

A man with glasses and a black shirt is sitting at a desk, holding a tablet. A woman with dark hair in a ponytail, wearing a white polka-dot shirt, is sitting next to him, looking at the tablet with her hand on her chin. They are in a modern office environment with shelves and plants in the background.

Business Insurance Essentials

Dr Jeffrey Scott | Head of Advice Strategy
July 2020

This presentation is intended for adviser and internal use only and should not be provided to clients or attributed to **MetLife** in any advice provided.

This material is intended to provide general information only and has been prepared without taking into account any particular person's objectives, financial situation or needs ('Circumstances'). Any general information contained within or given during this presentation (whether orally or in writing) does not consider your Circumstances. Nothing in this presentation is intended to be investment, financial advice or a recommendation to invest in a financial product. Before acting on such information, you should consider its appropriateness, taking into account your Circumstances, and read the applicable Product Disclosure Statement (PDS) and obtain professional advice in this regard.

MetLife and its related entities distributing this document and each of their respective directors, officers and agents believe that the information contained in this document is correct and that any estimates, opinions, conclusions or recommendations contained in this document are reasonably held or made as at the time of completion. However no warranty is made as to the accuracy or reliability of any estimates, opinions, conclusions, recommendations (which may change without notice) or other information contained in this document and, to the maximum extent permitted by law, **MetLife** disclaims all liability and responsibility from any direct or indirect loss or damage which may be suffered by any recipients through relying on anything contained within or omitted from this presentation (orally or in writing).

Superannuation, tax and other relevant information is based on our interpretation of law as at the date of this presentation. The information contained in this presentation or given during this presentation does not constitute legal or tax advice. You should not rely on the superannuation or tax information in this presentation and seek your own expert advice.

The information provided in this presentation is not intended to be a comprehensive review of all developments in the law and practice, or to cover all aspects of those referred to. Readers should take their own specific legal advice before applying it to specific circumstances. Nothing in this document is intended to provide legal or other professional advice. Readers should not rely on any information contained in this document as if it were legal or other professional advice.

This presentation has been prepared by **MetLife Insurance Limited (MetLife)** (ABN 75 004 274 882, AFSL No. 238096) and is not intended to constitute financial product advice. It has been prepared without taking into account any person's objectives, financial situation or needs.

Information in this presentation is not to be shared with any third parties.

Although the statements of fact in this presentation are obtained from sources that MetLife considers reliable, no warranty as to the accuracy, reliability or completeness of any such information is provided.

Products are offered by **MetLife**, which is an affiliate of MetLife, Inc. and operates under the "MetLife" brand. None of the obligations of **MetLife** is guaranteed by MetLife, Inc. (Incorporated in the USA) or any other member of the MetLife group. This Presentation was prepared by and remains the property of MetLife.

The presentation may not be used without the prior express approval of **MetLife**.

July 2020

Agenda

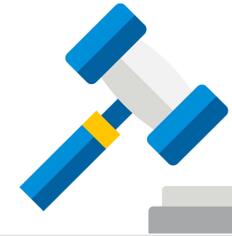
1. Overview
2. Structures, valuations and life insurance
3. Life insurance policy structures
4. Taxation of life insurance outside superannuation
5. Key Person insurance
6. Buy Sell Arrangements
7. Life insurance and SMSFs
8. Business structures utilising superannuation

Overview

Hayne Royal Commission & LIF Review 2021

15 Insurance specific recommendations (of 76)

- Recommendation 2.4 – Grandfathered commissions:
 - Grandfathering provisions for conflicted remuneration should be repealed as soon as is reasonably practicable.
- Recommendation 2.5 – Life risk insurance commissions:
 - When ASIC conducts its review of conflicted remuneration relating to life risk insurance products and the operation of the ASIC Corporations (Life Insurance Commissions) Instrument 2017/510, ASIC should consider further reducing the cap on commissions in respect of life risk insurance products.
 - Unless there is a clear justification for retaining those commissions, **the cap should ultimately be reduced to zero.**



Hayne Royal
Commission

Royal Commission
into Misconduct in
the Banking,
Superannuation and
Financial Services
Industry

14 December 2017

–

4 February 2019

Four ways to grow revenue

1. See more clients.
2. Sell more insurance to existing clients.
3. Expand the scope of advice.
4. Charge a Fee for Insurance Advice which is greater than the permitted commission payable under the Life Insurance Framework (LIF).



Structures, Valuations and Life Insurance

Business Structures & Financials

Business Structures

- Business Structures
- Sole proprietorship
- Partnership
- Company
- Phillips trust / Service trust

Financials

- Profit and Loss Statement
- Balance Sheet
- Valuation

How to Value a Business – Talk with an Accountant

Asset Valuation

- Total assets less total liabilities

Income valuation

- Multiple of earning
- Discounted cash flow
- Price to earnings ratio
- Expected return on investment (ROI)

Entry cost valuation

- Purchasing assets
- Creating services and/or products
- Recruiting and training employees
- Building a customer base

Industry rules of thumb

- What are similar businesses worth
- Turnover
- Number of customers
- Number of outlets

Factors influencing the value of a Business

1. Have a business plan & understand the market
2. Ensure all documentation, paperwork & financials are complete
 - a) Compliance
 - b) Tax returns (ATO)
 - c) Client files
3. Business profitability – now and in the future
4. Structured exit from the business
5. Obtain appropriate advice
 - a) Legal
 - b) Accounting and Taxation
 - c) Financial
6. Be prepared

