"KEY-MAN" INSURANCE

INLAND REVENUE BOARD
MALAYSIA

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1. This Ruling explains:
   (i) the deductibility of premium expense paid for a "key-man" insurance policy; and
   (ii) the taxability of insurance proceeds received on "key-man" insurance.

2. The related provisions for the deductibility of premium expense and the taxability of insurance proceeds are sections 33 and 22 of the **Income Tax Act, 1967** (the *Act*).

3. The words used in this Ruling have the following meanings:

   3.1 "Controlled company" has the same meaning as in section 139 of the Act.

   3.2 "Whole life", "endowment", "term life" and "accident" policy in relation to insurance have the same meanings as in the insurance business.

4. **"Key-man" insurance**

   4.1 Generally, a premium paid on an insurance, which is intended wholly and exclusively to recover moneys that would replace a loss of profits on the happening of the event insured against, would be allowable as a deduction against the gross income of a business.

   4.2 Death, critical illness, sickness, accident or injury of an employee or a director may result in a loss of business income for the employer or company. Insurance may be taken on the life of an employee or a director who is a "key" person to cover the risk of loss of business income. This type of insurance is known as "key-man" or "key-person" insurance.

   4.3 The right to the insurance proceeds of a "key-man" insurance **must** remain with the employer or company and the proceeds must **not** be payable to the "key-person" or his family.

5. **Deductibility of premium expense**

   5.1 The premium on the policy is allowable if the insurance has no element of investment and the insurance is taken on the life of a "key-person" whose absence would result in a reduction in the profits of the employer or the company.

5.2 Policies that have no element of investment are term life and accident policies. These policies expire at the end of the insured period and there is no return on the premium paid if the insured person lives or is not injured. The premium payable on a term life policy or an accident policy of a "key-man" insurance is allowable as a deduction against gross income from a business.

5.3 A whole life policy and an endowment policy have elements of investment and are therefore regarded as capital assets of a company. Both policies have cash values that can be redeemed after being in force for several years. For an endowment policy there is a lump sum payable upon maturity of the policy. The premium payable on a whole life or an endowment policy is not allowable in arriving at the adjusted income from a business of a company.

Example 1

A company purchased a "key-man" endowment policy on the life of the managing director with the company as the beneficiary. The annual premium payable is RM20,000 and the sum assured is RM500,000. Under the direction of the managing director, the company's profits have increased 20% each year for the last five years.

Although the company is the beneficiary of the insurance policy and the managing director is a "key-person" in the company, the annual premium payable is not allowable as the company has acquired an asset. On maturity of the policy, the company will receive RM500,000 plus bonuses declared by the insurance company.

6. Taxability of insurance proceeds

The proceeds receivable on a term life policy or an accident policy is taxable on the employer or the company as the sum is receivable in respect of an insurance premium that has been allowed previously. On the other hand, the proceeds receivable in connection with a whole life or an endowment policy is not taxable as the insurance premium has not been allowed.

Example 2

A company acquired a "key-man" term life policy on the life of the managing director with an annual premium payable of RM30,000. It also acquired a "key-man" whole life policy on the life of the sales manager with an annual premium payable of RM20,000. The premium of RM30,000 had been allowed and the premium of RM20,000 had been disallowed in the tax computation. Both the managing director and the sales manager were killed in an accident and the company received cash payments of RM2,000,000 and RM500,000 in respect of the term life and whole life policies.

The sum of RM2,000,000 received by the company is taxable on the company as it is received in respect of a policy where the premium had been allowed previously while the sum of RM500,000 will not be taxable as the premium had not been allowed previously.

7. In the case of a controlled company, premium paid for a "key-man" insurance policy on the life of a director or an employee who owns shares in the company is not an allowable deduction as there are other motives for the purchase of the insurance policy. Other than providing a cover for the risk of loss of business income, it is also for the advantage of the director or employee in their capacity as shareholders of the company. Similarly, premium paid on "key-man" insurance policy on the life of a partner or sole-proprietor is not allowable.

8. This Ruling shall be effective for the year of assessment 2004 and subsequent years of assessment.

Director General
of Inland Revenue