INSURABLE INTEREST

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# Abstract

The only certain thing in this world is uncertainty. One can never predict as to what is in store in the future. Purchasing an Insurance policy can help people financially during difficult times. In business it is usually the owners, founders or one or two employees who are very important to the organization and without them the company activities would come to halt. A Keyman Insurance would help the company survive the loss of a person who is crucial to the organization. The paper aims to analyze the importance of Keyman Insurance for a business organization.

Keywords: Keyman Insurance, Term Insurance, Life Insurance

# Introduction

The world in which we live is full of uncertainties and risks. Individuals, families, organizations, property are exposed to various kinds of risks and dangers. It includes loss of lives, well-being, resources, property and so on. However, it is not always rationally possible to prevent those risks, thus the concept of insurance comes into play. Insurance mitigates the risk of loss caused by various factors. It provides financial stability to people at the time of crisis. It protects individuals, organizations as well as businesses from potential risks.

As a company puts a lot of time and effort in developing the abilities of its employees as well as making a significant contribution to their overall development it is important for the company to protect itself from loss of such employees. Thus, the Keyman insurance comes into play. Keyman insurance is defined as the insurance taken by the company on the life of its key employees. In Keyman Insurance the proposer, as well as the premium payer, is the employer itself and the life of the employee is insured and the benefit, in case of a claim, goes to the employer. The ‘Keyman' or Key person is an employee of the company having special skill or special set of abilities or one who contributes significantly to the profits of the company. The purpose of Keyman insurance is to enable the company to survive the loss of an important individual of the company who makes the business work. The company can utilize the insurance proceeds towards finding a replacement, if necessary, paying off the debts, distribute money to investors and provide financial stability to the company at the time of crisis. The policy gives alternatives to the company for the smooth functioning of their activities inspite of the loss of its key individuals.

## Keyman insurance

## KEYMAN INSURANCE- DEFINED

A Keyman Insurance is the life insurance policy taken on the key executive’s life. The company is the one, who pays the premium and also enjoys the benefit of the policy. The maturity amount is receivable by the company. It is also known as ‘key woman insurance’ or ‘business life Insurance’.

A Keyman Insurance is necessary in cases where the loss of a key executive would result in a substantial negative impact on the company's activities. The Insurance proceeds would help the company in finding a suitable substitute for the key executive or to implement other strategies to save the business.

In a small business, the key person is usually the owners or the promoters of the company. However, the main qualifying point for the Keyman Insurance policy is only that the absence of the key individual would sink the organization.

The object of the Keyman Insurance is to monetarily protect the business from financial loss due to death of the Keyman or in the case of Keyman quitting the company and the insurance proceeds would help the firm recover from the loss caused. As the name infers, the 'key man' is the way to the business' prosperity; without the person in question, the organization would bumble. Keyman incorporates a key-woman also and there can be more than one Keyman in an organization. Keyman protection can likewise be utilized to cover the partners in a partnership firm. The death of a Keyman can result in two types of losses for the company-

(a) Loss arising from profit reduction of the company

(b) Costs incurred by the company in replacing the Keyman

*WHO CAN BE A KEYMAN?*

Any individual having specialized skills whose loss can bring about financial instability in the company is eligible for Keyman Insurance. They could be Directors, Key Sales People, Key Project Managers, People with special skills etc.

*HOW DOES A KEYMAN INSURANCE WORK?*

In a Keyman Insurance policy, the company buys term insurance for its key employees. The company pays the premium and is the beneficiary of the policy. In case of loss of the key employee the insurance proceed will be paid to the company. These funds can be utilized until the company can find a new replacement.

To determine whether the company needs such type of insurance the executives must look out for persons in the company who is irreplaceable in a short period and without whom the business would come to halt.

*WHAT HAPPENS IN CASE OF KEYMAN QUITTING THE COMPANY?*

The employer has the following options in case the Keyman quits the company:

1. The employer can stop paying the insurance premium and allow the policy to lapse.
2. The employer can assign the policy in favor of Keyman.
3. It may continue paying the premiums and collect the maturity amount when the claim arises.
4. The policy could be transferred to new employer of the keyman on mutually agreed terms and conditions.

