[1]) and the purpose of the policy is to facilitate the transfer of ownership on the exit of a business owner.

Policy type	Are the premiums generally tax deductible	Are the proceeds generally assessable as income	Are the proceeds generally subject to Capital Gains Tax
Term Life	No	No	No, unless the recipient is not the original owner of the policy and has acquired the policy for consideration.[2]
Total and Permanent Disablement and Living insurance	No	No	Yes, unless the recipient or beneficiary of a trust is the life insured or a defined relative[3] of the life insured.

Income Policies

The table below illustrates the treatment of Income Protection and Business Overheads, where the purpose of the policy is to replace the income or revenue of the policy owner.

Policy type	Policy structure[1]	Are the premiums generally tax deductible[2]	Are the proceeds generally assessable as income[3]
Income Protection	Owned by the insured as an individual and paid either by the individual or the employer.	Yes	Yes
Business Overheads	Owned by a company, trustee of a trust, sole trader or a partner in a partnership.	Yes	Yes

Note: The taxation information in this guide is based on BT's understanding of legislation current as at 1 July 2019. This may vary according to your individual circumstances and is also subject to change. Our comments are general in nature and you should always seek professional tax advice regarding your own position.

1. Other legal agreements, such as a Partnership Agreement may also deal with a transfer of business equity on the departure of a business owner, however many do not include a valuation of the business.
2. To the extent the income protection policy provides for benefits of a capital nature (non-income replacement benefits) that part of the premium attributable may not be deductible.
3. Benefits considered non-income replacement benefits may also not be considered assessable.

Superannuation owned policies

The following tax treatment applies to policies owned by the trustee of a superannuation fund for the 2019/20 financial year. Note that since 1 July 2014, Living (trauma) insurance and certain types of Total and Permanent Disablement (TPD) policies can no longer be established inside superannuation.

Policy type	Are premiums tax deductible to the superannuation fund	How are the insurance proceeds taxed when paid from the superannuation fund	Are contributions to superannuation deductible
Term Life	Yes	Death benefits paid as a lump sum to a member's dependents[1] are tax-free. Death benefits paid as a lump sum to a non-dependant for tax purposes are taxed as follows (excluding Medicare Levy[2]): **Tax free component:** Tax free **Taxable component (element taxed):** Up to 15% **Taxable component (element untaxed[3]):** Up to 30% Death benefits paid as an income stream[4] are tax-free if either the deceased or beneficiary is aged 60 or over. In all other cases, the taxable component of the income stream payments is taxable at the recipient's marginal rate (less a 15% tax offset), until the recipient turns 60.	Employer contributions – including salary sacrifice and Superannuation Guarantee, are generally tax deductible to the employer. You may be entitled to claim a tax deduction for personal contributions you make to super. **Note:** Employer superannuation contributions and personal contributions to superannuation that are tax deductible will count towards your concessional contributions cap. There are penalties for exceeding the concessional contributions cap. Please refer to the BT Protection Plans PDS for more information.
Total and Permanent Disablement	The deduction available will depend on the type of TPD definition. Certain definitions, such as Own Occupation TPD are generally only partially deductible.	Disability superannuation benefits paid as a lump sum to the insured member may comprise a tax free and taxable component. The tax free component is tax free and the taxable component is taxed as follows (excluding Medicare Levy[2]): **Under preservation age:** Up to 20% **Preservation age to 60:** Tax free up to $210,000 and taxed at up to 15% above $210,000. **60 and above:** Tax free Disability superannuation benefits paid as an income stream to a member 60 or over are tax free. Whilst the member is under 60, the taxable component of the income stream payments is taxable at the recipient's marginal rate (less a 15% tax offset).	
Income Protection	Yes	Income paid to the insured member is generally assessable income for tax purposes.	

1. A dependant for tax purposes includes a spouse (legally married or de facto including same sex) or former spouse, a child under 18, a person who was financially dependent on the deceased and a person with whom the deceased was in an interdependency relationship. The tax treatment that applies to direct payments to beneficiaries will also apply to payments made via a deceased's estate. However, the Medicare Levy does not apply to death benefits paid to an estate.
2. Medicare Levy is 2% of taxable income.
3. The amount of the untaxed element is calculated pursuant to a formula set out under tax legislation.
4. A death benefit can only be paid as an income stream to certain dependants, including a spouse, a child under 18, a financially dependant child between 18 and 25, other financial dependants that are not children, a disabled child and a person who was in an interdependency relationship with the deceased member.

For more information

bt.com.au

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Speak to your financial adviser

Disclaimer

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Case studies and examples provided in this booklet are for illustrative purposes only.

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