Life Assurance Online

Consumer Guide

To

Income Protection Insurance

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INTRODUCTION

This booklet is intended as a general guide to income protection insurance to help you understand how the plans work and what the limits and options are.

It covers in outline the different types of plans available for the self employed, employed and those available to a business. The final sections deal with the tax implications and a glossary of terms.

The guide is not intended to give financial advice under the Financial Services and Markets Act 2000 or the rules and regulations of the Financial Services Authority. If you are in any doubt you should seek professional advice from an Independent Financial Adviser.

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This guide is intended only for the use of UK residents and British expats. We hope you find it useful. For further information and a quotation please go back to our web site at http://www.lifeassuranceonline.co.uk

PROTECTING YOUR INCOME

Income protection plans are available for the self employed, employed and for a company wishing to provide income protection for employees.

How the plans work

An income protection plan is designed to provide you with a source of income if you are unable to work due to illness or disability. The amount insured is normally paid by the insurance company on a monthly basis after one month from the end of the deferred period subject to certain limits.

On individual plans while monthly payments are being made the premium does not have to be paid. When you recover from your illness and are able to return to work monthly payments cease and premiums must be paid again.

The plan is set up to run for a period of years or to a future age and can cover you up to your planned retirement date. On individual plans the insurance can be set up to cover you for your own occupation or any occupation.

If you are covered for your own occupation the insurance company will not require you to seek other employment. If it is set up for any occupation you could be asked to find work which you are capable of doing but which is not your normal occupation.

The underwriting is fairly strict for this type of insurance and will take in to account your health, medical history, occupation, pastimes, sex, whether you smoke, term of years and the options you have chosen.

This type of insurance is also known as Permanent Health Insurance (PHI). This reflects the fact that the insurance company will not cancel the plan irrespective of the number of claims you may have made.

Insurance limits

There is a limit to the amount of income that can be insured. The limit will depend on your employment status and the type of arrangement you have.

On individual plans for both employed and self employed the limits set by insurance companies is generally in the region of 65% of income at the time of application.

For the self employed it is the gross income in the last 52 weeks prior to incapacity. For employed persons it is gross income plus benefits in kind in the past 52 weeks prior to disability. Director shareholders of close limited companies can also insure part of their dividend income and pension contributions paid by the company.

In the event of a claim the actual amount paid will be based on income at the time of a claim but will not be more than the amount insured. For example, a self employed person insures the maximum income available based on an income of £30,000 pa. Three years later income has fallen to £20,000 pa. A claim at this time will be based on £20,000 income and not £30,000.

It is therefore important that the plan is reviewed regularly to ensure that the income insured is sufficient for your needs but not over-insured.

Other sources of income that take the maximum benefit over the limit allowed, may reduce the amount actually paid in a claim. These could include:

- Ongoing payments from employment such as sick pay or self employment.

- Pension payments unless they were being paid prior to the start of the plan.

- State benefits paid due to incapacity such as incapacity benefit, income support or other means tested benefits.

- Other insurances which provide regular payments or make payments normally due. For example, mortgage payment protection insurance, payments made under another income protection plan and credit repayments.

Types of plans

For both employed and self employed persons individual plans are available. There are also special types of plans for companies wishing to provide income protection for employees.

Director shareholders of close limited companies can decide that the company will provide income protection arrangements for them including selected employees. In this case the company makes the application and in the event of a claim the insurance company will pay the income to the company.

The company then passes the income to the director shareholder through the normal PAYE system. This income is treated as earned income and taxed in the normal way.

Options

There are a number of options available on individual plans and the more common ones are listed below:

- The amount insured at the time of application can be set to a level amount or increasing each year by a fixed percentage or the retail price index (RPI).

- Some plans allow for further increases in cover. For example up to 30% every 3 years without having to provide further evidence of health, occupation or pastimes.

- For director shareholders the amount insured can include part of regular dividend payments and pension contributions paid by the company.

- The deferred period before payments are made can normally be set to 4, 13, 26 or 52 weeks. The longer the deferred period the lower the cheaper the plan will be.

- Some plans have a career break option which allows the insured to stop full time employment and replace the normal benefit with Housepersons Benefit without further evidence of health or pastimes.

TAX IMPLICATIONS

For individual plans the income is currently (2010/11) paid free of income tax. The premiums paid do not qualify for tax relief.

Where a close limited company takes out cover for an employee the income paid to the company is liable for income tax and national insurance. The premiums paid by the company normally qualify for corporation tax relief and are taxed as a benefit in kind for the employee.

Tax law is subject to change and you should consult professional advice to clarify your position.

GLOSSARY OF TERMS

Deferred Period

This is the period of time that must elapse before a payment is made under a claim. It is chosen at the time of application and is normally 4, 13, 26 or 52 weeks. Payments are normally made one month after the end of the deferred period.

Houseperson Benefit

This is a reduced level of cover where the insured is no longer in employment but engaged in domestic house duties.

Career Break

An option on a plan which allows the insured to take a break in their career yet still be covered at the reduced level of Houseperson Benefit. When the insured returns to employment, normal cover can usually be resumed without further evidence of health provided this is done within a certain period of time.

Benefits in Kind

These are taxable benefits provided by an employer to an employee such as a company car. The value of these benefits can be insured under an income protection plan subject to certain limits.