The role of life insurance

Principal purpose of insurance

1. Eliminate debt
2. Create an income stream.

Not covered by Life Insurance

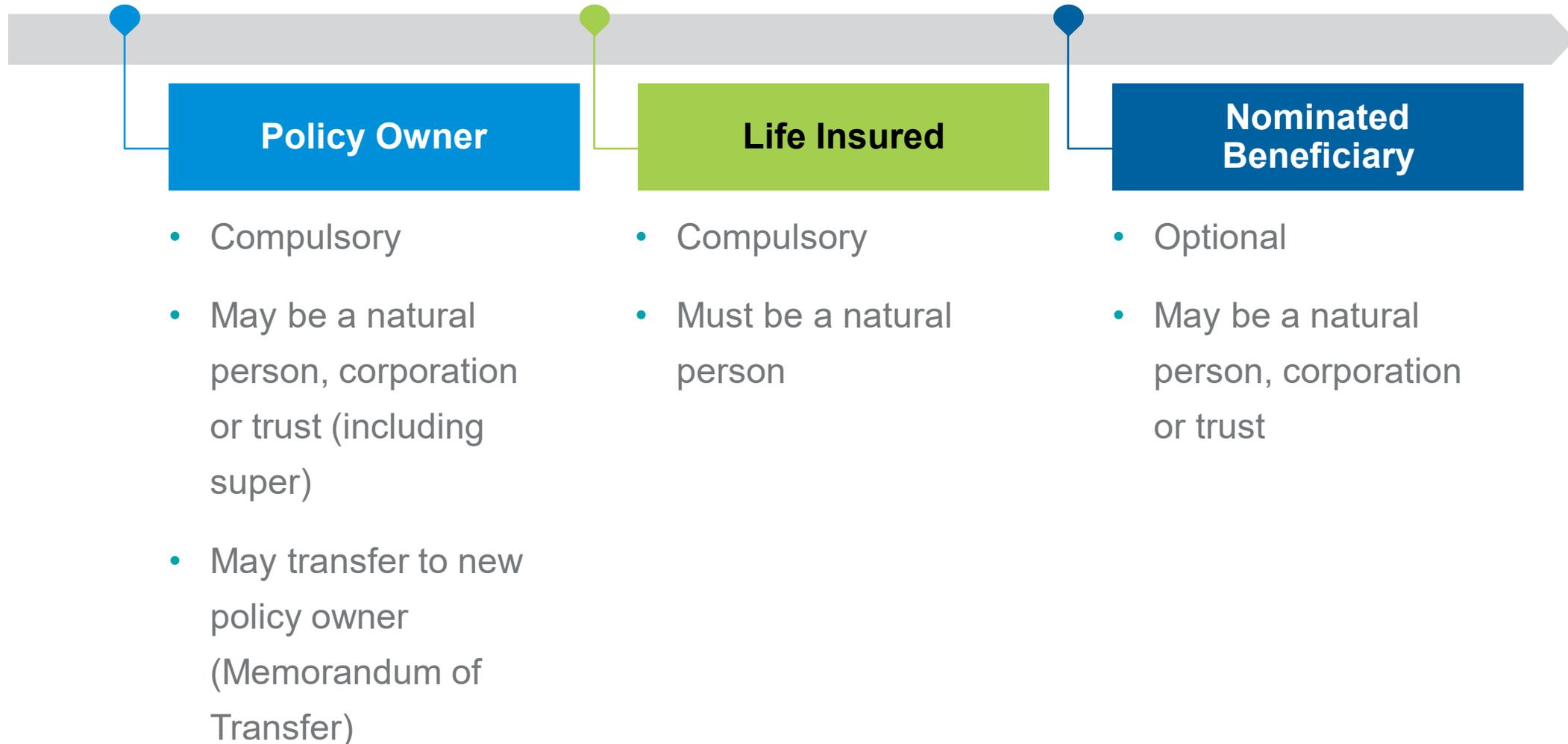
1. Voluntary Retirement
2. Bankruptcy
3. Divorce
4. Loss of Licence / Deregistration
5. Dislike business partner
6. Incarceration / Criminal Conviction
7. Etc...

Alternatives to Life Insurance

- Savings or sinking fund
- Line of credit or loan from lending institution
- Directors loans or loan account
- Sell existing assets
- Capital raising or IPO
- Assume it will never happen (not recommended!)

