

# Group Protection Scheme Earnings Information Sheet

## Helping you understand more complex scheme earning definitions for a group protection policy

Making sure the right definition is selected is important. This information sheet is designed to help you understand how to provide data accurately where Dividends, Fluctuating Emoluments, or Partnership Earnings are used, along with scheme earnings applicable for those on a Zero-Hour contract.

## Things to consider when selecting a scheme earnings definition

The scheme earnings definition chosen should be one where the policyholder is able to provide accurate data at inception and every annual renewal date in a timely manner. Accurate data may also be required if the policy is changed within the unit-rate guarantee period. It should be a definition where appropriate evidence such as a pay slip to show basic salary, tax return for dividends / partnership earnings, can be provided in the event of a claim, if requested. If the policyholder is using payroll information, this must be amended to provide the correct details where there has been absence.

Some scheme earnings definitions require an averaging over a period (usually 3-years) to provide an annual amount, or a period for the full salary such as last 12 months or P60. Where the employee's employment, equity partner or LLP member's partnership history does not cover the required time frame, the earnings should be annualised over the period they have completed, with a reasonable estimate made where insufficient information is available such as the joining date. Scheme earnings definitions can be chosen where the amount can change during the policy year or be fixed at either the annual renewal date or a set date such as 6<sup>th</sup> April, where the amount of benefit covered will not change for a year. Some scheme earnings definitions are always fixed for the policy year, where dividends are to be included for group income protection cover for example.

## Providing scheme earnings where there is or has been absence

Where a member enters temporary absence, including working reduced hours, the scheme earnings to declare, is the scheme earnings amount that was applicable at the date prior to the start of the temporary absence. The amount declared on the data you provide, should reflect the amount that the policy would pay in benefit if an event occurred on the inception / renewal date. Please refer to the policy terms for details of increases allowable for those on long term absence.

Where there have been periods of temporary absence, and the employee is now fully at work, but during that absence period no income, or a reduced amount was received, such as a period of sickness for a P60 scheme earning definition, an appropriate estimate of the correct annual amount should be provided on the data which ignores that period of absence. If data is provided by using payroll information, please ensure the scheme earnings are amended so that they are in line with the scheme earnings definition and do not just provide the amounts paid. In the event of a claim where the data doesn't reflect the member's correct scheme earnings, the benefit may be limited to the lower of the amount shown on data or the correct calculation, and therefore it is important to provide accurate data. Members currently in receipt of group income protection benefits, should be shown on the data with nil salary but with their full, pre-absence, scheme earnings shown on the data for group life assurance and group critical illness.

The terms of the policy take precedence over anything within this information sheet.



# Scheme Earnings

## 1. Dividends

Dividends, income derived from ownership of a share, can be included within a scheme earnings definition for shareholding directors who are also employees of the company to be covered. Only dividends received as 'cash' income can be covered, that is, those the employee receives in their bank account and not reinvested in other dividends or similar.

Where dividends are covered for group income protection, receipt of those dividends must cease by the end of the deferred period, or the benefit payment will be reduced accordingly. The claim benefits will be paid to the employer to be distributed through PAYE. In the event of a claim we may ask for copies of the applicable tax returns to evidence the amount claimed.

The following standard scheme earnings definitions are available where dividends are to be covered.

- Basic annual salary plus average of the last 3 years' cash dividends fixed at the previous 5<sup>th</sup> April.
- P60 earnings plus average of the last 3 years' cash dividends fixed at the previous 5<sup>th</sup> April.

To calculate the scheme earning dividend amount, use the annual average of the last 3 tax years, from 6<sup>th</sup> April to 5<sup>th</sup> April. Then add this average to the applicable basic salary or P60 figure at inception / the annual renewal date, and this gives the scheme earnings figure to provide. The scheme earnings figure on which benefits are calculated will not change through the policy year as it will be fixed at each renewal date.

### Examples of how to calculate a scheme earnings amount where there is a 3-year average

These examples help show how to calculate the accurate average of the last 3 years' cash dividends fixed at the previous 5<sup>th</sup> April but can be used as an example for any 3-year average. It assumes an inception date and annual renewal date of 1<sup>st</sup> January where the dividends are received on the 1<sup>st</sup> of the month.

**Example 1:** Dividends have been earned for the full previous 3 tax years. The dividends should be averaged over the full 3-year period.

Year	Time period	Monthly Dividends	Basic Salary pa
1	1 <sup>st</sup> January to 31 <sup>st</sup> December	£5,000.00	£5,000.00
2	1 <sup>st</sup> January to 31 <sup>st</sup> December	£10,000.00	£5,000.00
3	1 <sup>st</sup> January to 31 <sup>st</sup> December	£12,000.00	£6,000.00
4	1 <sup>st</sup> January to 31 <sup>st</sup> December	£6,000.00	£6,000.00

Dividend amount earned in tax year:

Tax Year	Calculation	Total Dividends Earned
1	$£5,000 \times 8 + £10,000 \times 4$	£80,000.00
2	$£10,000 \times 8 + £12,000 \times 4$	£128,000.00
3	$£12,000 \times 8 + £6,000 \times 4$	£120,000.00
Total received in previous 3 tax years:		£328,000.00
Annual average: $£328,000.00 / 3$ :		£109,333.33

Scheme earnings for 1<sup>st</sup> January membership data:

Basic salary (£6,000) plus dividend average (£109,333.33) = £115,333.33

**Example 2:** Dividends have not been earned for the full 3 tax years but have been earned for over 12 months. The dividends should be averaged over the period received.

Eligible Shareholding Director, employed on 1<sup>st</sup> August year 2.

