

# **IRAS CIRCULAR**

**“KEYMAN” INSURANCE : DEDUCTIBILITY OF  
PREMIUMS – ADDENDUM TO PRACTICE NOTE  
1993/IT/5 DATED 25 FEB 1993**



INLAND REVENUE  
AUTHORITY  
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## INTRODUCTION

The deduction of insurance premiums as an expense comes under section 14 of the Singapore Income Tax Act which provides that only expenses that are wholly and exclusively incurred in the production of income are deductible. Furthermore, section 15 provides, among other things, that sums employed as capital are not allowed a deduction.

2 Generally, premiums incurred by a company in taking up an insurance policy on the life of an employee are deductible for income tax purposes if the employee or a nominee of the employee is the beneficiary of the policy. This is because the payment of the insurance premiums by the employer is a benefit of employment to the employee and therefore constitutes part of the staff costs of carrying on a business.

3 On the other hand, if the insurance policy is taken up by the company to provide for itself a lump sum receipt (i.e. the company is the beneficiary of the policy), the premiums incurred are not deductible because the expense is not incurred in the production of the company's income but rather to acquire a capital asset, i.e. the insurance policy. However, if the insurance policy is taken up on the life of a key personnel of the company (commonly referred to as "keyman" insurance) to insure the company against loss of profits arising from the demise of the insured, being the key personnel, the premiums are allowed as a deduction.

4 Regarding premiums paid on "keyman" insurance policies, IRAS had previously issued an Interpretation & Practice Note (now available in IRAS' website under the E-Tax Guide No. 1993/IT/5 dated 25 Feb 1993 under the title "Keyman" Insurance - Deductibility of Premiums) to explain the requirements that have to be satisfied before the deduction of premiums on a "keyman" policy can be allowed. To recapitulate, the requirements are as follows:

- (a) The insured must be a "key" person associated with the business of the employer. Whether a person qualifies to be a "key" person is a question of fact. Generally, to qualify as a "keyman" the person would have to possess special qualifications and experience that are of irreplaceable value to the company and are critical in bringing in the profits such that his death would result in the company suffering a significant loss of profits;
- (b) The purpose of the insurance policy must be to insure the company against loss of profits arising from the demise of the "keyman" insured. The capital sum insured must be directly related to the profits attributable to the services of the "keyman". For this, reference is made to the type of responsibility which the "keyman" has for the operations of the company. Usually, the capital sum assured for the purpose of "keyman" insurance policy is limited by the quantum of annual profits attributable to the "key" person in his capacity as the one having prime responsibility for the profitability of the company. To qualify for deduction, the insurance policy must also remain the

property of the company and there should be no assignment of the benefits under the policy to the insured or his family.

5 The purpose of this Circular is to make further clarifications on what has been published in the E-Tax Guide No. 1993/IT/5 regarding the deductibility of premiums incurred on “keyman” insurance, especially in the light of enquiries received since its publication.

6 The clarifications cover whether premiums incurred for “keyman” insurance would qualify for deduction under the following circumstances:

- (a) Where the policy provides, separately or together, for compensation of loss of profits arising from the demise of the “keyman” or the disability of the “keyman” ;
- (b) Where the policy provides for a cash surrender value or an investment value;
- (c) Where the benefit from the policy accrues to the “keyman” in his personal capacity;
- (d) Where the policy provides for a capital sum assured which exceeds the annual profits of the company; and
- (e) Where the loss of the “keyman” would affect the company’s entire business structure.

## **CLARIFICATION**

### Where the policy is to insure against loss of profits arising from a “keyman” being disabled

7 The rationale for allowing a deduction of the premiums for “keyman” insurance is that it is an insurance against loss of profits to the company in the event of death of the “keyman”. The crucial test in determining that the policy is indeed an insurance against loss of profits to the company is that the employee whose life is being insured is identified as having the prime responsibility for the profitability of the company. Hence, where the premiums incurred on a “keyman” policy to insure the company against the loss of profits covers the situation where the insured is disabled, resulting in the profitability of the company being affected adversely, the premiums payable would also qualify for deduction. To qualify for deduction, the condition that the capital sum assured for such a “keyman” policy should not exceed the annual profits of the company that is attributable to the “key” employee who is being insured against disablement will also apply.

### Where the policy provides for a cash surrender value or an investment value

8 Premiums for “keyman” policies are allowed a deduction on the basis that the purpose of the “keyman” policy is to compensate the company for

loss of profits arising from death or disability of its key employees whose services are invaluable to the company. The premiums are therefore considered as expenses wholly and exclusively incurred in producing the income of the company's business / trade. Where there is a cash surrender value or an investment value provided under the terms of the "keyman" policy, the premiums for such a policy would not be considered to be incurred wholly and exclusively by the company against loss of profits. This is because the investment element of the policy will be made to the company even if the event which the insurance coverage is taken for does not occur (i.e. the death or disability of the "keyman"). Therefore, where a "keyman" policy has a cash surrender value or an investment value, the premiums paid for such a policy cannot qualify for tax deduction, regardless of the type of insurance such a policy is classified under (e.g. life insurance, endowment insurance, crisis cover plus, group personal insurance, etc).

#### Where the benefit from the policy accrues to the "keyman" in his personal capacity

9 There could be instances where the business is owned by the "keyman" or substantially owned by the "keyman" or his relatives. In such a case, the tax deduction on the premiums incurred by the business / company will be denied if the facts show that the benefit from the policy accrues to the "keyman" in his personal capacity. This is because the premiums paid under such circumstances are then not wholly and exclusively incurred in the production of income. An example where the benefit of the policy could be considered to accrue to the "keyman" in his personal capacity is when the "keyman" is the sole proprietor of a business. Another example where such a situation may arise is when the "keyman" owns a substantial share of a company together with his relatives. Whether the benefits of the insurance policy has accrued to the "keyman" in his personal capacity will be determined based on the facts of each case.

#### Where the policy provides for a capital sum assured which exceeds the annual profits of the company

10 As the purpose of a "keyman" policy is to insure against loss of profits to the company, the capital sum assured for the purpose of such a "keyman" insurance policy would approximate the extent of the annual profits of the company that is attributable directly to that key employee. The premiums paid for such a policy where this factor is satisfied are deductible for income tax purposes. However, where the capital sum assured is based on an amount exceeding the annual profits of the company, the premiums incurred for such policies do not qualify for deduction as the premiums are not wholly and exclusively incurred in the production of income.

#### Where the loss of the "keyman" would affect the company's entire business structure

11 Where the insured person's death or disability affects the company's entire business structure such that the company can no longer carry on its

business, then the premiums incurred on the insurance policy taken on the life of this person are clearly in respect of the capital structure of the company and not just for the loss of profits. Such being the case, a deduction of the premiums would have to be denied.

## **ENQUIRIES**

12 Taxpayers who have any enquiries on this Circular may call the following helpline:

For companies	:	1800-3568622
For sole proprietorships and partnerships	:	1800-3568611

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