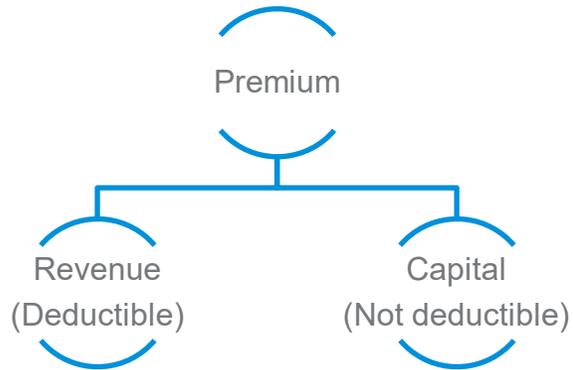
Life insurance policy structures

Life insurance policy structure

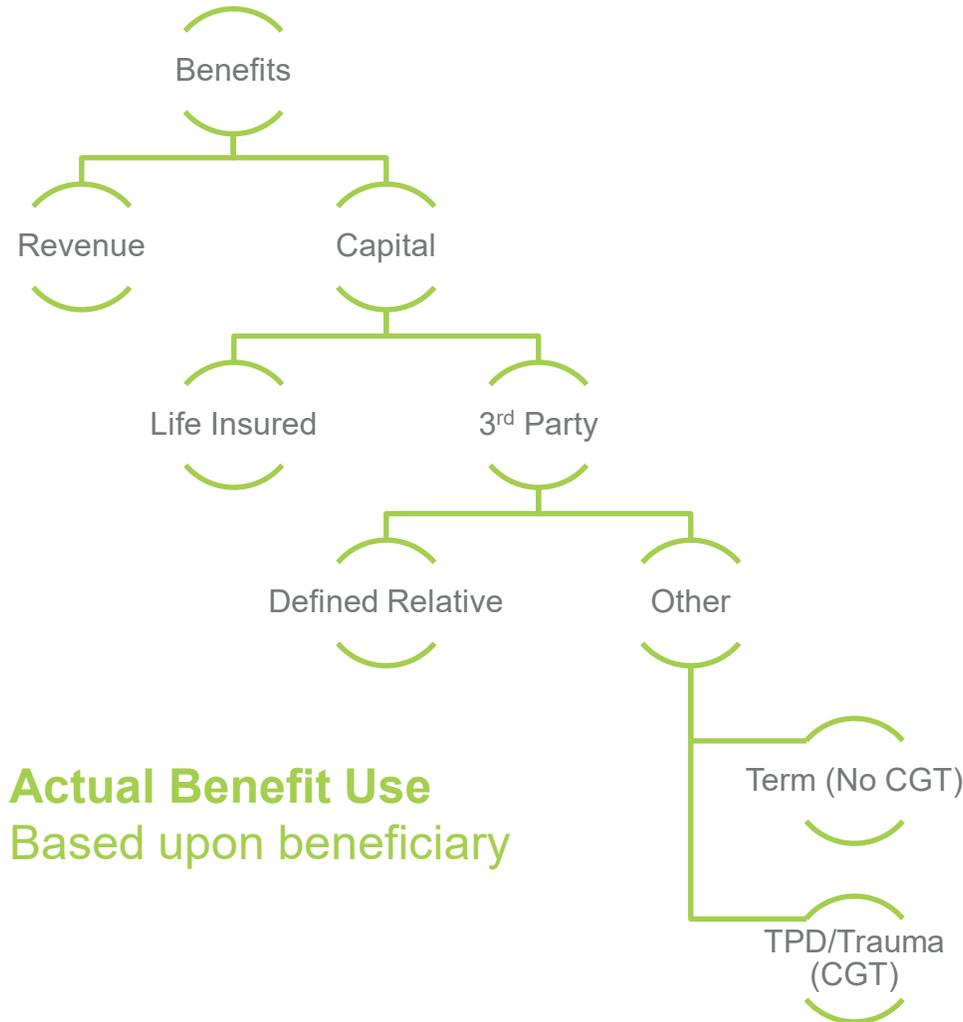


Taxation of life insurance outside superannuation

Ownership and taxation of life insurance outside super



Intended Policy Use
Based upon policy owner



Actual Benefit Use
Based upon beneficiary

Relative of a person means:

the person's spouse (de facto, legally married, or same sex ... not former); or
 the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendent or adopted child of that person, or of that person's spouse; or
 the spouse of a person referred to in paragraph (b).

Source: s995.1 ITAA 1997

Key person insurance

Importance of your people – Key Person

Tax Deductibility - depends on the type of policy used and its purpose

Revenue purpose

- Compensate for reduced profits/replacement costs

Capital purpose

- Repayment or reduction of debt/goodwill/credit standing

Premium deductibility

- Assessed on all surrounding circumstances
- Taxpayer to prove or substantiate purpose of cover

“Take away my people but leave my factories and soon grass will grow on the factory floors. Take away my factories but leave my people and soon we will have a new and better factory.”

**Andrew Carnegie,
1835-1919**

Key person cover

Tax deductibility

If the following six requirements are met, the Revenue Purpose Cover is tax deductible:

1. The policy must be a term insurance policy
2. The policy must be owned by the trading entity on the life or disability of a key person (e.g. by an employer on the life of a key employee)
3. The purpose in effecting and maintaining the policy must be of a revenue nature
4. The employee must be a “key person”. That is, “... the loss of that employee would result in a significant loss of profits being derived by the employer.”

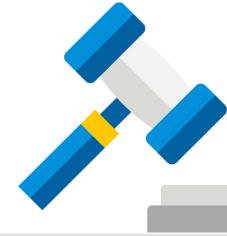


Key person cover

Tax deductibility

If the following 6 requirements are met, the Revenue Purpose Cover is tax deductible:

5. While the business must be adversely affected should a key person be lost to the business, revenue purpose insurance premiums can only be deductible if the business will continue despite the loss of the key person.
6. The sum insured is based on a 'reasonable estimate' of the loss of revenue that would be likely to occur. Contemporaneous documentation should be available showing how the sum insured was calculated at the time the policy was entered into and how it was regularly reviewed.



If the six requirements are met then a tax deduction is available under section 8-1 ITAA 1997

IT 155
Paragraphs 4, 7 & 10

IT 2434
Paragraph 23

EDR3
Paragraph 27

Buy sell arrangements

Buy sell agreements

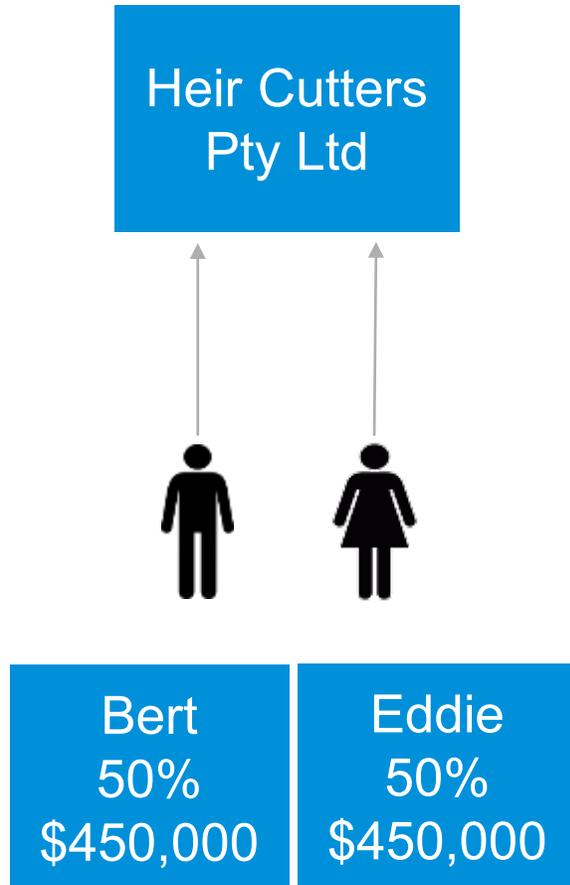
1. Disposal arrangement (Contract)

