

# KEY EMPLOYEE INSURANCE



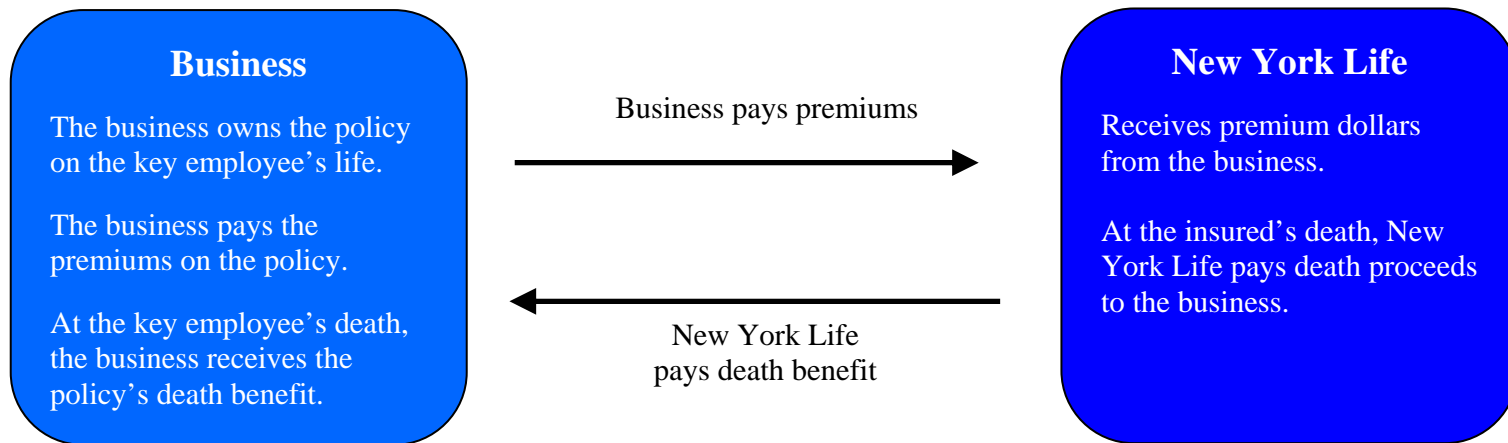
Prepared for:

Presented by:

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# Key Employee Insurance

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A successful business is dependent on its men and women, and every organization has one or more key persons. Their ability, talent, and expertise make up that "intangible asset value" which may outweigh the equipment, accounts receivable, and inventory in contributing to the success of the business.

Whether the business is a proprietorship, partnership or corporation, there are key persons: the founder who built the business; the executive who formulates and executes policy; the engineer who schedules and supervises production; the treasurer who plans budgets, arranges financing, and controls costs; or the sales manager who analyzes the market and promotes the sale of products or services. The knowledge, leadership, judgment, or connections of these key persons are what make things happen profitably.

The death of a key person will often have a devastating effect upon the future of a business. To protect against this sudden loss, many businesses purchase life insurance policies on certain key employees. Although the premiums are not deductible, the proceeds at date of death are generally received income tax free by the company.<sup>1</sup> These proceeds can fill several needs:

- Assist in finding and training a new employee to replace the deceased key person.
- Fulfill any contractual agreement to continue the employee's salary to his or her family for a certain number of months.
- Provide the funds to purchase stock belonging to the deceased shareholder.
- Bolster the company's credit standing.

The death of a key person can result in serious consequences for the business. Credit could be substantially impaired, or even worse, loans would be called if the key person was a co-signer. If a business loan has been guaranteed by one or more officers of a company, most loan documents permit the lender to call the loan in full upon the death of any co-signer. This can be very burdensome to a company already suffering the loss of an essential member of the management group.

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<sup>1</sup> However, proceeds are included in "adjusted current earnings" to the extent that they exceed the policy's tax basis, for purposes of the Corporate Alternative Minimum Tax (C Corporation).

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The loss of that "intangible asset value" represented by the key person may be greater than that caused by a fire, flood, or other catastrophe. When insuring a loss through death, permanent whole life insurance accumulates reserves which may be used for the ultimate retirement, termination, or retraining of successors.

Businesses insure against casualty losses, and the same technique is appropriate for losses of key persons. The difference is that a business might never experience a fire, but each key person will disappear someday through death, disability, retirement, or termination.

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