



Web Exclusives

[Read More Web Exclusives »](#)

Disability Insurance: Business Funding Needs

LARRY SCHNEIDER

Published 2/3/2010

[Magazine Subscription](#) | [Article Reprints](#)

[Return To Article](#)



This is the seventh article in an eight-part series, discussing disability income insurance. The rest of the series, along with other articles by Mr. Schneider can be found [here](#).

Now that you have provided your client with a disability income insurance (IDI) policy, which takes care of his or her personal needs (food, rent and the like), what other policies can also be provided in the event they get disabled and as a result cannot work? What if there are business expenses to be paid? What if the business has a partner and the disabled partner wants to be bought out? What if there is a non-owner "rainmaker" in the company and that person becomes disabled?

You, as an agent or financial planner, should stress to your client that only having IDI isn't enough; the client should also be concerned about keeping the business doors open and paying employee's salaries while disabled as well as having the funds for a buy-out.

Fortunately, there are policies specifically designed to remedy each of the aforementioned (and other) problems:

Business overhead expense: This policy will reimburse all covered expenses that are incurred as a result of a covered disability.

This policy, like the IDI policy, has an elimination period and typically has a choice of three benefit periods (12, 18 or 24 months), and has a tax-deductible premium (IRC-55-264). Benefits are taxable (IRC-55-264), but when the expense is paid, it becomes a tax deduction (IRC-162) and so there is a wipe.

Key-man: This policy, when taken out on a key-person (rain-maker), will provide a tax-free benefit (IRC-104 (a)(3)) to the business, in order to offset lost profits, or to pay the disabled person while also paying the possible replacement. The premium is NOT a tax deduction (IRC-205).

Buy-sell: This policy provides a benefit amount available to the non-disabled partner, so that according to the terms of the buy-sell agreement, the disabled partner MUST relinquish ownership of their shares. Typically the elimination period is no less than 12 months (hey, you don't want to kick out your partner for just a broken leg do you?) and benefits either be had on a lump-sum basis, or a monthly payout (lower premium). The premiums are NOT tax-deductible (IRC-213,265); however benefits paid are tax-free (IRC-104(a)(3)). Legal counsel should always be sought.

Without such funding, where will the money come from? If the business takes out a loan, it could hurt the balance sheet, if/when the business is sold.

There are basically two types of funding agreements and these are referred to as cross-purchase and entity-purchase buy-sell agreements.

Under the entity-purchase (stock redemption), the company buys the policies for each of the shareholders or partners. The company is the owner, pays the premium, and is the beneficiary of the policies. There's also a sinking fund method.

With the cross-purchase, each of the owners buy a policy on each other (cumbersome when there is more than two or three partners).

Carriers have valuation formulas to determine how much can be issued and the business must periodically be re-evaluated to make sure it is not over- or undervalued in terms of the benefit amount (no, these policies are not 100% non-can) and some carriers reduce the payout amount/premium, once a covered partner reaches the age of 60. Some valuation methods are book value, straight capitalization, years purchased, or any combo therein.

The advantages of a buy-sell agreement funded by disability insurance are that it: assures a definite price and a buyer; eliminates the need for the company to have the ability to come up with the money; avoids costly and time-consuming litigation to reach a fair price; ensures that active owners remain in control; and keeps disabled owners from selling their shares to a stranger.

NOTE: There are also policies that cover unusual requirements such as: buy-in, pension completion, severance and contract completion, just to name a few.

Larry Schneider is a disability specialist with over 35 years experience and is the owner of Disability Insurance Resource Center. He is also an expert witness consultant for disability insurance claims which have been inappropriately denied and a national resource for hard to place prospects, as well as a brokerage for standard cases. One of the author's divisions has developed a Sales and Marketing Turnkey System, made up of eight manuals and other sales aids, each devoted to one segment of the sales cycle (prospecting, rebuttals, etc.). You can contact him at (800)551-6211, by e-mail at info@di-resource-center.com, or by visiting his Web site at www.di-resource-center.com.



