Small-Business Life Insurance Kit

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Allianz Life Insurance Company of North America

Key person life insurance

Protecting the operations of your business

Key person life insurance can help you retain your key employees and plan for the continuity of your business.

If something were to happen to one of your key employees, what would happen to your business?

Whether a key person leaves for a different position, is unable to work, or passes away, the disruptive effect on your business could be the same.

The loss of a **VITAL EMPLOYEE** can have a much more catastrophic impact on the survival of a small company than a large one.[1]

Although you can't prevent some of these situations, there is much you can do to prepare. One option might involve the purchase of key person life insurance.

What is key person life insurance?

Simply put, key person life insurance is a life insurance policy that covers one (or more) of your key employees, with the primary goal of protecting the value and ongoing operations of your business.

Key person life insurance can be the foundation of a succession plan for your business. By offering a death benefit – and in some cases, potential cash value you can access in an emergency – key person life insurance can help make sure that, for your business, life will go on.

Key person life insurance can also help protect your business from a key employee leaving your company, by helping you secure the benefits you offer through a separate nonqualified plan as an additional incentive for the employee to stay.

Since life insurance is an underwritten product, any strategy that includes it is contingent on health underwriting and, in some cases, financial underwriting.

Who is a key person?

A key person is an employee whose absence would have an adverse economic effect on your business. Adverse effects from the loss of a key person may include a decline in profits, the loss of credit standing, or the extra expense of hiring a capable replacement.

Remember that, as the owner of your business, you're also a key person. All of the benefits we discuss here apply to you, too.

For all that's ahead.℠

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[1] "Small World, Trends in the U.S. Small Business Market," LIMRA, 2013.

Product and feature availability may vary by state.

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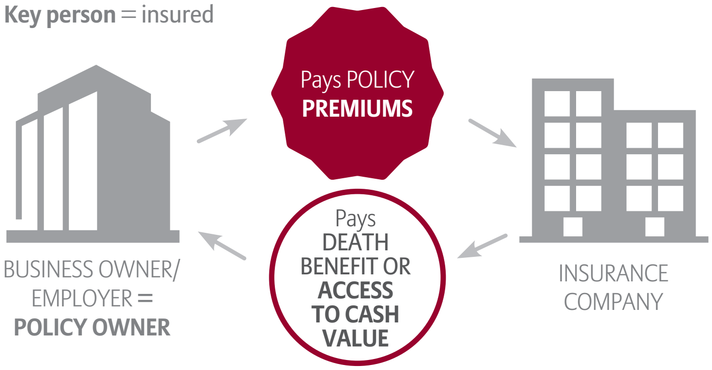
How does key person life insurance work?

Your business purchases a fixed index universal life insurance policy on the key employee, pays the premiums, and is the beneficiary in the event of the employee's death. As the owner of the policy, your business may surrender it, borrow against it,[1] and use either the available cash value or the death benefits as desired.



Determining the amount of life insurance needed

Although there are no hard rules for calculating a key employee's economic value, these guidelines may help:

- **Replacement value:** The appropriate level of coverage could equal the cost of recruiting and training an adequate replacement.
- **Business life value:** Estimate the loss of annual earnings if the key person were to die, and multiply that by the number of years the key person would have worked until retirement.
- **Multiple of salary:** The death benefit could equal the key employee's annual salary, times the number of years a newly hired replacement might take to reach a similar skill level.
- **Contribution to profits:** You may calculate the key employee's value in terms of the amount of income (through sales revenue, for example) their departure would cost your company.

What are the tax implications?

The premiums you pay for key employee life insurance are not deductible from your business's federal income tax, since your business is the recipient of the benefits. However, in most cases, any death benefit your business receives is not taxable.

An employer-owned life insurance policy is subject to the requirements of Internal Revenue Code Section 101(j) in order to obtain an income-tax-free death benefit. In general those rules require that before the policy is issued, the employer must provide the insured with a written notice of the life insurance and obtain a written consent from the insured. Consult with your tax advisor or attorney for application of those rules to a specific situation.

Nevertheless, if your business is a C corporation, the receipt of death benefits may increase the corporation's liability for the Alternative Minimum Tax. Before purchasing key person life insurance, you should consult a tax professional about your unique circumstances.

What happens if the key employee leaves or retires?

If an insured key employee terminates his or her relationship with you, there are various options for the life insurance policy:

- Your business can continue to own the policy, pay the insurance premium, and receive the death benefit upon the death of the former key employee.
- If your key employee is retiring, you can offer the policy as a bonus, at its present value. The employee would become the owner of his/her own policy. Such compensation would be considered taxable income for the retiring employee for income tax purposes.
- Your company can surrender the policy to the life insurance company and obtain the cash surrender value.

Call your financial professional today to learn more about how life insurance can be an important part of your business continuation plan.

[1] Policy loans and withdrawals will reduce available cash value and death benefits and may cause the policy to lapse, or affect guarantees against lapse. Additional premium payments may be required to keep the policy in force. In the event of a lapse, outstanding policy loans in excess of unrecovered cost basis will be subject to ordinary income tax. Tax laws are subject to change. You should consult a tax professional.

Policy loans are not usually subject to income tax unless the policy is classified as a modified endowment contract (MEC) under IRC Section 7702A. However, withdrawals or partial surrenders are subject to income tax to the extent that the cash value in the policy immediately before the distribution exceeds the owner's tax basis in the policy and, if taken prior to age 59½, a 10% federal additional tax may apply. Tax laws are subject to change and you should consult your tax professional.

This piece is designed to provide general information on the subjects covered. Pursuant to IRS Circular 230, it is not, however, intended to provide specific legal or tax advice and cannot be used to avoid tax penalties or to promote, market, or recommend any tax plan or arrangement. Please note that Allianz Life Insurance Company of North America, its affiliated companies, and their representatives and employees do not give legal or tax advice. You are encouraged to consult your tax advisor or attorney.

Guarantees are backed by the financial strength and claims-paying ability of Allianz Life Insurance Company of North America.

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