

Key Person

Essentials 2018

Every business operating today has key people that help it remain successful and profitable. Although most businesses insure their property and profits, few think to insure their most precious assets – the men and women whose experience, talent, and judgment contribute substantially to the financial success of the business. Loss of a key person can adversely affect the business' earning potential and will cause expenses related to finding his/her replacement.

Key Person Insurance Can Provide a Business with Financial Security

- Typical losses associated with losing a key person include:
 - Loss of management experience and leadership
 - Loss and disruption in production
 - Loss of credit rating for business
 - Loss of capital that is now required to find a replacement
- Closely held businesses are particularly at risk since there are typically one or two people whose skill and contacts make the business profitable.

How Key Person Insurance Works

1. The business purchases a key person life insurance policy on the key employee. The business is owner and beneficiary of the policy. There is no special key person policy. The business should choose the policy that best fits its needs.
2. The business makes non-deductible premium payments and retains all ownership rights.
 - a. Cash values inside the policy grow tax-free
3. If key person dies, the business will receive income tax-free death proceeds.
 - a. In order for the death proceeds to receive income tax-free treatment, the Pension Protection Act of 2006 requires two items are met:
 - The notice and consent requirements are met
 - The insured is an employee or a key person as defined by the tax law*, the proceeds are used to purchase the key employee's interest in the business from one of the persons listed below, or the ultimate payee is:
 1. A member of the insured's family
 2. The designated beneficiary (other than employer)
 3. A trust established for the benefit of any such person
 4. The insured's estate

Considerations

- Business receives needed funds at key person's death. These funds can be used to offset production declines, bolster the business' credit rating, and find the key person's replacement.
- The business can access the policy's cash value if necessary.
- Then properly structured, the death proceeds will be received income tax-free.

Essentially

All businesses have key people who keep things running successfully through their ideas, know-how, experience, and leadership. A business can range anywhere from a local convenience store to a large manufacturing plant, but regardless of size, it has key people who contribute to its success. The only difference is that a larger business may have more of them.

