A Key Employee Indemnification Insurance Plan

While you've probably insured your business against the loss of buildings and equipment, what about your company's most valuable assets...your key employees?

Prepared for: **Successful Business**

Brought to you by:

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Need for Key Employee Indemnification

Why Does Your Company Need a Key Employee Indemnification Insurance Plan?

While you've probably insured your business against the loss of buildings and equipment, what about your company's most valuable assets...your key employees?

The talents and experience of key employees can account for much of the success of your business. If a key employee were to die unexpectedly, your profits might suffer. You could also face the financial strain of recruiting, hiring and training a suitable replacement.

What Happens When a Key Employee Dies?

Every successful business has one or more key people who are primarily responsible for the success of the business. When the business loses one of these key people, it may suffer a tangible financial loss arising from one or more of these causes:

Reduction in Earnings	Are significant portions of business sales or receipts attributable to a few key people?
Disruption of Management	Is business management concentrated in the hands of a select few key people?
Replacement Costs	How much would it cost to recruit, hire and train a replacement for a key employee?
Credit Problems	How will your creditors react to the loss of a key employee?
Confidence Problems	How will your customers, suppliers and other employees react to the loss of a key employee?

A Potential Solution Using Life Insurance

Purchase life insurance on any key employees whose death would result in financial loss to your business.

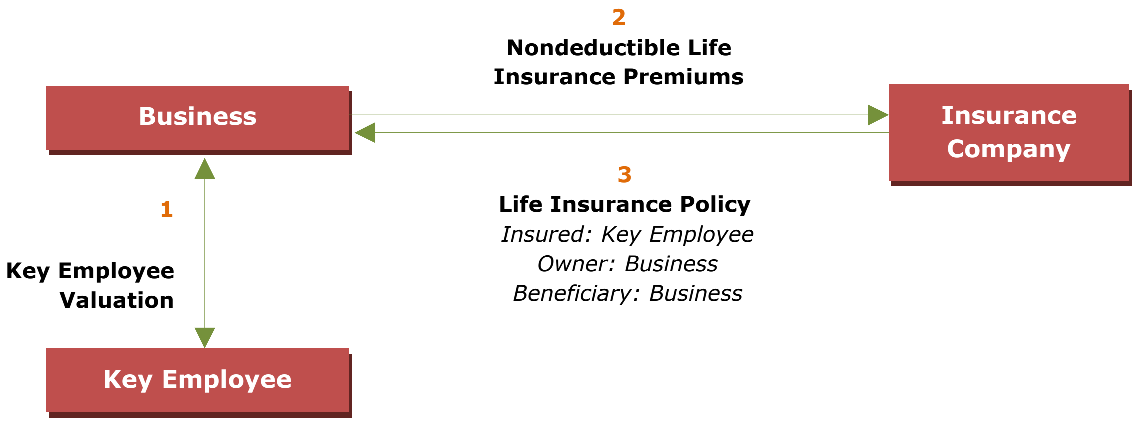
The proceeds from key employee indemnification insurance can be used to:

- Indemnify your business for the permanent loss of the key employee's skills and experience.
- Replace lost profits.
- Locate, hire and train a replacement.
- Provide a financial reserve during the adjustment period following the key employee's death.
- Fund the purchase of a deceased shareholder's ownership interest in the business.
- Provide benefits to the deceased employee's family.

The Mechanics of a Key Employee Indemnification Insurance Plan

The bottom line is that key employee indemnification insurance can provide the cash your business will need -- **for whatever purposes** -- to see itself through the difficult transition period that follows the death of a key employee.

Here's how a key employee indemnification insurance plan could work for your business today...



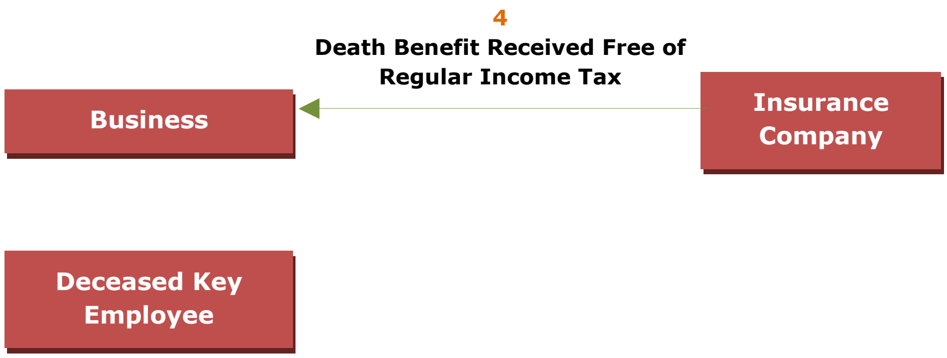
1. Your business establishes the value of the key employee's contribution to the business.

