

The Business Need for Disability Insurance

Self-motivated individuals frequently play a crucial role in the success of a business. This is particularly true of small businesses in which one or two talented people possess highly specialized skills or knowledge that other employees do not have. If such a “key” person were to suffer a long-term disability, not only would the individual face substantial financial risk, but the very survival of the company could be in jeopardy.

Although sole-proprietorships and partnerships are generally the most vulnerable, corporations, particularly corporations built around one or two individuals, are also at significant risk. However the business is organized, when you consider the likelihood that you or one of your key employees may become disabled, there is a clear need to protect both your personal income and the financial well-being of the company.

Options to Consider

There is no single strategy or type of policy to protect your business from the risks posed by a key employee’s disability. Like a puzzle, a number of pieces are needed to complete the picture:

- **Adequate cash reserves:** Liquid funds can cover a short-term disability.
- **Key employee disability insurance:** Pays income to a disabled key employee. If the employer pays any portion of the premium, then a proportionate amount of the benefit is taxable income to the employee. If the employer pays the entire premium, the entire benefit is taxable.
- **Business overhead expense insurance:** This type of insurance covers normal operating expenses such as employee salaries, equipment leases, utilities, rent, advertising, maintenance, etc.
- **Qualified sick pay plan:** The federal tax code prohibits a business owner from paying himself (or herself) a salary while disabled, and then deducting the payments as an allowable business expense. A formal, written qualified sick pay plan (also known as a salary continuation plan), established in advance, can provide for funding the disability benefits as well as maximizing the tax benefits.
- **Disability buy-out:** In the event that you or another owner of the business suffers a permanent disability, disability insurance can be used to fund a buy-sell agreement.

Seek Professional Guidance

The guidance of knowledgeable tax and insurance professionals is essential in preparing for the potential impact of disability on a business.