*BASIC MINIMUM REQUIREMENTS TO BE FULFILLED BEFORE BUYING KEYMAN INSURANCE*

The basic eligibility criteria to be fulfilled before buying the Keyman Insurance Policy is:

1. The Keyman should have subscribed to less than 51% shares in the company.
2. The total number of shares of the company held by the Keyman and his family together should be less than 70% of the company's shares.
3. Some proof of the key important position held by the Keyman in the company.

*TYPES OF POLICIES TO BE BOUGHT AS KEYMAN INSURANCE*

Earlier life insurance, as well as term insurance policy, were allowed to be taken as Keyman Insurance. However the changes in IRDAI rules now only allows term insurance to be bought as Keyman Insurance. The term of the policy usually coincides with the retirement age or the contract period of the keyman. The only option for a nominee in a Keyman Insurance Policy is the company.

## Advantages of keyman insurance policy

Be it small or large companies Keyman insurance can prove to be very useful for the company. Keyman Insurance policy can of great importance for family businesses that are immensely dependent on certain individuals. It helps the businesses to endure the financial strain and continue without any halt in the business activities due to loss of key individual of the company. The low cost and the ease of securing the keyman insurance policy make the important business decision a simple one.

### The advantages of Keyman Insurance are as follows:

1. In case of death of the key person, the company gets the insurance proceeds which can be used by the company for the purpose of copying up with any kind of financial loss.
2. The employer can claim the deduction for the premiums paid, as a business expense under Sec 37(1) of the Income Tax Act.
3. No prior intimation to the income tax authority is needed for the purpose of claiming the deduction amount.
4. The company can raise loans on the policy from LIC at 12% annum.
5. Keyman insurance policy on the life of the employee will ensure long term loyalty by him towards the company.
6. Protect the company from the risk of financial loss against the loss of a Keyman.
7. Any premium to be paid by the company on the insurance policy taken on the life of a Keyman will not be taken perquisite to the employee.
8. It will prove to be beneficial for the company in the long run as the chances of retention of the employee is higher.
9. It can help the company in tax planning.

## Taxation aspects of keyman insurance

Prior to the changes in IRDAI regulations, the company used to buy a life insurance policy on the life of a keyman and during the term of the policy surrendered it to the Keyman. The Keyman usually paid the surrender value to the employer. The insurance proceed received by the Keyman on the maturity of the policy was tax-free under the Income Tax Act. Further, the premium paid by the employer previously before the assignment of the policy was also tax-free as it was treated as a business expense.

However, in 2013, the scenario changed. The new rules in Income Tax Act provided that any Keyman insurance policy after its assignment to the Keyman will retain its character and the insurance proceeds will be fully taxable in the hands of the Keyman. The Keyman would not be granted an exemption under Section 10(10D) of Income Tax Act. With the changes in Section 10(10D) of and IRDAI regulation which now only allows term policies to be taken as Keyman insurance, the present position is as follows:

### IN THE HANDS OF THE COMPANY:

The premium paid by the company is tax-free as it is treated as business expenditure under Section 37(1) of the Income Tax Act,1961. The insurance proceeds on the maturity of the term policy will be taxable as business income in the hands of the company.

*IN THE HANDS OF KEYMAN:*

The premium paid by the employer is not taken as a perquisite in the hands of the Keyman under Section 17(2) of the Income Tax Act,1961 and therefore the Keyman is not liable to pay any tax on such premiums.

In case the policy is assigned to the Keyman, he/ she can choose a nominee for the policy. Thus in case of death of the Keyman during the term of the policy the nominee can claim for the insurance amount. However, even in this case, no tax exemption under Section 10(10D) will be allowed.

# Conclusion

A Keyman Insurance policy is the insurance taken in the name of the key employee of the company to cope up in case of sudden loss of such employee. A Keyman can be a Director, senior managers, key sales people or persons who are beneficial to the financial success of the organization.

As the loss of such Key individual can tremendously jeopardize the growth of the company, taking an insurance policy in their name can bring about financial stability on account of the loss of such employee. The functions of the company will be carried out smoothly without any halt. It can also infuse some sense of loyalty on such key person towards the company. Further, the company can also benefit from tax planning.

Keyman Insurance is usually important for joint family businesses that are highly dependent on a few individuals. It can help in reducing the financial strain on the loss of some important individual of the organization and bring about financial stability in the company. Further low cost and the ease of securing a Keyman Insurance Policy makes this important decision an easy one.