

# Frequently Asked Questions: Keyperson Insurance

## Introduction

This factsheet provides answers to many of the most frequently asked questions relating to keyperson insurance.

## What is a keyperson?

A keyperson is an individual who is vital to the success of a business. The loss of a keyperson's specialist knowledge, skills or expertise could cause severe financial problems for the business and they are likely to be difficult to replace.

## What is keyperson cover?

This is the name given to life assurance cover taken out by a business on the life of a keyperson to protect its future profits and ensure continuity should the keyperson die or become seriously ill.

## What type of policy should be used?

The choice of policy will be largely influenced by the specific needs of the business, cost and tax implications.

Typically, the need for cover will be identified as short-term and suitable term assurance will be the most popular solution. As the serious illness of a keyperson could cause as many problems as their death, critical illness cover is often added to a keyperson life policy.

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## How do you calculate the amount of cover?

The sum assured under a keyperson cover policy should reflect the loss of profits that are expected to occur on the keyperson's death. A simple method is to take the keyperson's salary and multiply it by a factor of up to ten but this is likely to be imprecise. Other methods are based on multiples of business profits (see our Adviser's Guide for further details).

## How would the cover be set up for companies?

The purpose of keyperson cover is to ensure that funds are made available to a business on the death or serious illness of the keyperson. For companies, it is the company itself who should be the applicant for the cover, on the life of the key employee or director. The company would own the policy and pay all premiums. A trust is not required. An authorised official of the company, such as the managing director or company secretary, would make the applicant's declaration.

## What about partnerships?

Limited liability partnerships (LLPs) and Scottish partnerships are legal entities in their own right and can therefore take out policies, on the lives of key individuals, in the same way as companies.

Partnerships under English law do not have a separate legal entity and cannot effect a life policy. If a partnership has a key employee, who is not a partner, a keyperson policy can be taken out jointly by all the partners or, where this is not feasible, by one or two partners authorised to act on behalf of the partnership. The policy would need to be held under trust for all partners for the time being, to accommodate any future changes in the partnership.

If the keyperson of an English law partnership is a partner, the above routes could be considered or alternatively the partner could take out an own life policy under a suitable trust for the other partners.

## Can sole traders take out keyperson cover?

A sole trader may take out a policy on the life of a key employee.

## What about tax?

If certain criteria are met (see "What are the Anderson Rules?" below) it is possible for a business to receive tax relief on premiums under a keyperson policy. The relief is obtained by treating the premiums as an allowable business expense, which means that they can be offset against business profits for corporation tax purposes.

The taxation treatment of any policy proceeds (i.e. payment of life cover or critical illness benefit) will often depend on whether the premiums were tax deductible. Usually, if tax relief has been allowed on the premiums then any proceeds received are treated as trading receipts and charged to corporation tax. Conversely, if premiums are not tax deductible then any proceeds are typically free of tax.

If a business is eligible for tax relief on premiums, it cannot elect to waive this right in order to receive tax-free benefits.

A business should always ask its local Inspector of Taxes to confirm the likely tax treatment, of any proposed keyperson cover, before proceeding.

## What are the Anderson Rules?

These are not rules at all but a set of principles that formed part of a statement made in 1944 by Sir John Anderson, Chancellor of the Exchequer.

The principles form the basis on which a local Inspector of Taxes will decide whether keyperson cover premiums qualify as an allowable business expense. There are three conditions that have to be met:

- the sole relationship between the business and the keyperson must be that of employer and employee. Relief will not be allowed if the keyperson has a significant stake in the business.
- the life policy is intended to meet loss of profits resulting from the loss of the keyperson's services.
- the policy is a short-term assurance (although 'short-term' is not defined, most tax inspectors will allow relief for terms of up to 5 years).

## Can a business assign a policy to the keyperson?

A business may agree to pass the legal ownership of a keyperson cover policy to the keyperson. This might happen if the keyperson was leaving the business or there was no longer a need for the cover. It can be achieved by making an assignment of ownership to the keyperson.

The business should seek taxation advice before proceeding with an assignment of this nature. This is a complex area and corporation tax, income tax, CGT and national insurance implications need to be considered.

### Important Information

This factsheet is based upon our understanding of current tax and other legislation at the release date and may be subject to change in the future. Whilst every care has been taken to ensure the accuracy of this information, Friends Life can accept no responsibility for any actions taken as a result of this release.

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