- Provides the option for the departing owner to sell his/her equity
- Provides the option for the remaining owner(s) to buy additional equity
- Stipulates the valuation method
- Stipulates the trigger events
- Normally facilitated via a Put-Call Option Agreement

2. Funding arrangement

- Life insurance (Death, Trauma, TPD)
- Personal savings
- Employee buyout
- Management buyout
- IPO/capital raising
- Competitor buyout

Buy Sell Agreement – Case Study 1



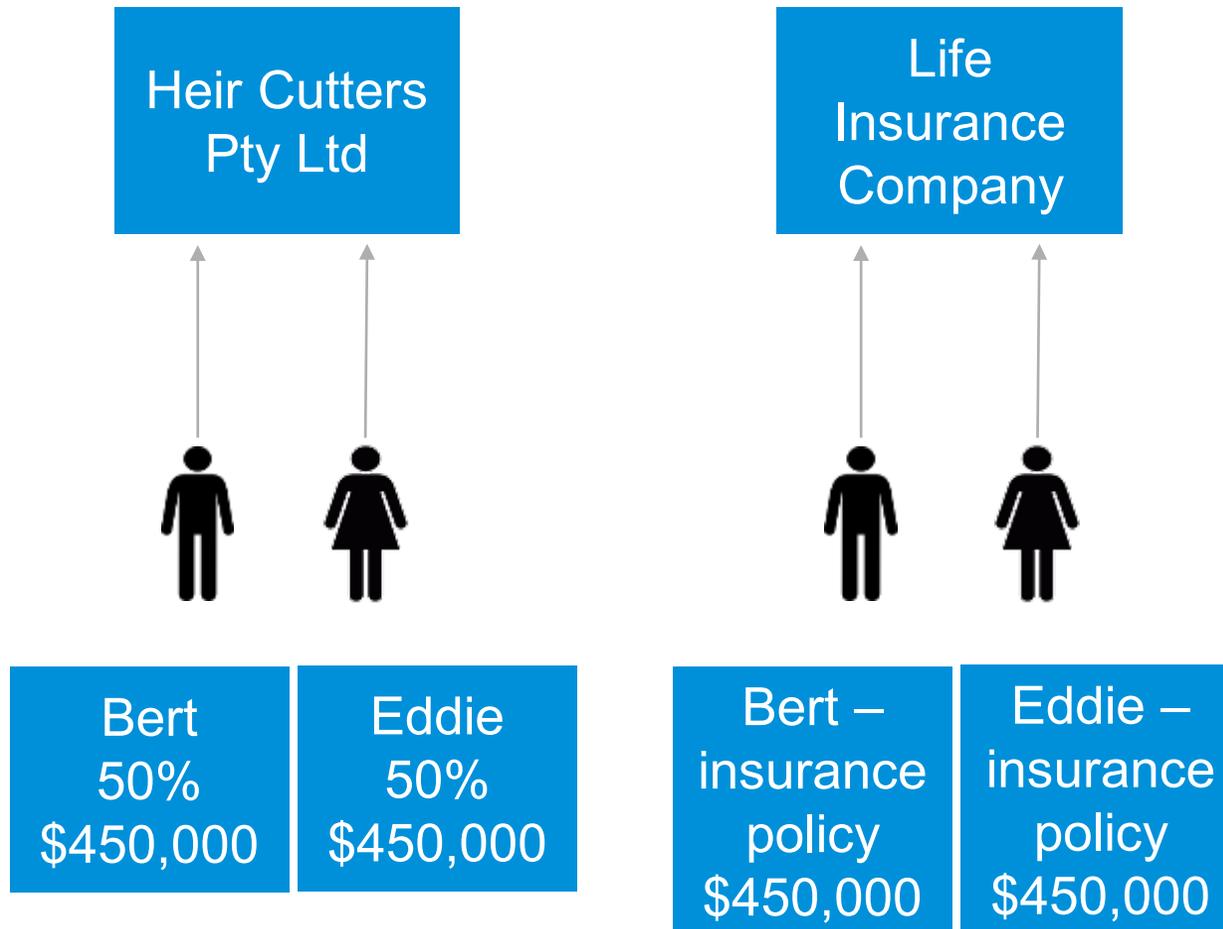
Bert and Eddie are unrelated business partners and owners of Heir Cutters Pty Ltd.

Business valued at \$900,000
Each has 50% share (\$450,000).

Purchase individually owned life insurance policy for each member.

Use proceeds from the death benefit paid from the insurance policy to fund the Buy-Sell Agreement.

