Fact Sheet

Key person Insurance

Can provide financial protection to your business in the event that a key person dies or is unable to work due to injury or illness.

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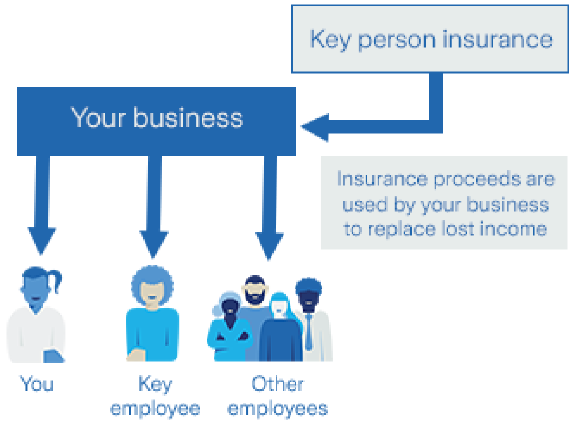
If a key person is unable to work due to accident, illness or death this may have a significant financial impact on your business. Insuring your key people can enable you to receive a lump sum to boost the working capital of the business and ride through a potentially difficult period.

How does key person insurance work?

Key person insurance involves taking out insurance cover (life, total and permanent disability (TPD) and/or trauma) with the key person as the life insured.

If the key person is unable to work (due to illness or death) the policy pays a lump sum to the business (or policy owner). The business can use that money to replace the lost revenue or capital value that should be generated by the key person.



The purpose of the insurance is to prevent a reduction in profitability or capital value of the business due to the loss of the key person.

Key people in your business

A key person is someone whose inability to work would cause a significant and direct financial loss to the business. This includes reduced revenue and/or loss of access to clients. A key person may be a sales person or a technical expert.

You need to consider who is a key person in your business. Consider what would happen if a particular person was not able to do their role? Can that role be easily done by another person and what amount of downtime would the business experience while finding a suitable replacement?

Key people in your business may include :

- Yourself
- Managing director or sales director
- Employees with specialist knowledge or strong client relationships

The loss of a key person can impact on the revenue and value of the business. Talking about your business and the roles of different employees with your financial adviser may help to determine the key people in your business.

The 'purpose' of key person insurance

There are two possible purposes for key person insurance – revenue or capital.

A revenue purpose is focused on replacing income lost due to the key person being unable to work. This may relate to loss of revenue if your key person is a sales person. Other revenue purposes include recruitment costs to find a replacement and training of a new employee.

A capital purpose is used to replace capital if the key person is unable to work. This could relate to the need to repay creditors or repayment to the key person if they have loaned the business money. There may also be an impact to the value of the company.

Taxation of policy proceeds

The tax deductibility of premiums and the taxation of insurance proceeds depend on the purpose of the key person insurance. A general summary of the income tax treatment is shown in the following table. It is important that you get specialist tax advice from your accountant or tax adviser if you are considering taking out a key person insurance policy.

Purpose	Premiums	Proceeds
Revenue	Tax deductible	Assessable income
Capital	Not deductible	Tax-free

Where a capital purpose exists, the proceeds of a key person policy are not assessable income however may be subject to CGT (capital gains tax), as shown in the following table.

Policy Type	CGT Treatment
Term Life	No CGT unless recipient was not the original beneficial owner and gave consideration for the policy

TPD and Trauma	CGT applies if the proceeds are paid to someone other than the life insured or their relative

Other things you should know

Key person insurance does not apply to the resignation or retirement of a key person. It applies to the key person being unable to work due to death, total and permanent disability or serious illness.

Specialist tax advice should be sought to understand the tax implications of key person insurance.

Legal advice may also be required to ensure the policies are structured correctly given your business's purpose in obtaining key person insurance.

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