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TEMPEWICK WEALTH MANAGEMENT

Key Person Insurance

A company's success often relies heavily on a small group of its employees. Losing the services of a member of the executive team or a crucial staff member with specialized skills can jeopardize the continuity of the business. These essential individuals are often referred to as "key persons.

What Is Key Person Insurance?

Key person insurance compensates a business for financial losses that would arise from the death or disability of a key member. In many cases, it provides the funds necessary to allow the business continue operations where it may otherwise fail. A key person insurance policy is paid for by the company, insures the key person, and names the company as the beneficiary.

Advantages

Key person insurance provides business owners, employees, and customers with the peace of mind of knowing the business will continue operations following the loss of a critical employee. The benefits provided can:

- Help offset revenue loss
- Finance the recruiting and training of a replacement
- Help maintain credit ratings

Taxation

Generally, the benefits under a life insurance or disability policy are received income tax-free by the business. Premiums paid for life or disability insurance for key person purposes generally are not tax deductible.

However, life insurance ownership poses a risk for alternative minimum tax (AMT) consequences for C corporations.

- Life insurance proceeds are included in the corporation's AMT calculation.
- Increases in life insurance policy cash values are included in the corporation's AMT calculation.

What Is a Key Person's Value?

It may be difficult to put a precise dollar amount on the value a key person brings to an organization.

There are three generally accepted estimation methods available:

1. Multiples of Compensation

Multiples between 2x and 10x have been used. The nature of the key person's services should be taken into account, with top executives being insured for a multiple at the top of the range.

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About our firm:
Tempewick Wealth Management is a wealth and insurance firm with professionals specializing in estate and investment planning, business succession and wealth transfer.

2. Cost of Replacement

This method factors in all facets of locating, hiring, and training a replacement. It includes recruiting costs such as advertising for the open position and an allowance for additional compensation required to attract the desired candidate. This method is generally used when skilled applicants are plentiful and the business does not anticipate a lengthy search for a replacement.

3. Contribution to Profits

This method multiplies the estimated revenue generation potential of the key person by the amount of time it will take to locate, hire, and train a replacement.

This is the most commonly used method for salespeople. An average of sales revenue generated in the past 3–5 years is used. This number is multiplied by the number of years that will elapse before the revenue generation is replaced.

Key Person Insurance

The business buys a policy on the life of each key person.

Upon the death or disability of the key person, the business receives an insurance benefit it can use to continue business operations and/or locate and train a suitable replacement.