For adviser use only

Business Protection: Share Protection

Premium Equalisation

As business owners set up Share Protection, they should aim to balance the premium payments among themselves. This process is referred to as premium equalisation.

The benefits of Premium Equalisation

The cost of protection premiums can vary depending on each individual's circumstances.

The premiums are paid by the business, so they count as a taxable remuneration for each director, and the business must report these benefits to HMRC on each individual's P11D form. If the business fails to report these individual P11D benefits, it could face large penalties from HMRC.

If the premiums are not equalised, then they could be treated as a transfer from the business owner who pays the most to the ones who pay the least. If deemed as a gift, this would introduce inheritance tax liability when the shareholder dies.

Without equalisation, HMRC could view the policies as 'gifts' (transfers of value) which could result in inheritance tax liability.

Although HMRC may only check cases occasionally on an ongoing basis, Premium Equalisation and P11D reporting are essential requirements that would be reviewed for any director's protection claims.

To help you, we offer a **Premium Equalisation calculator**, but it's good to know how the calculation works too.

Premium Equalisation in action: Achieving a fair distribution of premiums

Meet the directors of the design consultancy 'Mercury'.

Davis is the original founder, and they have a number of lucrative high-profile clients. They regularly review their business plan, which currently estimates the business's worth at £1million. Share Protection (Life Insurance with Critical Illness Cover to age 60) is being arranged as follows:

Director	Lennon	Davis	Townsend
Age (next birthday)	45	55	35
Share	35%	40%	25%
Sum Assured	£350,000	£400,000	£250,000
Annual Premium*	£421.06	£733.36	£181.09

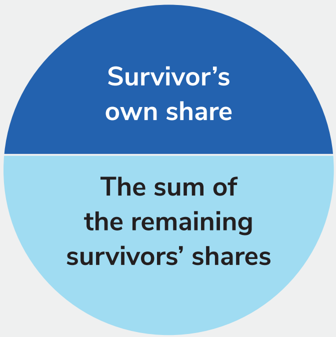
A concern may arise as to why the premiums paid by each director are different. This is because the age of each director is different, and the cost of life and critical illness depends on age. So, the older directors will naturally pay a higher premium than the younger directors.

The older director may also worry that they are less likely to benefit from the arrangement, as they have a higher chance of dying or suffer a critical illness. There could be some element of inequality here, but it could also be argued that the older director could hold the larger share of the business.

To balance the cost of the life and critical illness and to remove the element of surplus, it would be possible to adjust the cost between the directors, ensuring that each director pays for the total cost according to the proportion they expect to benefit from the arrangement.

*Quotes used for demonstration purposes only, based on non-smoker, no waiver, term with reviewable Critical Illness Cover, annual premiums.

To achieve a fair allocation of premiums, the following formula will help to calculate suitable expenses for each director.



Davis owns 40% of the business, Lennon owns 35% and Townsend has 25%. If Davis dies, his share of the business will be divided between Lennon (35/60, 58%) and Townsend (25/60, 42%).

This is shown for all directors in this example:

Director share	Lennon 35%	Davis 40%	Townsend 25%
Lennon dies		40/65 = 62%	25/65 = 38%
Davis dies	35/60 = 58%		25/60 = 42%
Townsend dies	35/75 = 47%	40/75 = 53%	

Lennon pays:

58% of Davis's premium **£425.34**

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47% of Townsend's premium **£85.11**

Total: £510.45

Davis pays:

62% of Lennon's premium **£261.05**

\+

53% of Townsend's premium **£95.97**

Total: £357.02

Townsend pays:

42% of Davis's premium **£308.01**

\+

38% of Lennon's premium **£160.00**

Total: £468.01

Usually, the premiums will be paid from a company account which are also treated as P11D, or part of the shareholders remuneration. The amounts shown could then be deducted from current, capital or loan accounts or, as another option, an individual director's drawings.

Premium equalisation calculator

Our **calculator** can be used to balance the premiums between partners or shareholders. You can share these calculations with your client's accountant so they can adjust any director's P11D benefits, if required. A similar principle may apply to different business types.

Find out more – Speak to your usual L&G contact.

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