

Executive Income Protection Technical Guide

For Adviser use only



About this guide

This guide has been designed for Advisers to provide further technical information on Executive Income Protection and reflects our understanding of current laws and tax rules which can change at any time.

This guide should be read together with the Policy Booklet and Policy Summary.

What is Executive Income Protection?

Whilst a traditional income protection plan is taken out by the life insured on their own life, Executive Income Protection offers clients who run their own businesses the alternative of being able to arrange cover for either themselves or an individual employee through the business.

Clients that run their own businesses can therefore choose between arranging cover through the business on a life of another basis or taking a higher income from the business to help meet the cost of arranging a traditional income protection policy to provide cover of their own.

With Executive Income Protection, the business is the policy holder who is responsible for paying the premiums and the employee is the life insured.

In the event that the life insured becomes incapacitated through illness or injury and is unable to work, benefits are paid to the employer. These are then used by the employer to fund ongoing sick pay through PAYE, subject to the usual deductions for: Income Tax, employee National Insurance, and employee contributions to a workplace pension.

Since benefits will ultimately be subject to Income Tax and National Insurance in the hands of the employee, the proportion of earnings that can be covered is higher than for a personal income protection policy which pays a tax free benefit.

Since the employer will use the benefits to fund the employee's ongoing sick pay, additional cover can also be provided to meet other employer costs that must also be met while continuing to pay the employee. This is chosen at outset at an additional cost and can include cover for:

- Employer National Insurance Contributions and / or
- Employer pension contributions.

How does Executive Income Protection differ from traditional Income Protection?

| | Traditional Income Protection | Executive Income Protection |
|--------------------------|-------------------------------|---|
| Basis of cover | Own life | Put in place by the employer for the employee |
| Taxation of premiums | Funded from taxed income | Funded from gross profit |
| Recipient of the benefit | The life insured | Benefit used by the employer to fund employee sick pay |
| Additional cover | N/A | Available to meet employer costs: Employer N.I. contributions Employer Pension contributions |
| Taxation of benefits | Tax free | No tax for the employer where used in full to fund employee sick pay Subject to income tax and National Insurance contributions in the hands of the employee |

Who can be covered by Executive Income Protection?

The person who is covered by Executive Income Protection must be a UK resident and an employee of a UK-resident business (England, Wales, Scotland and Northern Ireland only).

A UK-resident employee usually includes company directors (on PAYE) and salaried partners. Members of a Limited Liability Partnership (LLP) and sole traders (as owners of their own business) are not eligible to be covered under this type of policy.

A UK-resident business can be a Limited company, a Limited Liability Partnership (LLP), a traditional English partnership, a charity or even a sole trader.

In most cases it will be clear whether a person is employed or self-employed from the way that they are taxed each year on their earnings, however, occasionally it may not be as clear, and specialist advice may be required. Information on HMRC's view on this area can be found at: [hmrc.gov.uk/employment-status/index.htm](https://www.gov.uk/employment-status/index.htm)

What type of business would most benefit from Executive Income Protection?

A recommendation for Executive Income Protection over a small group income protection scheme could be appropriate where a business:

- Does not have a sufficient number of employees to offer a group income protection scheme by providing the alternative of arranging individual Executive Income Protection Plans for individual employees;
- Wants certainty of ongoing premium costs to cover an individual employee that won't be subject to future rate reviews once the policy is put in place by providing individual Executive Income Protection instead;
- Already has group income protection in place for the majority of employees, but wants to use Executive Income Protection to insure a higher level of sick pay for an individual employee or to provide a longer term benefit.

What about IR35?

Contractors who trade through their own company can also arrange Executive Income Protection through their business. If you have clients that operate in this way while providing services to other businesses, changes to IR35 that come into effect from April 2021 will limit their ability to engage on this basis with other businesses that have met two or more of the following criteria:

- Have an annual turnover of more than £10.2 million
- Have a balance sheet total of more than £5.1 million
- Employs 50 employees or more

For further information please refer to the following website:

<https://www.gov.uk/guidance/april-2020-changes-to-off-payroll-working-for-clients>

How should cover be arranged?

