

Did you know?



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Key person revenue cover for sole traders!

All businesses should consider using life insurance to compensate them for any financial impact on their revenue due to the loss of key employees who are responsible for the ongoing success of the business, through their death, disablement or critical illness. A regular question raised by advisers through our adviser hotline is whether sole traders can take out key person revenue cover and claim the premiums as a tax deduction.

Who is a key person?

A key person is an individual whose continued association with a business provides that business with a significant and direct economic gain. A common example of a key person is an employee who is directly responsible for bringing in sales or who holds the key technical expertise on which a business relies.

What is key person revenue cover?

Key person revenue cover compensates a business for a reduction in profitability.

The loss of a key person can cause revenue to decrease, and business costs to increase. Key person revenue proceeds can be used to:

- Replace the revenue the key person would have generated; and fund the extra costs the business would have in finding a suitable replacement.
- Other areas of business profitability impacted by the loss of a key person include:
 - sales revenue: the loss of a key person directly responsible for sales can mean a fall in sales until a replacement is found and starts to generate similar results
 - recruitment: the costs incurred to find, attract and recruit a suitable replacement may be considerable and will impact on business profits
 - training: the replacement key person may require extensive and expensive specialist training
 - stability: the loss of a key person may also indirectly affect business revenue, leading to short-term restructuring and extra pressure on other staff and affect their morale. This loss could also impact on suppliers and associated businesses.

What about sole traders?

Sole trader and one-person incorporated businesses cannot normally insure themselves as a key person for key person revenue purposes and get a tax deduction for the premiums.

Income tax ruling IT2434 defines a key person and states that the business must suffer a loss of profits during the continuation of business. If the business would automatically cease when the person was lost, then the business could not continue or suffer a loss of profits after the occurrence of the insured event.

When determining whether an employee is a 'key man' in this context the Australian Taxation Office has consistently adopted the view that an employee may be accepted as a 'key man' where the loss of that employee would result in a significant loss of profits being derived by the employer during the continuation of business operations subsequent to that loss. This would be a situation where there is a continuing business and the resulting loss of profits is a matter that would be expected to be overcome as another employee or a new employee is trained to replace the expertise lost with the former employees. A 'key man' is not seen to exist in a situation where the loss of an employee, such as the owner/manager of a 'one man' incorporated business, could be expected to result in the termination of the business.

However, if the business was to be continued by a family member or it was intended to be sold to a nominated third party for example, an employee under a business succession agreement, there might be sufficient continuity to satisfy IT2434.

Even if the sole trader could not obtain deductible key person revenue cover, he or she could obtain personal insurance to deal with the increased needs of his/her family resulting from the occurrence of the insured event.

In addition, sole traders or one-person incorporated businesses that have employees working for them may be able to insure those employees as key persons.

Summary

Key person revenue cover can be used to replace the revenue generated by the key person and fund the extra costs to the business in finding a suitable replacement. Importantly, sole traders can consider key person revenue cover if they satisfy the requirements of the tax ruling IT2434 and have a continuity plan for the business in place.

Important information

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