Buy Sell Agreement – Case Study 1



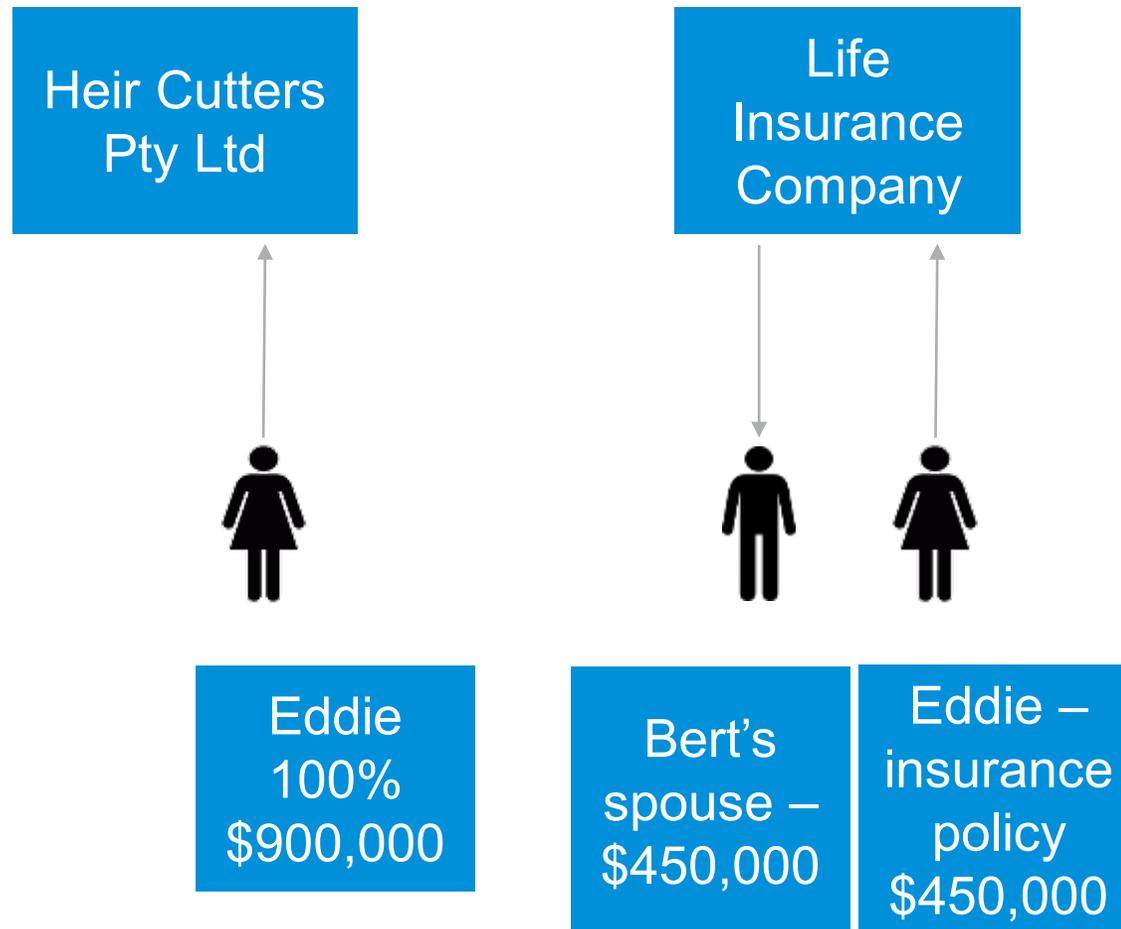
Bert and Eddie are unrelated business partners and owners of Heir Cutters Pty Ltd.

Business valued at \$900,000
Each has 50% share (\$450,000).

Purchase individually owned life insurance policy for each member.

Use proceeds from the death benefit paid from the insurance policy to fund the Buy-Sell Agreement.

Buy Sell Agreement – Case Study 1



Bert and Eddie are unrelated business partners and owners of Heir Cutters Pty Ltd.

Business valued at \$900,000
Each has 50% share (\$450,000).

Purchase individually owned life insurance policy for each member.

Use proceeds from the death benefit paid from the insurance policy to fund the Buy-Sell Agreement.

Buy sell agreement – Case study 2

The business has four directors, comprising of two couples:

1. Justin and Sophie
 2. Scott and Jenny
- Justin and Scott run the business and actively work in the business.
 - Sophie and Jenny are homemakers. They do not have the skills or expertise to run the business or work in the business. If their spouses die they don't want to be part of the business. They just want money so they can continue to live in a lifestyle they have grown accustomed.
 - All four share equally in the profits from the business.



