Key Person Protection

WHAT IS KEY PERSON PROTECTION (PROFIT PROTECTION)?

Key Person Protection (Profit Protection) helps safeguard a business against the financial effects of death, terminal illness, and specified critical illness (if chosen) of a key person. It's designed to provide a financial buffer in the event of a key person becoming permanently or temporarily unable to make their normal contribution to the business. Proceeds would typically be used to replace lost profit or to fund finding and hiring a replacement for the key person.

HOW DOES IT WORK?

Key Person Protection (Profit Protection) is life assurance or life assurance and critical illness cover (if chosen) written on the life of the key person but owned by the business so that any money due becomes payable to the employer.

The business pays the premiums. This applies to both Limited Companies and Limited Liability Partnerships.

With a partnership, the policy is written on an own life basis and may be placed in trust for the benefit of the other partners.

WHO IS A KEY PERSON?

Key people are individuals whose skill, knowledge, experience or leadership contributes to a business' continuing success.

Typical examples of a key person might be:

- The owner of the business, who's long working relationships with major clients are crucial.
- The head of product development in a business.
- The sales director who brings in the larger part of the business.
- A 'figurehead' whose style, personality or reputation is crucial.
- A technician who understands key customer requirements.

HOW TO RECOGNISE A KEY PERSON?

It's important to establish who the real key people are by asking yourself: -

- Which sales person would they least like to lose to the competition?
- How important are the research and development staff to the business?
- Have any executives been expensive or hard to recruit? (If so, they could be equally costly and difficult to replace.)
- Is responsibility for computer systems vested in one highly knowledgeable person?
- Who's the person with the most valuable contacts?

DETERMINING THE LEVEL OF COVER

The level of cover reflects the cost that losing a key person could have in terms of profits – for instance, it might be equal to the amount of profit typically generated by a sales director.

Issues such as the cost of finding, hiring and training someone to the same standard should also be taken into account.

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TAX TREATMENT OF PREMIUMS

There is no direct legislation on the subject of key person policies and therefore businesses should always consult their inspector of taxes. The principles were laid out back in 1944, when the Chancellor, John Anderson, made a statement around the tax treatment of key person policies.
In summary he said that, provided that:

- the sole relationship is employer/employee;
- the cover is for loss of profits;
  and
- the policy is a short term assurance plan

A company's tax inspector may allow corporation tax relief on the premiums.

HM Revenue & Customs (HMRC) have also produced guidance as to whether key person policy premiums can be allowed as deductions by the business (Business Income Manual (BIM45525)). With respect to the term of a key person policy, HMRC state that it "should not extend beyond the period of the employee's usefulness to the company." If a key person is a substantial shareholder, it is unlikely that tax relief will be granted on the premiums. Policies with an investment element, for example an endowment, are unlikely to qualify either.

TAX TREATMENT OF CLAIMS

Generally speaking, if tax relief has been allowed on the premiums, the proceeds will be taxed as a trading receipt. If no tax relief has been received at outset, the proceeds will not be taxed. But this is merely a general statement: the tax treatment of premiums is independent to that of the tax treatment of proceeds. Much will depend on the judgement of the local tax inspector.

PROTECTING YOUR BUSINESS IS OUR PASSION

Why not visit us and have a coffee with one of our experienced business protection advisers who will explain how we can help.

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