This is the seventh article in an eight-part series, discussing disability income insurance. The rest of the series, along with other articles by Mr. Schneider can be found [here](#).

Now that you have provided your client with a disability income insurance (IDI) policy, which takes care of his or her personal needs (food, rent and the like), what other policies can also be provided in the event they get disabled and as a result cannot work? What if there are business expenses to be paid? What if the business has a partner and the disabled partner wants to be bought out? What if there is a non-owner "rainmaker" in the company and that person becomes disabled?

You, as an agent or financial planner, should stress to your client that only having IDI isn't enough; the client should also be concerned about keeping the business doors open and paying employee's salaries while disabled as well as having the funds for a buy-out.

Fortunately, there are policies specifically designed to remedy each of the aforementioned (and other) problems:

Business overhead expense: This policy will reimburse all covered expenses that are incurred as a result of a covered disability.

This policy, like the IDI policy, has an elimination period and typically has a choice of three benefit periods (12, 18 or 24 months), and has a tax-deductible premium (IRC-55-264). Benefits are taxable (IRC-55-264), but when the expense is paid, it becomes a tax deduction (IRC-162) and so there is a wipe.

Key-man: This policy, when taken out on a key-person (rain-maker), will provide a tax-free benefit (IRC-104 (a)(3)) to the business, in order to offset lost profits, or to pay the disabled person while also paying the possible replacement. The premium is NOT a tax deduction (IRC-205).

Buy-sell: This policy provides a benefit amount available to the non-disabled partner, so that according to the terms of the buy-sell agreement, the disabled partner MUST relinquish ownership of their shares. Typically the elimination period is no less than 12 months (hey, you don't want to kick out your partner for just a broken leg do you?) and benefits either be had on a lump-sum basis, or a monthly payout (lower premium). The premiums are NOT tax-deductible (IRC-213,265); however benefits paid are tax-free (IRC-104(a)(3)). Legal counsel should always be sought.

Without such funding, where will the money come from? If the business takes out a loan, it could hurt the balance sheet, if/when the business is sold.

There are basically two types of funding agreements and these are referred to as cross-purchase and entity-purchase buy-sell agreements.

Under the entity-purchase (stock redemption), the company buys the policies for each of the shareholders or

partners. The company is the owner, pays the premium, and is the beneficiary of the policies. There's also a sinking fund method.

With the cross-purchase, each of the owners buy a policy on each other (cumbersome when there is more than two or three partners).

Carriers have valuation formulas to determine how much can be issued and the business must periodically be re-evaluated to make sure it is not over- or undervalued in terms of the benefit amount (no, these policies are not 100% non-can) and some carriers reduce the payout amount/premium, once a covered partner reaches the age of 60. Some valuation methods are book value, straight capitalization, years purchased, or any combo therein.

The advantages of a buy-sell agreement funded by disability insurance are that it: assures a definite price and a buyer; eliminates the need for the company to have the ability to come up with the money; avoids costly and time-consuming litigation to reach a fair price; ensures that active owners remain in control; and keeps disabled owners from selling their shares to a stranger.

NOTE: There are also policies that cover unusual requirements such as: buy-in, pension completion, severance and contract completion, just to name a few.

Larry Schneider is a disability specialist with over 35 years experience and is the owner of Disability Insurance Resource Center. He is also an expert witness consultant for disability insurance claims which have been inappropriately denied and a national resource for hard to place prospects, as well as a brokerage for standard cases. One of the author's divisions has developed a Sales and Marketing Turnkey System, made up of eight manuals and other sales aids, each devoted to one segment of the sales cycle (prospecting, rebuttals, etc.). You can contact him at (800)551-6211, by e-mail at info@di-resource-center.com, or by visiting his Web site at www.di-resource-center.com.

Name:	<input type="text"/>
Email (will not be published):	<input type="text"/>
Subject:	<input type="text"/>
Comment:	<input type="text"/>