Justin owns 25%

Sophie owns 25%

Scott owns 25%

Jenny owns 25%

The company is
valued
at \$4 million

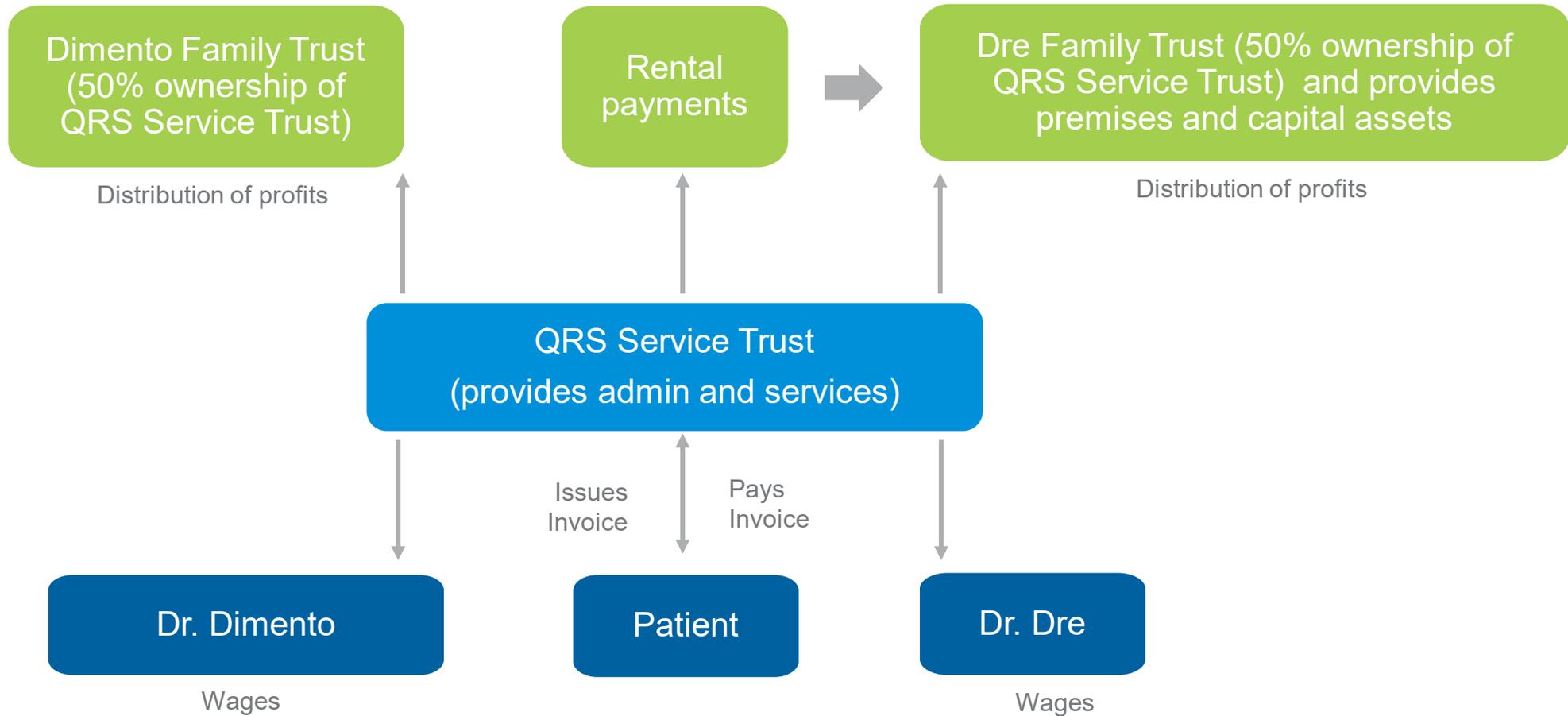
Business Succession

Case Study 3 - Brief First Meeting

- Dr Dre and Dr Dimento have both recently attained their FRACGP (18 months ago).
- They have opened a new General practice in Macquarie Street in Sydney.
- Dr Dre and Dr Dimento are both recently married with stay at home spouses.
- They employ one administration assistant (medical)
- They employ one registered nurse.
- They tell you that they each own 50% of the business.
- They tell you that they own the business premises.
- They want to own the business premises via their SMSF.
- They tell you that the business is worth \$8 million.



Buy sell agreement – Case study 3



Buy sell agreement – Case study 3

The reality (business)

- Dre Family Trust owns the business premises.
- Dre Family Trust owns 50% of the company.
- Dimento Family Trust owns 50% of the company.
- Their registered nurse is paid \$150,000 per year.
- Their medical receptionist is paid \$75,000 per year.
- Leasing cost for their offices are \$65,000 per year.
- Medical indemnity insurance is (up to \$20 million cover) costs \$10,000 each per year.
- AMA Membership is \$2,000 each per year.
- Each doctor is paid \$250,000 per annum.
- Total gross revenue per annum is \$1.5 million.
 - \$750,000 per doctor per annum.
- Profit before tax is \$500,000.

Average salary is \$74,762 for registered nurse.

Average salary is \$55,278 for medical receptionist.

AMA recommends GPs charge \$78 per consultation (patient can recover \$36.30 from Medicare).

Workers Compensation permits \$290/hour plus GST

Buy sell agreement – Case study 3

The reality (personal)

- Each doctor has a student loan of \$100,000.
- Dre Family Trust is controlled by Dr Danielle Dre's father and mother, Fred and Wilma. The other member of the trust is Dr Dre's wife, Heather.
- Dr Dre and Heather live in an investment property owned by Fred and Wilma.
- Dimento Family Trust is controlled by Dr David Dimento and his wife, Mary. They are the only 2 members of the trust. Dr Dimento and Mary have 2 children, Harrold (4) and Megan (2).
- Dr Dimento and Mary live with their 2 children in a recently purchased new home worth \$2 million (mortgage of \$1.5 million).

Buy sell agreement – Case study 3

The questions

- What are the risks to the business?
- What are the barriers to entry for other practices?
- What happens if the registered nurse leaves?
- What happens if the medical receptionist leaves?
- How much debt does the business have?
- Where do the patients come from?
- Where does revenue come from?
- How loyal are the patients to Dr Dre or Dr Dimento?
- What personal debt does each of the doctors have?
- What happens if Dr Dre wants to leave the practice?
- What happens if Dr Dimento wants to leave the practice?
- What is the value of the business?

Valuation: 1.0 to 5.0
x EBITDA* for a GP
medical practice.

- **Single doctor = 1-2x**
- **Multiple doctors = 3 – 4x**
- **Multiple doctors + urban = 4 – 5x**
- **EBITDA* = Earnings before interest, tax, depreciation and amortization**

Buy sell agreement – Case study 3

The questions

- Where do the patients come from?
 - Walk-in + some referrals
- Where does revenue come from?
 - Medicare + Private Health Care + Workers compensation + Private billing
- How much debt does the business have?
 - Nil
- What is the value of the business?
 - \$500,000 to \$2.5 million

Valuation: 1.0 to 5.0 x EBITDA* for a GP medical practice.

- **Single doctor = 1-2x**
- **Multiple doctors = 3 – 4x**
- **Multiple doctors + urban = 4 – 5x**
- **EBITDA* = Earnings before interest, tax, depreciation and amortization**

Buy sell agreement – Case study 3

The structure

- What types of policies are required?
- What is the sum insured of each policy?
- Who owns each policy?
- Who is the beneficiary of each policy?
- Should they transfer the ownership of the business premises into their SMSF?

