Five things you need to know about Key Employee Insurance (Life/Disability)

1. Who owns the policy and how is it funded: This is an insurance policy taken out by a business to compensate that business for financial losses that would arise from the death or extended incapacity of the member of the business specified on the policy. The policy is designed for employees of a business who are uniquely valuable to the company.

2. Why having a key employee policy is beneficial: Money from the policy would help offset such costs as: hiring temporary help, training a successor, and business shortfalls / losses due to the absence of the key employee.

In some cases this type of coverage would be a mandatory stipulation from a lending institution to protect their interest and investment.

Professional services may have a higher need for this type of coverage due to legal or ethical restraints. For example, a law firm or medical office can't replace a twenty-year veteran with a new graduate.

There also may be positive tax implications if the agreement structure is appropriate to the specific type of business. (C corp., S corp., etc…) This should be evaluated on a case-by-case basis. If the premiums are not taken as a tax deduction, the death benefit to the company/owner would be tax-free.

3. Should you use Term or Permanent Insurance: It all depends on the individual situation, purpose, and budget. Term is the cheaper alternative, especially if you can get a "first to die" provision. This allows coverage of multiple lives with the cost of one policy.

If you elect to use permanent insurance, the policy could be transferred to the insured person upon retirement as a form of added compensation. This could be part of an executive bonus package that would keep your important personnel productive and loyal to the company/owner. This may help the bottom line and be beneficial in tax planning.

With a permanent policy the company/owner would have the option to take out a policy loan against the cash value. Interest on loans taken against a key man insurance policy may be allowed as a business expense. (This should be evaluated on a case-by-case basis to ensure accuracy.)

WINCH FINANCIAL
Investing for all seasons

4. Pension Protection Act of 2006/ COLI (Corporate Owned Life Insurance) Best Practices Act: Under this law, life insurance death benefits of employer-owned life insurance policies issued after the effective date of August 17, 2006 are income taxable (to the extent the death benefit exceeds the employer's premiums) unless certain requirements for an exception to taxation are met.

5. How do you avoid key employee insurance taxation?

Notice and Consent Requirements:

- The employee must be notified in writing, **prior to the issuance of the life insurance policy**, that the employer intends to insure his/her life and the maximum face amount that can be applied for on his/her life.
- The employee provides written consent to being insured under the policy
- That the employer may choose to keep the policy in force even after the employee separates from services for the employer.
- The employee must be notified in writing that the employer is the beneficiary of all or part of the death benefit proceeds.

Unless the employer provides written notice and obtains the employees' written consent prior to the issuance of the policy, the death benefit of the life insurance policy will be taxable from day one. Notice and consent may not be obtained after the life insurance policy is issued to remove this taxable death benefit status.

WINCH FINANCIAL
Investing for all seasons
424 E. Wisconsin Avenue | Appleton, WI 54911
T: 920-739-8577 | 800-640-8010 | F: 920-954-5499