

KEYMAN INSURANCE

Keyman insurance is an insurance taken by a business firm on the life of an employee (Keyman) whose services contributed substantially to the success of the business of the firm. The object of Keyman insurance is to indemnify a business firm from the loss of earnings resulting from the death of a valuable employee. Loss of earnings may occur because immediate replacement of the Keyman may not be possible and it may take a longer time to train another person to perform his functions. Further loss may occur if the Keyman insurance can be estimated to be the monetary value of the likely profits of the concern due to the death of the Keyman.

Keyman Insurance can be taken by a business firm on the life of its employee/s and no benefit of any sort accrues to the concerned employee/s. While the primary object of this insurance is to protect the company against premature death of a valuable employee, the company secures also some tax advantages.

“Keyman is a person whose services contribute substantially to the success of the business. Generally he is a person with special technical knowledge who can only be replaced at a considerable cost of training. The basic purpose of the company taking this insurance is to protect itself against premature death of a person whose services to the firm have significant and unique effect on the profitability of the firm operations. It implies therefore that in the period immediately following his death, there will be a vacuum in the company in the company with the result that the company incurs financial losses or even at times becomes unable to fulfill the commitments made by it. The insurance money in such circumstances comes in handy. If this reason for indemnifying against loss is absent or if the sum assured is excessive in relation to the object, the moral hazard is high. In every firm there is a person who administers the business, but from the above it will be clear that all such persons cannot be considered as Keymans.”

(C.O Circular Ref.: Actl/1035/4 dt. 05.07.74)

“The object of Keyman insurance is to indemnify the company for the loss of earnings resulting from the death of a valuable replacement of any trained person to perform his functions. In addition, loss may be more if the Keyman can be replaced only at considerable cost of training.

It would not be appropriate to issue a Keyman insurance where the profit has been in the decline and the turnover of the company is also on decline, unless there are very special circumstances. The divisional offices must very carefully consider the need and justification for Keyman Insurance under such circumstances.”

(C.O Circular Ref.: Actl/1563/4 dt. 02.09.95)

“A Keyman Insurance Policy of the Life Insurance Corporation of India, etc. provides for an insurance policy taken by a business organisation or a professional organisation on the life of an employee, in order to protect the business against the financial loss, which may occur from the employee's premature death. The keyman is an employee or a director, whose

services are perceived to have a significant effect on the profitability of the business. The premium is paid by the employer.”

(C.O Circular Ref.: CBDT/762/4 dt. 18.02.98)

Thus Keyman Insurance cannot be given in the following cases-

1. Keyman has share holding of more than 51% in the firm.
2. His Family has a share holding of more than 70% in the firm, “Family” of Keyman includes Keyperson, spouse, minor children.
3. The Company is incurring losses consistently.
4. The Keyman is illiterate.

QUANTUM OF KEYMAN INSURANCE

The Keyman is generally identified by his qualifications, experience, responsibilities, remuneration and his contribution to the growth of the company. The following factors would generally be taken into account while deciding the quantum.

1. The qualification of the Keyman.
2. Experience vis-a-vis exposure in different capacities.
3. His services in the company and previous record.
4. Whether he is the only Keyman in the particular area or otherwise.

It is very difficult to find out in exact terms, the primary contribution of the Keyman. Thus the following methods may be used in deciding the Sum Assured under KMI.

i Multiple of Keyman’s compensation.

Keyman insurance is to be limited to 10 times of the Keyman’s compensation package which will include annual total salary paid to Keyman, annual bonuses which are of a regular nature and also paid as fixed percentage of salary and various other perquisites in the form of well furnished house, utility bills, car and commission out of net profits paid to such an employee. The notional value of the perquisite can be taken as 30% of the gross annual salary of the Keyman or as may be prescribed by the company.

ii Gross profit / Net profit method:

- a Public Limited (quoted) Companies

Five times of averages 3 years ’net profits (before tax) or the three times average 3 years’ gross profit, whichever is lower.

Where higher amount of depreciation is charged to profit and loss A/c (for availing of income tax benefits) a part of excess depreciation may be added to the net profits of the company for calculating the maximum allowable cover.

- b. Private Limited or Closely held public limited Companies.

- i. Number of shareholders or employee - 10 or more

- To be treated on par with Public limited companies
- ii. Number of shareholders or employee - less than 10
Maximum allowable Keyman cover will be 3 times of average net profits (before tax) of last three years.

Where higher amount of depreciation is charged to profit and Loss A/c (for availing of income tax benefits) a part of excess depreciation may be added to the profits of the company calculating the maximum allowable cover.

