



KEY MAN LIFE INSURANCE

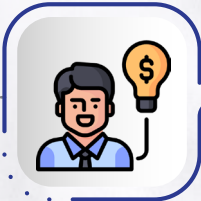
AN OVERVIEW

Definition



Key Man Life Insurance is a life insurance policy a company purchases on a key executive or employee whose death would significantly impact the business. The company is both the owner and the beneficiary of the policy, and it pays the premiums.

Who is it for?



Founders or Co-founders



Top Executives

(e.g., CEOs, CFOs, COOs)



Key Employees

with specialized skills or knowledge



Individuals

whose relationships or reputation are crucial to the business

When should a company get it?

Significant Financial Loss:

If the loss of a specific individual would result in substantial financial loss or operational disruption.



Reliance on Expertise:

When the company heavily relies on the expertise, skills, or relationships of a particular person.

Securing Loans or Investments:

Lenders and investors often require this insurance as a condition.

Smooth Transition:

To cover costs associated with finding and training a replacement.

Tax Implications

1. Premium Payments:

- Not deductible as business expenses under **IRC § 264(a)(1)** if the company is the beneficiary.



2. Proceeds:

- Generally not taxable as income under **IRC § 101(a)(1)** if the company is the beneficiary and the policy is not part of a tax avoidance scheme.

3. Impact on Shareholder Basis (for S corporations):

- Premiums paid decrease shareholders' basis only to the extent that they pay for the insurance feature. The portion that increases the cash surrender value does not reduce the shareholders' basis.

Example Using Numbers

Scenario:

Company: XYZ

Insured: CEO, Grace

Policy Face Value:
\$1,000,000

Annual Premium:
\$50,000

Annual Increase in Cash Surrender Value:
\$10,000



Tax Implications:

1. Premium Payments:

- \$50,000 annual premium is not deductible.

2. Impact on Shareholder Basis (for an S corporation):

- Shareholders' basis reduced by \$40,000 each year (\$50,000 premium - \$10,000 increase in cash surrender value).

3. Proceeds:

- \$1,000,000 death benefit received tax-free.



Summary:

Annual Premium:

- \$50,000

Shareholders' Basis Reduction:

- \$40,000/year

Death Benefit:

- \$1,000,000 tax-free



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