Executive Income Protection is arranged to the employee's normal retirement age, which is typically between age 50 and 70. When selecting the deferred period, you will need to think about how long the business can continue to pay ongoing sick pay to their employee from existing business revenues and profit retained within the business.

Careful consideration also needs to be given to how long the business is prepared to provide ongoing sick pay. Is the business happy and able to pay for a benefit that potentially might need to be paid for the remaining duration of the policy or does it plan to limit to payments to a maximum of one or two years?

What types of earnings can Legal & General take into account?

In providing Executive Income Protection, we can take the following earnings into account:

- Annual Salary including Salary, Over Time, Bonuses, and P11D Benefits
- Dividends which will cease in the event of the employee's incapacity
- Spouse/Registered Civil Partner earnings and dividends which will cease in the event of the employee's incapacity (where the spouse or Registered Civil Partner does not have cover of their own)

How much cover can be requested with Legal & General?

We will cover up to 80% of the employees' earnings subject to a maximum benefit of £300,000 per annum (£25,000 per month). Where indexation is required, the maximum cover for Increasing Executive Income Protection is £210,000 at outset of the policy. Additional Cover can also be arranged at outset of the policy at an additional cost for the following:

- Employer pension contributions which is the lower of an average of the previous three year's contributions prior to incapacity, one third of earnings, or a maximum of £40,000.
- National Insurance contributions payable by the employer when using the benefit to fund employee sick pay subject to a maximum of £42,500.

How do Executive Income Protection and Income Protection Benefit from Legal & General compare?

| | Income Protection Benefit* | Executive Income Protection |
|---|---|---|
| Basis | Own Life | Life of another |
| Definition of Incapacity | Own Occupation | Own Occupation |
| Houseperson Cover | Yes – Subject to ADL definition | No |
| Requirement to be registered with UK GP | Two years | Two Years |
| Premiums | Level Costed/Guaranteed | Level Costed/Guaranteed |
| How long will benefit be paid? | For duration of a valid claim | For duration of a valid claim |
| Low cost / Limited Benefit Period | One or Two year low cost | One or Two year limited benefit period |
| Deferred Period | 4, 8, 13, 26, and 52 wks | 4, 8, 13, 26, and 52 wks |
| Stepped Benefit | Yes | No |
| Definition of earnings | Earnings and dividends | Earnings and dividends Spouse’s earnings and dividends |
| Maximum Age (at end of policy) | 70 (65 for driving based occupations and 50 for fitness instructors/dance teachers) | 70 (65 for driving based occupations and 50 for fitness instructors/dance teachers) |
| Benefit Formula | 60% first £60,000; 50% thereafter | 80% of earnings |
| Maximum Benefits at the start of the policy | £240,000 per year (£20,000) per month £168,000 per year (£14,000) per month for increasing Houseperson £20,000 per year (£1,666.67) per month | £300,000 per year (£25,000) per month £210,000 per year (£17,500) per month for increasing |
| Additional Cover | N/A | Employer pension contributions max £40,000 Employer NI contributions max £42,500 |
| Increasing cover option | Yes | Yes |
| Proportionate Benefit | Yes | Yes |
| Income Guarantee | £1,500 £3,000 for NHS Dentists, Doctors, Midwives, Nurses or Surgeons | N/A |
| Linked Claims | 52 weeks | 52 weeks |
| Changing Your Policy (GIO) | Yes | Yes |
| Continuation Cover | No | Yes |
| Death Benefit | 12 x monthly premium | No |
| Rehabilitation Benefit | Yes | Yes |
| Waiver of Premium | Yes | Yes |

* The monthly benefit we pay out under an Income Protection Benefit plan may affect your client’s claim to benefits paid out under other income protection policies.

