

Disability Income Insurance for Colorado Attorneys

BY DAVID M. RICHARDS

Most people don't like to think about the financial effect of a disabling injury or illness. But the risk of becoming disabled for 90 days or longer during our working years is significant—about one in eight will be disabled for five or more years during their working years.¹ Accordingly, many financial advisors consider this a starting point in the general protection discussion of a financial plan.

This article provides an overview of the most common types of disability income (DI) insurance policies.² It examines their role in a financial plan and reviews considerations for coverage depending on whether an attorney is a solo practitioner versus an associate or partner in a firm. The article also discusses business owner and partnership issues with

respect to overhead expense obligations and buy-sell agreements.

Group Short-Term Disability Coverage

These DI insurance policies provide weekly benefits for short-term³ disability claims resulting from an attorney's (or staff member's) injury or illness. They typically replace a maximum of 60% of the insured's taxable income (W2 salary and K1 distribution if a partner) with a benefit cap of \$1,500 per week. They have much shorter waiting (elimination) periods than long-term disability policies and typically pay after only one week away from work for injury or illness. There are some contracts with zero-day waits for accidents and as long as a 14-day wait for a claim related to an illness. Benefits are typically taxable to the recipient because the employer is

Most individual disability policies have guaranteed premiums, are portable from job to job and state to state, and allow insureds to customize their coverage with various optional benefits.

paying for and deducting the premium as an employee benefit. Short-term DI insurance policies are required by law in most states (including Colorado) to consider maternity leave as a qualified illness claim and pay benefits for up to six weeks for such. Many employees value these policies because they're rarely available in the individual marketplace.



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Group Long-Term Disability Coverage

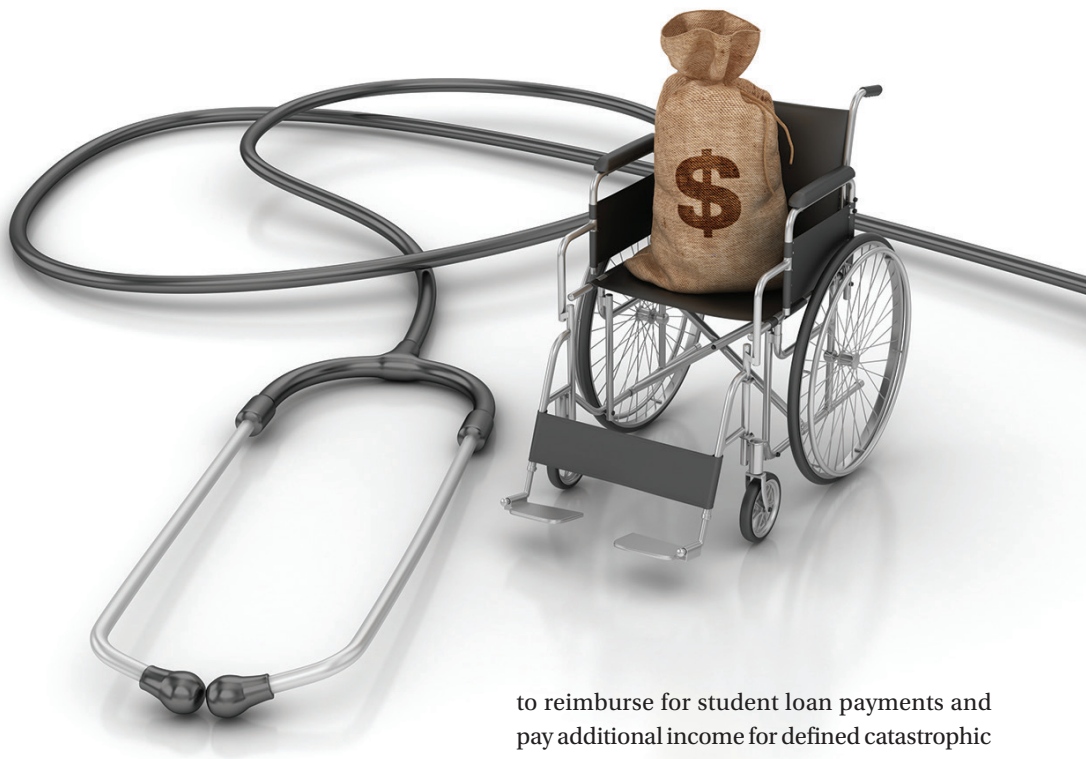
This type of group DI insurance provides monthly benefits for long-term disability claims resulting from an attorney's (or staff member's) injury or illness that prevents them from working in their "own occupation."⁴ They typically replace a maximum of 60% of the insured's taxable income (W2 salary and K1 distribution if a partner) with a benefit cap of \$6,000 per month for smaller groups (two to 10 attorneys and staff) or \$10,000 to \$15,000 per month for larger groups (10 or more attorneys and staff) and pay benefits to "normal social security retirement age."⁵ They are often cost effective but do have some drawbacks compared to individually owned DI insurance policies. For example:

