Disability and the American Business

Today's business owner faces a myriad of potential crises. Materials are delayed. . .machines need repair. . .prices escalate. . .business plans need to be revamped. *Successful* business owners repeatedly hurdle these immediate barriers because they are innovative, creative, and resourceful. But, even the most successful enterprise can come to a screeching halt if an owner or an employee suffers an untimely disability.

Food for Thought

If you were to suffer a sudden disability, how would you pay for the expenses related to your lifestyle (e.g., housing, insurance, food, transportation, clothing, etc.)? Would your business be able to continue generating income for you? Do you have money in liquid savings to support yourself and your family during a three-month disability? How about for an extended disability? In addition, if an employee suffered a sudden disability, would you be able to fund disability income for that employee out of ongoing cash flow?

While there are defenses against some unforeseen events, many small business owners do not have a **qualified income replacement plan** for themselves and their employees. But, in five steps you can walk *your* business down the path to ensuring you have the right level of protection in place.

Step One: Commitment

By committing yourself and your business to acquiring a qualified income replacement plan, you can help ensure you and your employees will continue to receive salaries despite a disability. In addition, you'll also receive the following advantages:

- If structured properly, the payment of benefits to a disabled owner or employee may qualify as "necessary business expenses" and will be tax deductible to the business under IRC Sec. 105 and 162.

- Providing a solution for loss of income during disability may result in retaining current employees, as well as inducing new employees to join your business.

- The plan demonstrates to your employees that you believe every employee should have their wages guaranteed from loss due to a sudden, untimely disability.

Step Two: Funding

Among the possible funding alternatives (e.g., relying on current revenue or retained earnings, borrowing money when the need arises, or purchasing disability income insurance), **disability income insurance** has distinct benefits and advantages including:

- The risk of providing salary continuation is transferred from the employer to the insurance company. In effect, a potentially open-ended drain on cash flow is replaced with a "known quantity," highly leveraged, fixed business expense.

- The use of insurance creates the presumption of a plan for tax purposes and establishes company policy *before* disability occurs. Without the presumption of a plan, the deductibility of insurance premiums may be challenged.

Step Three: Tax Implications

***Option A*:**

Premiums paid by the business are *deductible* by the business as a regular business expense. Any disability income insurance *proceeds* received by the employee would be *taxable income*. These benefits received from an employer-paid plan during the first six months of a disability are subject to the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA), this is so for both the employee, as well as the employer's matching share.

However, if you are more than a 2% owner of a **subchapter S corporation**, you may not be able to deduct (as a business expense) the cost of disability income insurance for yourself, but you could deduct the cost of such insurance coverage for your employees.

***Option B*:**

If the business pays the premiums and receives the policy proceeds, the premiums are not deductible by the business and not taxable to the employee (IRC Sec. 265(a)). In this case, the disability income insurance proceeds are not taxable to the business. When the employee receives the proceeds from the business, it would be treated as regular *taxable income*. The tax consequences in this case are similar to those in most personal disability income policies, whereby if the premiums are made with after-tax dollars, the disability income would be free of income taxes.

Step Four: Plan Design

The *type* of plan selected and the *extent of coverage* determine the cost. A few major considerations are:

- The **definition of disability** is considered a loss of income with either an inability to perform one's *own* occupation or an inability to perform *any* occupation. “Own” occupation coverage is usually more expensive than “any” occupation coverage.

- The length of the **elimination period** indicates the length of time that must elapse before benefit payments begin.

- The **maximum benefit provided** that may be stipulated by either dollar amount or a percentage of base salary capped at a maximum amount.

- The real key to plan design begins with a realistic understanding of the risks involved. The right policy can then provide financial security for you and your business to help mitigate the potentially devastating effects of a major accident or long-term illness.

Step Five: Implementation

A good idea won’t pay bills and a patented invention doesn’t automatically create business net worth. The owner who captures the vision of a qualified income replacement plan will share that concept with his or her employees. Many successful business owners have the motivation to place a needed benefit into action because they know that potential crises and unforeseen events may disable their companies and, as a result, the families involved. In this respect, a qualified income replacement plan can be a valuable addition to any business’s benefit package.

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