

Insuring Key People at Small Companies

At a multinational corporation, the loss of any single employee may hardly cause a ripple in its ongoing business. That's often not true for a small business. If you're the prime mover, your inability to work could have severe consequences. The same is true if you have partners or other vital personnel who can no longer do their jobs.

Building a strong team can hedge against this risk. Even so, your company may want to acquire insurance that will provide needed cash in a worst-case scenario. These policies have been called "key man" insurance, but today a more apt description is "key person" or "key employee" coverage.

Life Insurance for Your Business

Key employee coverage usually includes life insurance. The insured individual probably would be you, the business owner, if you're actively involved in operations. Partners or co-owners also could be covered; the same is true for, say, a sales or production employee whose absence would create a huge gap in profitability.

The typical structure of key employee life insurance is to have benefits paid to the company in case of the insured individual's death. The cash flow could help keep the company viable while a replacement employee is sought and installed. In another situation, key employee insurance can be part of a buy-sell agreement.

Example: Diane Edwards and Frank Grant are co-owners of EG Corp. The company buys life insurance on both Diane and Frank. If Diane dies while her life is covered, the proceeds will go to EG, which can buy Diane's shares from her heirs, leaving Frank as the principal owner. The reverse will happen if Frank is the one to die.

Coverage Choices

As is the case with any type of life insurance, some decisions must be made. Should key employee insurance be term or permanent? Term policies tend to have much lower premiums; they may make sense if the coverage will be needed only for a certain amount of time. A business owner who expects to sell the company or retire within 10 years might prefer a 10-year term policy, for example.

Permanent insurance (which might be known as whole life, universal life, or variable life) generally has much higher premiums. These policies usually have an investment account called the cash value. As the owner of the policy, the company might be able to tap the cash value via loans or withdrawals, if necessary. As the label indicates, permanent life could be worth buying for long-lasting coverage.

In addition to the type of policy, a small company buying key employee life insurance must decide how much coverage to acquire. Ideally, the amount should be sufficient to keep the company going until it recovers from the individual's death, perhaps with a new hire or new owner. If such an amount is difficult to determine, you might go by a rule of thumb, such as buying coverage equal to 8 or 10 times the insured individual's salary. The amount of insurance should be reviewed periodically and changed when appropriate.

Dealing with Disability

If a key individual gets sick or injured and becomes unable to work, the impact on the company can be as serious as that person's death. Therefore, key employee disability insurance also should be considered. Disability policies have many moving parts: the definition of disability, the waiting period before benefits begin, the length of time benefits will be paid, and so on. An experienced insurance professional may be able to help your company find effective disability coverage at an affordable price and also assist with key employee life insurance.

For both life and disability key employee policies, the premiums your company pays probably will not be tax deductible. Any life insurance benefits on an employee's death that are payable to the company may be taxable income to the extent the benefits exceed the premiums and other amounts paid by the company for the policy. On the other hand, because key employee disability premiums are not deductible, benefits received from a policy generally are tax-free. Our office can explain the likely tax treatment of any key employee insurance you are considering.