

The Importance of Disability Buy-Out Planning

Overhead Expense Insurance in Business Continuation Planning

Jim Ehrich, RHU Emeritus, President
Client First Brokerage Services, Inc.

Advisors who work closely with business owners most likely have discussed plans to continue their clients' businesses in the event of death. A natural extension of this planning is to make business clients aware of two equally important needs that can be overlooked: how to pay business expenses and ensure business succession in the event of a disability.

While many business owners plan for the survival of their businesses in the event of death, many don't consider the effects of disability on the firm's future. Or, like many of us, they just don't believe they will ever become disabled.

Two types of coverage can help. Disability buy-out insurance provides funds for the purchase of a disabled business owner's interest in the event of a long-term, total disability. Overhead expense insurance covers operating expenses of a business when the owner can no longer generate revenue due to disability.

The two products work nicely in tandem. Overhead expense insurance fills the gap immediately following the onset of disability to keep the doors open. If the disability becomes long term and a buy-sell agreement is in place, disability buy-out insurance can fund this obligation.

The market for disability buy-out and overhead expense is primarily small, closely held businesses. The owners play an active role in the business and often, their personal service is essential to the business' survival. By offering disability buy-out and overhead expense, you can address the full line of business continuation needs of this market. You'll also be in a good position to generate additional compensation by expanding your markets and product lines.

Disability buy-out and overhead expense offer many benefits for your customers. In the case of overhead expense, the coverage removes doubt about the business' ability to continue to pay fixed, ongoing expenses in the absence of a disabled owner.

Disability buy-out insurance provides the following advantages:

- ◆ Maintains business continuity and credibility, which are concerns of customers, creditors and employees;
- ◆ Assures that the disabled owner and his/her family will not have to manage the business in the event of total disability;
- ◆ Assures that the active partner(s) retain control of the business;
- ◆ Assures the disabled owner that his/her financial future is not contingent on the strength of the business; *and*
- ◆ Provides funds needed to pay medical bills and living costs.

There are several ways to fund a buy-sell agreement, but none that provide the advantages, security and affordability of disability buy-out insurance.

For More Information

Jim Ehrich, RHU Emeritus
Client First Brokerage Services Inc.
1-800-966-1496 x7115
jim.ehrich@clientfirst.com

(Continued from page 1)

One option commonly practiced by small businesses is to reinvest profits into the business after taking out enough to live on. At times, these businesses must rely on cash flow to pay for expansion and development, or must borrow money against the business. However, in an unforeseen situation like disability, there is no guarantee that the money will be there to pay for a partner's interest in the business.

Another option is to take out a loan from a financial institution. Unfortunately, loans are difficult to come by in this situation. The business may not be considered a good credit risk when a key contributor is disabled. Disability buy-out insurance, however, provides guaranteed cash flow when needed—and usually is much more affordable than the alternatives.

If your clients are considering disability buy-out and overhead expense coverage, you should understand how the following could impact their situations:

Tax consequences: As is the case with most financial products, disability buy-out and overhead expense have important tax consequences your clients should understand.

Premiums for disability buy-out coverage are not deductible. However, disability benefits paid to the business or to the non-disabled business owner(s) are received income tax-free. In the case of overhead expense coverage, premiums are deductible and benefits are taxable to the business. However, expenses being covered by overhead expense are deductible.

Payout methods and elimination periods: If you're already working with clients on life buy-sell arrangements, it makes sense to look for tie-ins with disability buy-out and overhead expense.

However, you might experience resistance from clients with limited benefit dollars who consider life buy-sell a higher priority. If this is the case, consider proposing coverage with longer elimination and benefit periods. Choosing an installment method of payment over a period of years rather than a lump sum payout for disability buy-out benefits will generally mean lower premiums. It could also mean a higher overall issue limit.

In general, the longer the wait and payout periods selected, the more your clients' dollars will work for them.

Buy-sell agreement: In the case of disability buy-out, make sure there is a buy-sell agreement in effect before a claim is made – or there may be no claim. Most companies require an agreement to be in effect as a condition of paying benefits. Ask clients if they're working with an attorney and offer your assistance.

Overhead expense policy features: Pay particular attention to covered overhead expenses. Be aware that there are overhead expense policies out there that only pay benefits for total disability.

Look for an overhead expense policy that provides both total and partial benefits. Check to see if replacement and employee salaries are covered. Also, look for carry forward of unused benefits and expenses.

Overhead expense product choices: Many companies now offer overhead expense products specifically geared for fee-for-service professionals or for the more general business owner.

Don't let a disability derail your clients' business continuation plans. Overhead expense and disability buy-out insurance coverage can help them protect the business they've worked so hard to build.