



# Agent and Advisor Guide to Advanced Markets Concepts



## Key Person

Loss of a key person can adversely affect the business' earning potential and will cause expenses related to finding his/her replacement. Typical losses associated with losing a key employee include:

- Loss of management experience and leadership;
- Loss and disruption in production;
- Loss of credit rating for business; and
- 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 it works:

1. The business purchases a key employee life insurance policy on the key employee. The business is owner and beneficiary of the policy.
2. The business makes non-deductible premium payments.
3. Cash values inside the policy grow tax-free.
4. If key employee dies, the business will receive income tax free death proceeds.

*Note: In order for the death proceeds to receive income-tax free treatment, the Pension Protection Act of 2006 requires two items are met:*

- a. The notice and consent requirements are met; and
- b. The insured is a key person or the ultimate payee (not beneficiary) is:
  - i. A member of the insured's family;
  - ii. The designated beneficiary (other than employer);
  - iii. A trust established for the benefit of any such person; or
  - iv. The insured's estate.

### A key person is defined as:

An employee at any time during the 12-month period before the insured's death

who is (at the time the policy is issued):

A director;

A highly compensated employee within the meaning of IRC 414(q) (\$110,000 in 2009); or

A highly compensated individual within the meaning of IRC 105(h) (5), except that "35 percent" shall be substituted for "25 percent" in subparagraph (c) thereof (an officer, a 10% owner, or in the highest 35% paid bracket)

### Advantages

Business receives needed funds at key employee's death. These funds can be used to offset production declines, bolster the business' credit rating, and find the key employee's replacement.

Business can access the policy's cash value if necessary.

When properly structured, the death proceeds will be received income tax free.

The preceding summary is intended to be a general discussion of the topic presented, and is based on our current understanding of applicable tax laws, regulations and rulings. In actual practice, the transaction discussed may be more complex and will require the attention and expertise of professional advisors. In no way should this summary be construed to constitute tax or legal advice. **For agent use only.**