

Business Disability Insurance and Your Medical Practice, Part 2

My last article published in the March 2012 issue of *Oncology Practice Management* described the benefits of Key Person Replacement insurance and how it can benefit a medical practice. This article focuses on 2 additional types of disability insurance that are often used to protect a medical practice—Disability Business Overhead Expense insurance and Disability Buy-Out insurance.

Few business partners have a plan in place to help protect their practice in the event of a prolonged or permanent disability of a partner, and few business owners realize that an illness or accident could cause such a disability. If you or one of your partners became disabled, the effect on your business could be devastating.

Disability Business Overhead Expense Insurance

As the owner of a medical practice, you are the key to its success. Your patients and staff rely on you. If you become disabled, you may be unable to provide the services your patients expect or the leadership that your employees need.

Overhead Expense Disability insurance is a cost-effective way to ensure that your practice can meet its ongoing expenses during a period of disability. Protecting your practice from financial loss is important, whether you eventually return to work or decide to sell your practice. Just as individual disability income insurance can help you pay your living expenses while you recover from a serious injury or illness, Overhead Expense Disability insurance can help you to keep your medical practice healthy.

Business Overhead Expense Disability insurance is a cost-effective

way to ensure that your business can meet its ongoing expenses during a period of disability by reimbursing the owner(s) of a practice up to 100% of the normal ongoing business expenses incurred during a disability. Items include:

- Rent
- Electricity
- Telephone
- Heat
- Water
- Laundry, janitorial, and maintenance services
- Employee salaries
- Employee benefits

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- Real estate taxes
- Property, liability, and malpractice insurance
- Interest on debt
- Depreciation
- Rent or lease expense of furniture or equipment
- Legal and professional services
- Professional, trade, and association dues
- Licensing fees
- Billing and collection fees

- Other tax-deductible business expenses
- Salary for your replacement (depending on insurance carrier).

Typically, monthly benefits up to \$50,000 are available with benefit periods up to 30 months.

Although this may be a substantial amount of coverage, it is not uncommon to find medical practices with overhead expenses that far exceed this limit. As a result, special risk insurers, such as Lloyd's of London, are able to supplement the traditional market with monthly benefits in excess of \$250,000.

Premium payments for Overhead Expense Disability insurance are tax deductible as a reasonable and necessary business expense (Rev. Rul 55-264, 1955-1 C.B. 11). As such, benefits received during disability, while taxable on receipt, are used to pay practice-related expenses, which are tax deductible. The net tax result is a "wash," so the net tax impact is neutral.

Disability Buy-Out Insurance

If you or one of your partners become disabled, the healthy partner(s) would be faced with the task of running the business and deciding how long the practice could continue paying the disabled physician. In all likelihood, the disabled partner would want to recover the capital he or she has invested in the business. The remaining partner(s) will be challenged to come up with the money to buy the disabled partner's share while remaining in practice.

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The first step in business continuation planning is to set up a buy-sell agreement. A buy-sell agreement is a contract for persons engaged in a business.

Buy-sell agreements are generally entered into between shareholders of a corporation, partners of a partnership, members of a limited liability company, or among any of these members and a key employee (physician), or an acceptable outside buyer (another licensed physician in your medical specialty).

The buy-sell agreement ensures that the business interest of a deceased, a disabled, or a departing owner is effectively transferred in accordance with predetermined, mutually agreed upon guidelines. Buy-sell arrangements take many forms, and each has its own legal, tax, and financial ramifications. The key is to find the agreement that best fits the needs of your business and family.

The disability clause in your buy-sell agreement and disability insurance funding provide income protection for your family. Your buy-sell agreement establishes the buyer for your interest, as well as the conditions under which they must buy. When you become sick or hurt, the disability insurance provides the buyer with the money to pay for your share of the business.

Once disabled under the terms of the policy, you must satisfy the policy's elimination period, typically 365, 540, or 730 days. The policy owner will then receive either monthly pay-

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ments and/or a lump sum benefit at the end of the elimination period or the date the buy-out expense is incurred, whichever is later.

The premiums for disability insurance to fund your buy-sell agreement

are not income tax deductible. It does not matter if the payments are made by the business itself or by the individual owners.

Disability Buy-Out insurance ensures business succession by reimbursing money used to purchase a disabled owner's interest. Although many fund buy-sell agreements with life insurance, the potential for disability is greater—and most often overlooked.

Summary

Although most physicians are keenly aware of the need to purchase individual disability insurance coverage, few are cognizant of the variety of disability insurance policies designed to help meet the needs of self-employed physicians and/or the shareholders of a medical practice. These include, but are not limited to, Key Person Replacement insurance, Disability Business Overhead Expense insurance, and Disability Buy-Out insurance. ●

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