2. After satisfying the notice and consent requirements for employer-owned life insurance contracts, your business purchases insurance in that amount on the key employee's life and pays the nondeductible premiums.

3. The life insurance policy is owned by your business, which is also named as the beneficiary.

The Mechanics of a Key Employee Indemnification Insurance Plan

Here's how a key employee indemnification insurance plan could work for your business at the key employee's death...



4. While the premium payments for key employee indemnification insurance are not tax deductible, the death benefit is received by the business free of regular income tax at the key employee's death, assuming the requirements for employer-owned life insurance contracts are satisfied. However, while policy proceeds are not subject to the regular corporate income tax, corporations that are subject to the alternative minimum tax (AMT) may incur a tax liability, both on annual cash value increases and on the death benefit.

The Value of Income Tax-Free Policy Proceeds

The value of life insurance policy proceeds received free of the regular corporate income tax can be significant, particularly as they relate to pre-tax profit equivalents.

For example, in your company's **39 %** tax bracket, **$1,000,000** of income tax-free key employee policy proceeds is equivalent to **$1,639,344** of pre-tax profits!

Ask yourself...

What amount of sales or receipts would your business have to generate in order to produce pre-tax profits of **$1,639,344** ?

Profit Margin	Sales Required to Produce $1,639,344 in Pre-Tax Profits*
10%	**$16,393,443**
20%	**$8,196,721**
30%	**$5,464,481**

In other words, a **$1,000,000** key employee indemnification insurance policy could replace **$8,196,721** of sales or receipts lost due to the death of a key employee, assuming that your business averages a **20%** profit margin!

This example assumes that the requirements for employer-owned life insurance contracts entered into after August 17, 2006 have been met (see next page).

** Pre-tax profits are equivalent to net sales or receipts before application of the regular income tax. Alternative minimum tax implications are not taken into account.*

Summary of Key Employee Indemnification Insurance Plan Tax Results

- Key employee indemnification insurance premiums are not deductible because the business owns the policy and is the beneficiary.

- So long as the key employee holds no incidents of ownership in the life insurance policy, there are no income tax consequences to the key employee.

- Employer-owned life insurance proceeds received by the business at the death of the key employee generally are not subject to the regular corporate federal income tax, assuming the following requirements are met for contracts entered into after August 17, 2006:

  - Before the employer-owned life insurance contract is issued, the employee who is to be insured must be notified in writing that the employer intends to insure the employee’s life. The notice must include the maximum face amount for which the employee’s life could be insured, as well as state that the policyowner (the employer) will be the beneficiary of the policy’s death proceeds. In addition, the employee who is to be insured must give his/her written consent to be insured by the contract and to the insurance coverage continuing after the insured employee terminates employment; **and**

  - The insured must have been an employee of the employer at any time during the 12-month period prior to the date of death or have been a director or highly-compensated employee at the time the contract was issued.

- Both the annual increase in the policy's cash value and the death proceeds may have corporate alternative minimum tax implications. Consult your professional tax advisor.

- Assuming the policy is properly arranged, with the key employee holding no incidents of ownership in the policy, the death proceeds will not be included in the key employee's estate. If, however, the key employee holds an ownership interest in the business, the death proceeds may increase the value of the business interest that is included in the key employee's estate for federal estate tax purposes. Again, your professional tax advisor should be consulted.

Key Employee Indemnification Insurance Plan Action Checklist

Now…

- ☐ Value each key employee's contribution to the business.
- ☐ Select the appropriate life insurance funding vehicle.
- ☐ Satisfy the notice and consent requirements for employer-owned life insurance contracts.
- ☐ Establish each key employee's insurability.
- ☐ Arrange for payment of premiums.

Short-Term…

- ☐ Draft and execute a corporate resolution authorizing the purchase of key employee indemnification insurance.
- ☐ Review the issued policy(ies).

Longer-Term…

- ☐ An annual review can help ensure that the plan remains current.
- ☐ Consider the use of selective executive benefits to retain the services of key employees, as well as to satisfy the personal financial security needs of business owners.

Important Information

The information, general principles and conclusions presented in this report are subject to local, state and federal laws and regulations, court cases and any revisions of same. While every care has been taken in the preparation of this report, neither VSA, L.P. nor The National Underwriter Company is engaged in providing legal, accounting, financial or other professional services. This report should not be used as a substitute for the professional advice of an attorney, accountant, or other qualified professional.

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