- They are taxable to the extent that the employer is paying the group premium, which is in most cases. This can significantly reduce benefits at claim time.
- They usually have longer elimination periods—typically 180 days versus 90 for individual DI insurance policies. Many also require these to be satisfied with days of total, consecutive disability, which can be difficult. This is like a deductible in time that must be satisfied after the onset of a disabling injury or illness before benefits become payable.
- They cannot be transferred when an employee or partner leaves a firm. If an individual has become uninsurable due to a health condition, this can be a serious problem going forward.
- They are governed by the Employee Retirement Income Security Act of 1974 (ERISA),⁶ which was designed to protect retirement income for pension plan participants. Because of this, insureds who challenge a company during a claim cannot sue for damages and attorney fees, but only for benefits from the policy that were determined to be payable by a court, and often after a very long delay during the challenge.
- They will offset benefits from social security disability payments, judgments from accident/negligence-related injury lawsuit settlements, and workers' compensation benefit payments, among others.

Individual Long-Term Disability Coverage

This type of individual DI insurance provides monthly income for long-term disabling injuries and illnesses that prevent the insured from working in his or her own occupation. There are many different definitions of "total disability" in the industry related to the all-important "own occupation" protection in the policy, so it's important to study the contract details. Some will pay full benefits if you're disabled as an attorney, even if you choose to work in another occupation. Others will not. Benefits can range from \$500 per month up to \$20,000 in today's market depending on the insured's taxable income. A good rule of thumb is to try to replace 50% to 60% of your gross taxable income with DI insurance.

Most individual disability policies have guaranteed premiums, are portable from job to job and state to state, and allow insureds to customize their coverage with various optional benefits. These benefits include cost of living adjustment benefits to increase monthly income benefits annually after a claim; partial benefits to pay income based on loss of income for a partial disability while still working as an attorney; and "future increase options" to allow individuals to increase their benefits as their income grows without proof of good health. Newer offerings can even include additional monthly benefits



to reimburse for student loan payments and pay additional income for defined catastrophic disabilities (with a definition much like long-term care insurance).

Business Overhead Expense Disability Coverage

Overhead expense disability policies pay monthly benefits to "reimburse" business owners for monthly overhead expenses associated with running their practice. These expenses include key employee salaries, office rent/mortgage payments, equipment leases, utilities, business loan payments, office supplies, and any other fixed expenses that exist in the practice while the attorney is out of work. They typically pay benefits for total and/or partial disabilities and have benefit periods of 12, 18, or 24 months, with benefits ranging from \$1,000 to \$50,000 per month. They are usually reasonably priced and have tax deductible premiums as an ordinary business expense.

Disability Buy-Out Coverage for Partnerships

Disability buy-out (or buy-sell) policies are designed to provide proceeds to satisfy the buy-out clause within a partnership agreement between two or more business owners. When a partner becomes totally disabled for a year or longer, the policy benefit is triggered and proceeds are paid directly to the nondisabled partner in a "cross sell" agreement, or to the corporation in an "entity purchase" agreement, for the purpose of "buying out" the interest

of the disabled partner. The proceeds of the policy are received tax-free by the nondisabled partner or the firm and are in turn paid to the disabled partner to purchase their interest in the partnership. Most properly structured partnership agreements will contain both a life and disability buy-out clause that calls for the purchase of life and disability coverage to provide the proceeds to purchase the interest of the deceased or disabled partner's interest in the business. These policies are vital to the smooth operation of a partnership in the event the unforeseen occurs. It can be very difficult to continue the business otherwise.

Conclusion

Whether you're a solo or small firm practitioner or an associate or partner in a firm, DI insurance is an important consideration when developing your financial plan. Understanding the basics of the coverage available to you to insure your

income and your practice is an important first step in protecting your most valuable asset: your ability to earn a living as an attorney. **CL**



David M. Richards is a Financial Advisor and Disability Income Specialist with 24 years of experience working with professionals around the United States. He has administered the CBA Member Marketplace discounted disability insurance program with Guardian Life since 2001—(303) 714-5875, www.cbadi.com.

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NOTES

1. National Association of Insurance Commissioner's Disability Insurance Tables A and C, assuming equal weights by gender and occupation class. See www.soa.org/experience-studies/2017/credit-disability-income.
2. The terms "disability insurance" and "disability income insurance" are often used interchangeably.
3. Short-term disability claims generally refer to claims for injury or illness that last from one day to 24 weeks.
4. "Own occupation" (also called "regular occupation") is the occupation (or occupations, if more than one) in which one is gainfully employed during the 12 months prior to the time he or she becomes disabled.
5. "Normal retirement age" (also called "full retirement age") was 65 for many years. However, beginning with people born in 1938 or later, that age gradually increases until it reaches 67 for people born after 1959.
6. ERISA, 29 USC §§ 1001 et seq., protects the assets of millions of Americans so that funds placed in retirement plans during their working lives will be there when they retire. ERISA is a federal law that sets minimum standards for retirement plans in private industry.

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