The maximum allowable sum assured as Keyman to the company will be lower of the above methods,

Other information:-

1. Plan Nos. 14, 48 and 162 are allowed for KMI No Supplementary benefit such as DAB, EPDB and Term Rider are to be allowed. It has been further decided vide C.O Circular Ref.: Actl/1917/4 dt. 27/11/2003 that all existing Plans including Bima Plus will be allowed except T. Nos. 2,5,8,89,90,91,103,114,136,143,149,152,160 and all children Plans.
2. Accident Benefit is not allowed
3. Nomination not allowed.
4. Assignment not allowed expect absolute assignment in favour of Keyman in case of his leaving the job of the company.
5. when issuing keyman insurance the following amendment should be affected to the standard policy forms:
 - a) The names of the life assured and the proposer should appear in the schedule.
 - b) The words "nominees under section 39 of the insurance act" , appearing in cage opposite the cage " to whom sum assured payable" should be deleted.
 - c) The following endorsement shall be placed on the policy for which prior consent from the employer should be obtained before the completion of the proposal. It is hereby agreed and declared that in the event of the employee life assured leaving employment of the employer, the within mentioned policy will be,
 - d) Either surrender to Corporation for its cash value or
 - e) Assigned absolutely in favour of the employee life Assured.

It is further agreed and declared that the within mentioned policy shall not be allowed to be assigned to any expect life assured himself absolutely.

6. Proposals on the lives of different Keyman / Partners form the same company / partnership firms should not be clubbed together for the purpose of deciding the underwriting authority. If the sum under consideration on each keyman / partner is within the power of the division, zone, then such cases should be underwritten only at the respective offices, regardless of the total sum proposed on all the lives of all Keyman / partner put together.

In the cases of keyman insurance to companies, the maximum allowable keyman insurance depends on the profits of the company. When there are more than one keyman proposals, the divisional offices should calculate the maximum permission keyman insurance as per financial underwriting rules.

If the maximum allowable cover is adequate for all simultaneous Keyman proposals put together, then even if one of the proposals is referred to CUS on medical grounds, the other simultaneous proposals, should be underwritten by the respective underwriting authority

However, if the maximum allowable cover is not adequate for all simultaneous proposals, then the other proposals should be kept pending till the decision from CUS is received. The fact that other proposals are kept pending should be clearly mentioned in the proposal referred to CUS so that the maximum amount that can be allowed under different proposals can be decided by CUS,

(Vide C.O Circular Ref.: Actl/1874/4 dt. 23.05.2003)

7. Maximum Age at entry for Keyman is 65 years and maximum maturity age is 75 years
(C.O Circular Ref.: Actl/1638/4 dt. 09.03.98)

Taxation Aspects:

Provision applicable to the company :

1. Corporate entities can claim the premium paid under keyman Insurance as bonafide Business expenses under section 37 (1) of the Income Tax Act.
2. As per the Finance Act 1996 the Amount received under Keyman Insurance, the policy will not be exempted from tax as per section 10(10D) of the income Tax Act. The proceeds of the policy will be treated as income under Section 28(vi) of the Income Tax Act.

Provisions applicable to the Keyman :

1. In the event of the policy being assigned to the Keyman, The Procedure Of the policy including bonus will be treated as "Profits in Lieu of Salary" under section 17 (clause 3) of the Income Tax Act.
2. In the event of a director being the assignee under the Keyman Policy. It will be treated as " income form other sources and taxed accordingly (section 56(2ic) of the income Tax Act,

The underlying principle is that the premium paid is allowed as a business deduction & the amount received should be taxed as business income.

The Various Requirement for Keyman insurance proposal

(vide C.O Circular Ref.: 1683/4 dt. 07.07.1999)

- i. Form no 340 should be submitted, signed by the person authorised by the company.
- ii. MHR in prescribed from by Manager (sales) /Marketing Manager
- iii. Authorised signatory of the company as per the board resolution must affix rubber stamp of his designation in the company's name below his signature on the proposal form.
- iv. Medical report from the medical examiner with adequate limit.

- v. Other medical requirement will be the same as for individual insurance on the life of L. A. previous insurance on his life is to be taken into account while considering SUG.
- vi. Copy of memorandum & Article of Association.
- vii. Copies of Audited Balance Sheets And profit & loss A/cs for Preceding 3 years.
- viii. Certified true copy of Board Resolution passed in the meeting of board of directions containing following information
 - a) Sum Assured desired.
 - b) Plan / Term.
 - c) Name & Signature of the person who is authorised to complete proposal papers.
 - d) The use of seal of the company - Annexure A
- ix. Keyman questionnaire is to be completed in the prescribed format and the same is to signed by the authorised person under the seal of the company - Annexure B
- x. Copies of I.T. returns of the company for proceeding 3 years.
- xi. Form to be filled in by the Keyman - Annexure C
- xii. Endorsement to be placed on policy - Annexure D
- xiii. Hence Forth revised Keyman Questionnaire will be used (Annexure 'A')

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