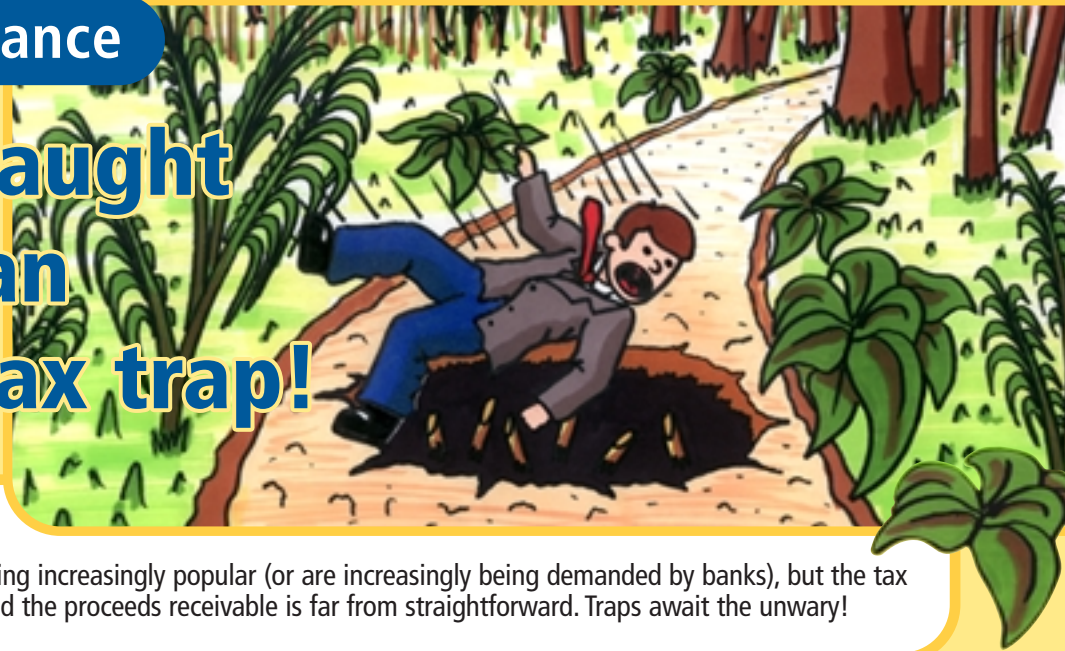


## "Key-Man" Insurance

# Don't get caught in a key-man insurance tax trap!



### Directors beware!

Key-man insurance policies are becoming increasingly popular (or are increasingly being demanded by banks), but the tax treatment of the premiums payable and the proceeds receivable is far from straightforward. Traps await the unwary!

### How do we define "key-man" insurance?

A "key-man" insurance policy is one taken out by a business on the life of key-worker to provide it with funds to protect it from the financial consequences of the key-worker dying or becoming incapacitated. The premiums are paid by the company and the proceeds will be receivable by the company, but it is the key-worker's life (or health) that is insured.

#### Tax trap 1

If the policy proceeds are not payable to the company, but are payable to the key-worker's estate or family, that is not a key-man policy and the premiums will constitute earnings on behalf of the key-worker and PAYE liabilities will arise. If the payments are not declared the back tax and NICs can be considerable when discovered by the Inland Revenue.

#### Tax trap 2

Assuming one is dealing with a true key-man policy, there are no PAYE or benefit in kind problems as no benefit accrues to the key-worker or his family. The company should be able to claim a corporation tax deduction, but – here comes the next tax trap – this might be denied if the key-worker is also a substantial shareholder in the company.

#### Tax trap 3

If the policy was taken to provide a financial "cushion" from the loss of the key-worker, then the proceeds will be taxed as if they were a trading receipt. It is often mistakenly assumed that if tax relief on the premiums is not claimed, then any proceeds receivable will be tax-free. This is not correct as the Inland Revenue has win-win rules. The taxability of policy proceeds is dependent upon the nature of the policy, not on whether a tax deduction is allowed (or claimed) in respect of the premiums. If the premiums are allowable as trading payments, the proceeds will inevitably be taxable as a trading receipt – but the reverse is not necessarily true.

### So take care!

It can be seen above that it is quite possible for premiums not to be tax deductible, but for the proceeds to be taxable! These proceeds will usually be quite large, so the tax liability arising could be significant. And if the intention is to pass the proceeds to the key-worker or his family, double-taxation could arise.

## Barnes Roffe Topical Tips

- Decide who the intended beneficiary is to be. If it is the key-worker or his family, the policy should be in his name and the premiums should be paid by him out of taxed income.
- For a true key-man policy, consider whether the premiums might not be regarded as "wholly and exclusively" for the company's trade (e.g. if the key-worker is a major shareholder) and therefore not tax deductible.
- Ensure that policies do not attain a surrender value (e.g. endowment policies) as such premiums will be capital in nature and gains will be taxable.

**Consult your Barnes Roffe LLP contact partner for detailed guidance in this important area.**