



NORTHWOOD

Financial Services cc

Authorized Financial Services Provider No. 13296

KEY-PERSON ASSURANCE

THE CONCEPT:

- Should the key-person die, become disabled or be diagnosed with a dread disease, the functioning and profitability of the business will be severely compromised.
- Cover will provide the funds to cover any losses incurred as a result of the incapacity of the key-person as well as the funds to find, employ and train a new key-person.

ESTABLISH AN EMPLOYER / KEY-PERSON RELATIONSHIP

- Employer: the business
- Key-person: an employee whose services are instrumental to the functioning and profitability of the business
- In a company or CC, directors and members can only be key-persons if they are also employees of the business. As proof, underwriting may check to see whether they are receiving a salary.

CONSIDER A POLICY WITH THE APPROPRIATE BENEFITS

- Such as Life Cover, possibly including disability and dread disease.

CONSIDER THE PARTIES TO THE CONTRACT

Business: Owner, premium payer and beneficiary.

Key Person: The life being covered.

CONSIDER WHETHER THE PREMIUMS SHOULD BE TAX DEDUCTIBLE FOR THE BUSINESS OR NOT:

If the premiums are tax-deductible for the business, they will fall into the business' taxable income when paid out. You will therefore need to sell more cover.

If the premiums are not tax-deductible, the proceeds will be tax-free.

ESTATE DUTY:

- Estate duty consequences will only arise if the key-person dies.
- Normally any cover taken out on your life and paid out to a third party as a result of your death is dutiable in your estate.
- However, the proceeds of a key-person policy are not dutiable provided:
- The policy was not effected at the instance of the key-person
 - No premium was paid by the key-person
 - No amount of the proceeds will be paid to the estate of the key-person, a relative or dependant of the key-person or a family company.

- “Relative”: Includes the key-person’s spouse and anyone related within 3 degrees and their respective spouse.
- “Family company”: Non-listed and capable of being controlled by the key-person (whilst alive) or any relative of the key-person.

CONSIDER THE AMOUNT OF COVER:

The rule of thumb is 7 times the annual salary of the key-person (although there are more complex ways of valuing a key-person).

Death, Disability and Dread Disease Cover:

If the premiums were tax deductible, extra death, disability and dread disease cover must be sold so that the company can pay the income tax when the proceeds are paid out:

E.g. CC with key-person who earns R 100 000 per annum:
Calculation: (Cover: 7 times annual salary) divided by [1 – MTR (as a decimal)]
700 000 / (1 - 0.28)
700 000 / 0.71
R 972 222

Death Cover Only:

If the death cover proceeds are going to be estate-dutiable on death, the executor of the deceased key-person will claim the estate duty from the business. More death cover must therefore be sold.

E.g. Same as above
Calculation: (Cover: 7 times annual salary) divided by [1 – estate duty (as a decimal)]
700 000 / (1 - 0.20)
700 000 / 0.80
R 875 000

Where the premiums were tax deductible i.e. income tax is payable on the proceeds and the death cover proceeds are dutiable, divide the death cover by 0.568. This is because income tax will only be payable on the proceeds after estate duty is subtracted:

$1 \times 80\% = 0.80$; $0.80 \times 72\% = 0.576$
E.g. Same as above
Calculation 700 000 / 0.576
R 1 215 278