Blueprints for Business

Key Person Life Insurance Coverage

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Key Person Life Insurance Coverage

The unexpected death of an owner, partner or key employee can have a devastating effect on a company. Replacing essential personnel of a company could cost significant time and money, which could threaten the continuity of your business. Creditors will want to be assured that the company will make good on its financial obligations and customers will need to be assured that your business will continue without interruption.

That's why it pays to plan for the unexpected. You need a financial blueprint that will instill a sense of confidence for you and your employees.

You most likely insure your physical assets as a matter of course. You may have insurance on your buildings, office furniture, vehicles, computers and the list goes on. But it is critical that you also insure your most valuable asset – your key employees.

Who Are Your Key Employees?

Key employees are people who can't be easily replaced and whose absence will reduce the financial performance of your company by increasing costs or losing profits. Key employees have special skills that have a direct impact on your profits year after year.

Think about your business. Do any of your employees have these characteristics?

- Special contacts or connections
- Unique sales ability
- Financial expertise
- Account management skills
- Product design/innovation
- Leadership skills
- Computer/technical skills
- Ability to get things done

If so, it is time to develop a financial blueprint to help protect your business and keep it stable no matter what the future brings.

When a Key Employee Dies

Life is fragile. Tragically, either through accident or illness, a key employee can die unexpectedly. Someone will have to step into the key employee's shoes and do the job he or she was doing. If a qualified replacement isn't ready to step in, financial disaster can result:

- Costs can increase
- Customers can take their business elsewhere
- Other employees may get frustrated and leave
- You may have to take over the key employee's duties
- Expansion plans may have to be put on hold
- Profits may fall

To prevent this from happening to your business, you need a plan.

Physical assets are usually relatively easy to replace. However, human assets – the people who make the decisions on how to position those physical assets – are hard to replace. They have special skills and know how to get the results needed. Even if you get lucky and quickly find a qualified replacement, it might still take many months for the replacement to become as productive as your key employee was.

The unexpected death of a key employee is a risk for nearly every business. One way to cushion the blow is to purchase life insurance on each key employee. As the owner and beneficiary of the policy, the business would pay the annual premium and receive the policy death benefits at the key employee's death. These death benefits are generally free from federal income taxes* (in a C corporation it is possible for the death benefit to trigger the alternative minimum tax). The business can use those death benefits to keep the business financially strong. Often they are used to pay the costs of finding, hiring and training a qualified replacement.

* Any death benefit received by the business may be subject to income tax unless the parties have complied with IRC Section 101(j).

Some Potential Advantages

Key person insurance gives a business several important advantages:

- Income tax-free death benefits may help replace profits lost due to the key employee's death.
- Income tax-free death benefits can create a cash cushion to keep lenders from foreclosing on business loans, reducing lines of credit or increasing interest costs.
- Income tax-free death benefits can be used to recruit, hire and train a replacement key employee.
- Income tax-free death benefits may potentially assure customers, creditors and employees that the business will continue to be financially stable and in a position to keep its promises.
- Policy cash values are an asset on the business' balance sheet.
- Policy can be used to fund executive benefits that tie the key employee to the business.

Some Potential Disadvantages

There are several potential disadvantages to key employee life insurance:

- Policy premiums are not deductible for income tax purposes.
- Policy cash values or death benefits may trigger an alternative minimum tax for C corporations.
- The key employee isn't prevented from leaving the business.
- The value of a key employee may be difficult to determine.
- To ensure the policy stays active, it must be sufficiently funded even when/if the business is not strong.

Business Owners Who Are Key Employees

Most business owners who work as employees are key assets of their businesses. They set the overall strategy and are responsible for making sure all the details get taken care of. To see if you are a key person, ask yourself these questions:

- If I die unexpectedly, is there someone else who can do what I was doing?
- Is there someone who can take over my leadership and decision making role?
- Will the fair market value of the business remain unchanged after my death?
- Will it make sense for my family to continue owning my share of the business?

If you answered "no" to any of these questions, your business is likely to suffer if you die unexpectedly. Income tax-free life insurance death benefits can provide a financial cushion to help it survive the transition while it tries to replace you. If the decision is made to close the business, life insurance death benefits can help recoup some of its lost value for your family.

Working with a Financial Professional

Along with your financial professional, you can address the problems a key employee's death may cause for your business in a four step process:

1. **Quantify Each Key Employee's Value:** Each of your key employees is unique and has a different impact on the business. It can be helpful to estimate the additional costs and lost profits the business will have to absorb should any of them die unexpectedly.
2. **Determine alternatives for key employee coverage:** Is each insurable and if so, at what rate? What insurance options make the most sense for each key employee? Before deciding what to do, you need to know what your alternatives are.
3. **Decide whether to self-insure or professionally insure:** After you've gotten all the facts, you can make informed decisions based on what's best for you and the business. You can decide to bear the risk of loss yourself or you may decide to transfer all or part of it to a life insurance company.
4. **Consider strategies to retain key employees until retirement:** It is important to plan for a key employee's absence not only in the event of death, but also if they leave to start their own businesses or to work for a competitor. Regardless of how a key employee leaves, your business will incur the same costs and losses. Thus, it makes sense to encourage your key employees to stay until retirement. To encourage long-term loyalty, consider offering these key employees some special benefits designed to meet their personal financial objectives.

Protecting your business is the cornerstone of a sound business plan. Key person life insurance can play a big role in that plan and can help keep your company financially strong. Your ING financial professional can help you meet your goals.

For more information please call your ING Financial Professional.