Taxation:

The premiums that the employer pays should not be treated as a P11D expense for the employee.

If the employee doesn't have a financial interest in the business and premiums are expended 'wholly and exclusively' for the purposes of the business, premiums should qualify as a business expense. However, you will need to confirm with Her Majesty's Revenue and Customs (HMRC) if this is also the case for employees who have a financial interest in the business.

In the event of a claim, the benefit will be treated as a trading receipt. However, it will also be treated as a trading expense when it is used to fund sick pay for the employee resulting in a neutral tax position.

The benefit should be passed on to the employee through PAYE after deduction for Income Tax and National Insurance. The business will also need to pay employer's National Insurance and meet any ongoing pension contributions payable in respect of the employee's salary. Additional Cover can be arranged under this policy to address these costs.

What should I consider when deciding which is best for my client?

The example on the next page compares the cost of providing Executive Income Protection through the business with the alternative of increasing the employee's salary so that they can arrange personal income protection of their own. The example assumes that the employee has gross annual earnings of £100,000.

Executive Income Protection can be used to insure a higher proportion of the individual's earnings which will be subject to income tax and national insurance contributions. Once this is taken into account it offers a comparable level of net benefit to a personal income protection product.

Executive Income Protection also allows the employer to insure any ongoing premiums that they will continue to make while paying sick pay to the employee which in this example is an extra £8,000 of benefit.

Premiums for Executive Income Protection will be more given the higher level of benefits that are involved. However, in this example the reduction in net profit for the business when paying for Executive Income Protection (including cover for employer pension contributions) is slightly less than the additional gross earnings that would otherwise be needed to fund the cost of Income Protection Benefit after Income tax and National Insurance is deducted.

Example:

| | Executive Income Protection | Income Protection Benefit |
|--|--|---------------------------|
| Benefits: | | |
| Maximum Benefit Based on L&G IP cover | £80,000 | £56,000 |
| Additional Cover for employer NI | £9,827.26 | N/A |
| Additional Cover for employer pension contributions (10% employer contribution) | £8,000 | N/A |
| Net Benefit to the employee | £55,043 | £56,000 |
| Benefit including employer pension contributions | £63,043 | N/A |
| Paying for cover: | | |
| Premiums paid by | The employer | The employee |
| Annual Premium* | £1,777 | £1,029 |
| Cost to the employee | | |
| 40% Marginal Income Tax Rate | N/A | £709.66 |
| 2% Marginal N.I Rate | | £35.48 |
| Gross cost to the individual | | £1,774.14 |
| Cost to the employer | | |
| Annual Premium | £1,777 | £1,774.14 |
| Employer NI | N/A | £244.83 |
| Total gross cost | £1,777 | £2,018.97 |
| Less Corporation Tax (19%) | £337.63 | £383.60 |
| Adjusted total cost | £1,439.37 | £1,635.37 |
| Annual saving | £196 a year, calculated as £1,635.37 (additional cost to the business to help fund personal cover) minus £1,439.37 reduction in net profit | |
| Additional Annual Benefit | £7,043 | |
| | Calculated as: £63,043 – £56,000 | |

* Example put together for a male, age next birthday 35.5, retiring at age 60, annual gross earnings of £100,000 occupation class 1, non-smoker, 8 week deferred period, providing own occupation cover. Tax information correct for the 2020/2021 tax year. Premiums correct as at June 2020.

Continuation Cover

What happens if the employee leaves their employer's business?

If the life insured is moving employers, the policyholder can transfer the policy to the new employer who will then be required to take over the payment of premiums ensuring there is no break in premiums. This option must be used before the life insured's 50th birthday, and up to 90 days after they leave their employment.

Disclaimer

This information represents a guide to Legal & General's current understanding of how the law and HM Revenue & Customs' practice might apply. We do not accept responsibility for any losses arising from actions or inactions taken as a result of this information. Please be aware that the law and HM Revenue & Customs' practice may be subject to change from time to time.