Buy sell agreement – Case study 3

The structure

- What types of policies are required?
 - Life Cover, TPD Cover, Trauma Cover, Income Cover, Key Person Extras
- Who owns each policy?
 - QRE Service Trust – Key person
 - Dre Family Trust – Buy Sell
 - Dimento Family Trust – Buy Sell
- Who is the beneficiary of each policy?
 - QRE Service Trust – Key person
 - Dre Family Trust – Buy Sell
 - Dimento Family Trust – Buy Sell
- Should they transfer the ownership of the business premises into their SMSF?
 - CGT consequences
 - SIS Act

Buy sell agreement – Case study 3

The structure

What is the sum insured of each policy?

- QRE Service Trust – Key person
 - Capital – Nil (no company debt)
 - Revenue – up to \$1.5 million per doctor (calculated as 2 years x \$750,000 of revenue generated per year)*
- Dre Family Trust – Buy Sell:
 - \$250,000 - \$1.25 million
- Dimento Family Trust – Buy Sell:
 - \$250,000 - \$1.25 million

Life insurance and SMSFs

SMSF statistics

- 598,582 SMSFs in Australia
- 1,124,699 members
- 12,338 new funds in 12 months to September 2019
- 23,241 new members in 12 months to September 2019
- 1 in 5 trustees failed to consider insurance*



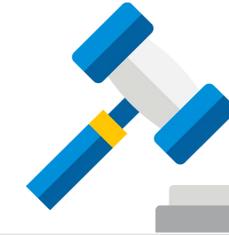
ATO – Self managed super
fund statistical report –
September 2019

* ASIC Report 575
- June 2018



Trustee responsibility – insurance

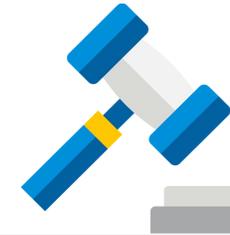
- For a self managed superannuation fund – The trustee of the entity must formulate, review regularly and give effect to an investment strategy that has regard to the whole of the circumstances of the entity including, but not limited to, the following:
- Whether the trustees of the fund should hold a contract of insurance that provides insurance cover for one or more members of the fund



Superannuation
Industry
(Supervision)
Regulations
1994 - REG 4.09
(2)(e)

Penalties

- 20 penalty units (\$4,200) administrative penalty for each trustee or director of a corporate trustee
 - Sections 166 & 34(1) SIS Act; Section 4AA Crimes Act 1914
- Up to 100 penalty units (\$21,000) for each trustee who intentionally or recklessly contravenes
 - Section 34(2) SIS Act; Section 4AA Crimes Act 1914
- A person who suffers loss or damage as a result ...may recover ... against that other person or against any person involved in the contravention
 - Section 55(3) SIS Act



ASIC Report 337 –
Paragraphs 121-140

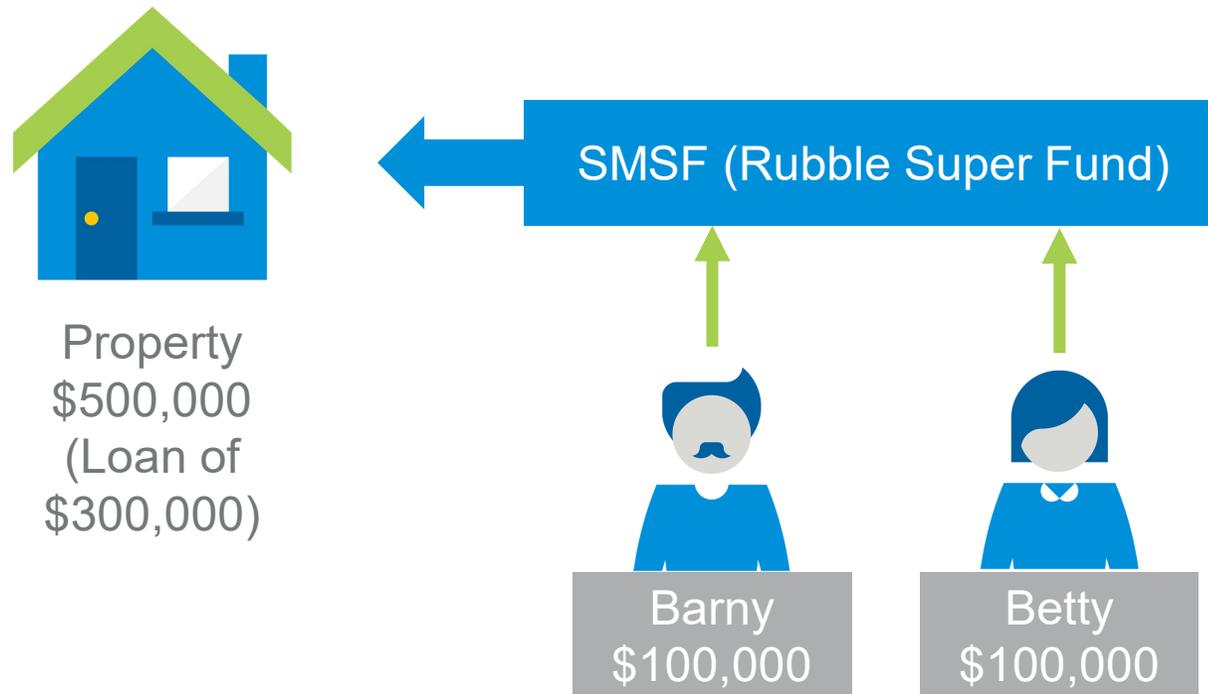
ASIC Report 575 –
Paragraphs 338-350

What are the penalties if a trustee fails to consider insurance as part of their SMSF's investment strategies?