Has only earned dividends for 21 months of the previous 3 tax years.

Year	Time period	Monthly Dividends	Basic Salary pa
1	1 <sup>st</sup> January to 31 <sup>st</sup> December	Not employed	
2	1 <sup>st</sup> January to 31 <sup>st</sup> July	Not employed	
2	1 <sup>st</sup> August to 31 <sup>st</sup> December	£12,000.00	£5,000.00
3	1 <sup>st</sup> January to 31 <sup>st</sup> December	£12,000.00	£6,000.00
4	1 <sup>st</sup> January to 31 <sup>st</sup> December	£6,000.00	£6,000.00

Dividend amount earned in tax year:

Tax Year	Calculation	Total Dividends Earned
1	Not employed as a shareholding director	
2	£10,000 x 5 + £12,000 x 4	£98,000.00
3	£12,000 x 8 + £6,000 x 4	£120,000.00
Total received in previous 21 months:		£218,000.00
Annual average: £218,000.00 / 21 (months) x 12:		£124,571.43

Scheme earnings for 1<sup>st</sup> January membership data:

Basic salary (£6,000) plus dividend average (£124,571.43) = £130,571.43

**Example 3:** Dividends have not been earned for a full 12 months. A reasonable annual estimate must be made based on the amount received.

Eligible Shareholding Director employed on 1<sup>st</sup> August year 4.

Has earned no dividends in the previous 3 tax years so an estimate must be made using figures received after the tax year.

Year	Time period	Monthly Dividends	Basic Salary pa
1	1 <sup>st</sup> January to 31 <sup>st</sup> December	Not employed	
2	1 <sup>st</sup> January to 31 <sup>st</sup> December	Not employed	
3	1 <sup>st</sup> January to 31 <sup>st</sup> December	Not employed	
4	1 <sup>st</sup> January to 31 <sup>st</sup> July	Not employed	
4	1 <sup>st</sup> August to 31 <sup>st</sup> December	£6,000.00	£6,000.00

### Example 3 (continued):

Dividend amount earned in tax year:

Tax Year	Calculation	Total Dividends Earned
1	Not employed as a shareholding director	
2	Not employed as a shareholding director	
3	Not employed as a shareholding director	
Total received in previous 3 tax years:		£0.00
Annual estimate: £6,000.00 x 12:		£72,000.00

Scheme earnings for 1<sup>st</sup> January membership data:

Basic salary (£6,000) plus dividend average (£72,000) = £78,000

## 2. Fluctuating Emoluments

These are elements which can change though the policy year such as commission or bonus. Where they are a significant part of the earnings received by an employee then the scheme earnings selected, should be averaged over the previous 3 years to avoid having an adverse effect on benefit. The 3-year average should include years the employee was eligible to receive these payments even if the amount earned was nil. Where the employee has not been eligible for the full 3-years then the calculation should be made on the period available with a reasonable annual estimate made where less than 12-month figures are available.

## 3. Partnership Earnings

Equity partners and members of a Limited Liability Partnership must use a scheme earnings definition related to their drawings from their firm (can include both monthly amounts and annual 'profit share'), we refer to these as 'partnership earnings'. The standard maximum amount of 'salary' for purposes of scheme earnings under a group protection policy is limited to total partnership earnings averaged over the last 3-years.

Where a partner has not received earnings for a full 3-years, the average should be calculated over the period available, or a reasonable annual estimate used if received for less than 12 months. It is possible to cover only part of the partnership earnings such as the annualised monthly drawing. If only part of the partnership earnings are covered, the scheme earnings will always be subject to the overall maximum of the average of total partnership earnings in the last 3-years. All fixed benefit amounts for group income protection are subject to this maximum.

**Example:** Partnership Earnings have been earned for the full previous 3 years. The Partnership Earnings should be averaged over the full 3-year period. The renewal date assumed is 1<sup>st</sup> January.

Year	Time period	Monthly Drawings	Annual 'Profit share'	Total Annual Partnership Earnings
1	1 <sup>st</sup> January to 31 <sup>st</sup> December	£5,000.00	£7,000.00	£67,000.00
2	1 <sup>st</sup> January to 31 <sup>st</sup> December	£10,000.00	£15,000.00	£135,000.00
3	1 <sup>st</sup> January to 31 <sup>st</sup> December	£12,000.00	£4,500.00	£148,500.00
Total Partnership Earning over 3 years:				£350,500.00
Annual Average of 3 years Partnership Earnings: £350,500.00 / 3:				£116,833.33

Scheme earnings for 1<sup>st</sup> January membership data: = £116,833.33

Salaried partners are employees and should have a scheme earnings definition applicable linked to their salary for example Basic Salary or P60. They should be in a separate category to Equity Partners and LLP members.

#### **4. Schemes earnings applicable for those on a Zero-Hour contract**

A scheme earning definition of basic salary is not appropriate for a zero-hour contract employee as the contractual hours they will work is unknown. If a benefit linked to a scheme earning definition is required, it should be linked to actual earnings such as P60. For group life assurance and group critical illness cover a fixed benefit or minimum fixed amount is a common approach. When providing scheme earnings data linked to amounts earned over a period, the scheme earnings for zero-hours employees for a full 12 months should be the total earned. The scheme earnings for a zero-hour contract employee are not amended for any temporary absence.

If a set number of hours is used, along with the employees' hourly rate, to calculate the annual scheme earnings amount, this could be reduced in the event of a group income protection claim if the average hours worked in the 12 months prior to the start of the deferred period is less than the hours used in the calculation of the scheme earnings.

## **Contact us**



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