

Key Employee Insurance

According to the D&B 21st Annual Small Business Survey, lack of qualified employees was the most frequently mentioned problem area. The death of a key person can cause serious problems for a business. To help protect against a loss, many businesses purchase life insurance policies on their key people. Proper key person insurance is an essential component in any sound risk management program.

How it Works...

The business owns the policy and pays the premiums. The premiums are not deductible, however, any death proceeds are received income tax free.* The life insurance proceeds received by the company can be used for a variety of purposes, including:

1. Recruiting and training a new person to replace the deceased.
2. Helping replace lost profits that would have been earned if the key person were still alive.
3. Providing continuation of salary to a deceased's family for a period of time.
4. Providing funds to pay a tax deductible, employee death benefit to the deceased's family, or estate.
5. Strengthening the company's financial position by helping to reassure other employees, creditors, and investors about the continuity of the business.

Many guidelines can be used to determine the economic value of a key person, for example, a multiple of the person's compensation, estimating lost profits, or the replacement method. Sound planning should examine all these methods to determine the appropriate amount of insurance coverage needed.

*Companies subject to the corporate Alternative Minimum Tax provisions may be subject to minimum tax on policy earnings and death benefits in excess of the company's investment in the policy.

Key Employee Insurance



Topco Corp.



Premium



At death of
John Dougherty



Insurance Company

Life Insurance
Cash Values
Available

Generally
Federal Income Tax-Free
Death Benefit

The death of a key employee can cause serious problems for the business. A study conducted in 1999 by Dun & Bradstreet indicated 32% of all small businesses and 44% of medium sized businesses surveyed consider finding qualified employees one of their biggest problems. To protect against this loss, the business can acquire a life insurance policy on the life of the key employee.

1. The business entity owns the policy and pays the premiums. The premiums are not deductible.
2. The company has all rights to the policy's living benefits, such as access to the cash values.
3. Death proceeds are received income tax free.* The life insurance proceeds received by the company can be used for a variety of purposes.

* For larger corporations it may subject the business to the Alternative Minimum Tax.