Business structures utilising superannuation

Life insurance in super

Tax Dependents



Barney and Betty are married and members of Rubble Super Fund (“SMSF”)

Account Balances:

- Barney - \$100,000
- Betty - \$100,000

SMSF loan of \$300,000 to acquire business real property valued at \$500,000.

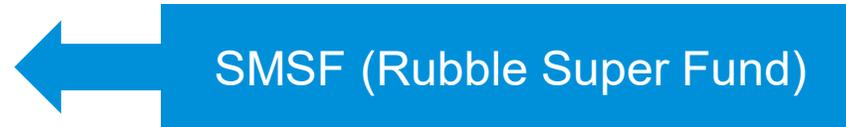
They run a small business.

Assumptions:

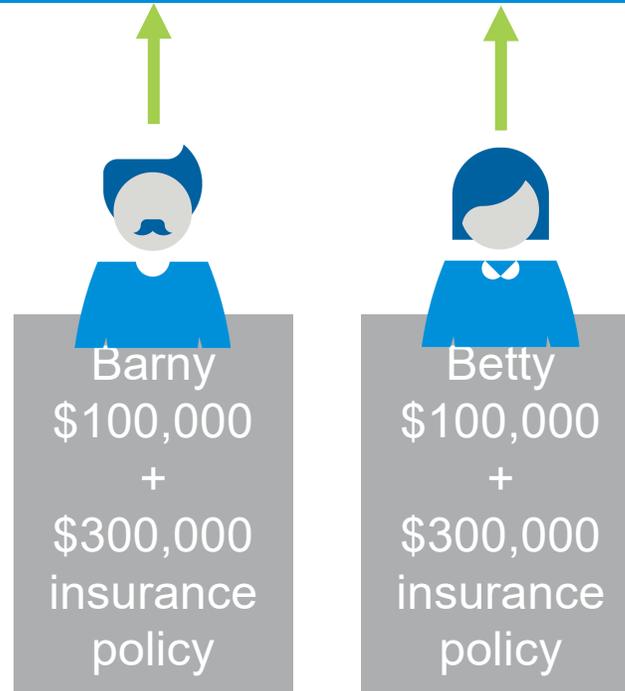
- Net rental yield 3.5%
- loan interest rate 6% (interest only)
- both members are under 55.

Life insurance in super

Tax Dependents



Rent	\$17,500
Concessional contributions	\$10,000
Total inflows	\$27,500
Interest	(\$18,000)
Operating costs	(\$2,000)
Life premiums	(\$1,000)*
Pension	\$0
Total outflows	(\$21,000)
Tax	(\$975)
Net cash flow (surplus)	\$5,525



Barney and Betty are married and members of Rubble Super Fund (“SMSF”)

Account Balances:

- Barney - \$100,000
- Betty - \$100,000

SMSF loan of \$300,000 to acquire business real property valued at \$500,000.

They run a small business.

Assumptions:

- Net rental yield 3.5%,
- loan interest rate 6% (interest only)
- both members are under 55.

Life insurance in super

Tax Dependents



Rent	\$17,500
Concessional contributions	\$5,000
Total inflows	\$22,500
Interest	\$0
Operating costs	(\$2,000)
Life premiums	\$0
Pension	(\$16,000)
Total outflows	(\$18,000)
Tax	(\$675)
Net cash flow (surplus)	\$3,825



Barney and Betty are married and members of Rubble Super Fund (“SMSF”)

Account Balances:

- Barney - \$100,000
- Betty - \$100,000

SMSF loan of \$300,000 to acquire business real property valued at \$500,000.

They run a small business.

Assumptions:

- Net rental yield 3.5%,
- loan interest rate 6% (interest only)
- both members are under 55.

Member cross insurance strategy

Prohibited!

- Policy over one member held in segregated investment pool for other member.
- Proceeds treated like investment income
- Allocated to relevant member benefit

Previously permitted

- ATO – NTLG Super Technical Sub Group – December 2012
- Cross insuring within fund formerly permitted
- Allocation on fair and reasonable basis
- Allocation not from reserve



ATO Website:
02 May 2018
(QC 42798)

Reserving strategy in super

Prohibited!

- Policy over one member held in segregated investment reserve to be used at a later date for benefit of fund.
- Proceeds treated like investment income.
- Allocated to reserve account inside SMSF .



ATO - Super
changes –
frequently asked
questions
(27 Oct 2017)
QC 51875

SMSFRB 2018/1

Buy-sell in superannuation

Prohibited ... in most cases!

- Breaches sole purpose test *
 - Insurance inside SMSF (death cover)
 - Buy-sell agreement outside SMSF
 - Contravention of s62 SIS Act 1993
 - Contravention of s65(1)(b) SIS Act 1993
-
- * - Non complying superannuation fund pays tax at 45%



ATO ID 2015/10

SMSFR 2008/1

SMSFR 2008/2

s295-10 ITAA1997

s995-1 ITAA1997

s26(2) ITRA1986

Summary

Summary

- Opportunities
 1. Debt protection
 2. Key Person cover
 3. Buy Sell arrangements
- Proceed with caution
 - Limited recourse borrowing arrangements (LRBA in SMSFs)
 - Buy-sell arrangements in SMSF (**AVOID!**)
- Review
 - SMSF investment strategy (including life insurance)



Questions?

Thank you.



MetLife

A man with glasses and a black shirt is sitting at a desk, holding a tablet. A woman with dark hair in a ponytail, wearing a white polka-dot shirt, is sitting next to him, looking at the tablet with her hand on her chin. They are in a modern office environment with shelves and plants in the background.

Business Insurance Essentials

Dr Jeffrey Scott | Head of Advice Strategy
July 2020