

What happens to your business if something happens to one of its Key People?

Many businesses rely on one or more key people for their continued operation and success. How can you protect your business if one of these key people dies or becomes disabled?

Having the right insurance in place can protect your business from the sudden loss of a key person in a number of ways. Not having the right protection could place your business in great difficulty, and could even prove fatal.

Who is a 'key person'?

A key person is any person who provides your business with significant economic gain or benefit through their continued association. Key persons play an important part in generating the revenue for the business, and/or obtaining business loans providing funds to repay outstanding loans.

The following are some examples of key people:

- Managing Director
- Partner
- Director who is guarantor for a number of loans
- Employee with a particular technical expertise
- Senior sales manager

What if a key person dies or becomes incapacitated?

If a key person can no longer work, the business would normally need to find and train a replacement. During this time, the revenue (sales) of the business could significantly reduce, putting further stress on the business and its ability to meet its everyday expenses.

The loss of a key person could also jeopardise any outstanding loans held by the business. For example, on the death of one of the business principals, a lender may call in a loan if it is not satisfied that it can still be repaid. Such an event could force the business to sell its assets in order to repay the loan at short notice.

How to use insurance to cover key person risk?

Insurance for key person purposes can protect your business if one of your key people dies or becomes unable to work. The insurance proceeds could be used to replace lost revenue or to protect the assets of the business by providing funds to repay outstanding loans.

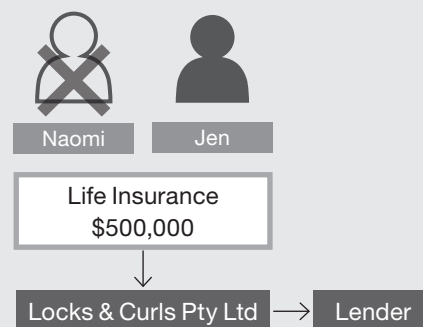
The following case studies provide examples of how insurance can be used:

Locks & Curls Pty Ltd

Jen and Naomi are directors of Locks & Curls Pty Ltd, a hair dressing business. The business has recently borrowed \$500,000 to purchase another shop as part of its expansion plans and Naomi is guarantor for the loan.

Locks & Curls establishes a life insurance policy providing \$500,000 cover. The company owns the policy and Naomi is the life insured.

A number of years later, Naomi dies and the lender requires the loan to be repaid.



Outcome: The proceeds from the life insurance policy allow Locks & Curls to repay the loan immediately, without having to sell the new property or any other significant assets.

Glas Landscaping Pty Ltd

Peter runs a landscaping business Glas Landscaping, which provides landscaping to corporate clients and councils. He employs Tony who has built a solid client base and is now responsible for generating 60 per cent of the business revenue.

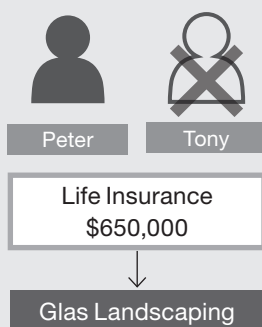
Last financial year, Glas Landscaping's net profit was \$1m.

Peter realises that Tony is critical to the immediate survival of his business and estimates that should he no longer be able to work, it would take him 12 months to find and train a suitable replacement. Peter establishes an insurance policy over Tony's life for \$650,000.

The amount of insurance has been calculated as follows:

Lost profit	\$600,000 (60 per cent of net profit)
Hiring and training a replacement	\$50,000
Total insurance required	\$650,000

Tony is permanently injured one day and can no longer work. The insurance proceeds replace 60 per cent of the business profit for 12 months, and cover the cost of finding and training a replacement for Tony.



Outcome: The insurance benefit has allowed Peter's business to survive the loss of its most valuable employee, with minimal disruption to its cash flow.

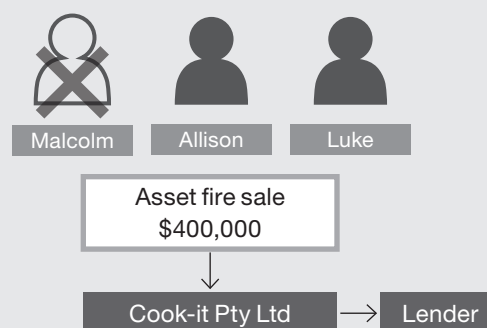
What can happen without life insurance for the key person?

A business could face significant hardship, or even closure, on the unexpected loss of one of its key people. Insurance can help minimise this risk.

Cook-it Pty Ltd

Malcolm, Allison and Luke are the principals of Cook-it Pty Ltd, a family owned and operated business which specialises in manufacturing commercial cooking equipment. The business recently borrowed \$400,000 to purchase new plant and equipment for its factory. Malcolm is guarantor for the loan.

When Malcolm dies, the lender requires immediate repayment. With no insurance proceeds, Cook-it is unable to repay the loan and is forced to sell a number of significant assets at short notice to avoid liquidation.



Outcome: The financial position of Cook-it Pty Ltd has substantially deteriorated and it may take many years to recover.

Who should own the insurance policy?

Insurance to cover key person for revenue purposes is generally held in the name of the business. If an insured person dies or becomes permanently disabled, the business will use the insurance proceeds to replace lost income or hire and train a replacement.

If the purpose of the insurance is to repay a loan, the policy owner will usually be the entity, which holds the loan. This will often be the business itself.

Are the insurance premiums deductible to the business?

The purpose of insuring the key person will determine whether the premiums are tax deductible and how the proceeds are taxed.

As a general rule, where the purpose of the insurance is to protect the revenue of the business, such as by replacing lost sales, the premiums will be tax deductible and the insurance proceeds will be assessed as income.

Alternatively, where the purpose of the insurance is to protect the assets of the business, such as to pay down an outstanding loan, the premiums will not generally be tax deductible and the proceeds will not be assessed as income. In some cases however, capital gains tax may apply.

You should always speak to your accountant or registered tax agent about the tax treatment of insurance policies.

The importance of financial advice

Insurance for a key person can be complex and the needs of each business will be different. Your financial adviser can give you advice about the right type and level of cover for the key person, tailored to your business needs. You should also seek professional tax advice.

Speak to your Financial Adviser about the right type of cover for your business needs.

**Contact Financial Solutions Victoria Pty Ltd for further information on
03 51532507 or visit www.finsolvic.com.au**