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Disability happens.

One in four of today's 20-year-olds will become disabled before reaching age 67.[1]

More specifically, statistics show that one out of four dentists will be disabled long enough to collect benefits at some point before retirement.[2]

Although the statistics are staggering, disability insurance tends to be one of the more overlooked forms of insurance. Case in point—68 percent of the private sector workforce has no private or long-term disability insurance.[3]

At CWA, we have been educating our clients on the types of disability policies needed to help protect their financial security for 30 years. We hope to provide you with a general overview of the many facets of disability insurance, offer food for thought as you complete your own risk planning analysis and, through a specific case study, outline the planning opportunities available should one become disabled.

Types of Disability Policies

There are three main types of disability insurance policies that CWA typically recommends for clients.

Long-Term Disability

Long-term personal disability policies (LTD) have a waiting period of several weeks to several months with a maximum benefit period ranging from a few years to the rest of your life.

Rule of thumb—the amount of disability insurance you can purchase varies based on your current income. We recommend you try to secure as much disability as you can with the minimum amount of coverage being equal to your current lifestyle expenses. Ideally, you want to lock in as much insurance as you can while you are still young and healthy.

Business Overhead Expenses

Business overhead expense (BOE) coverage reimburses a business for overhead expenses should the owner experience a disability. Eligible benefits include rent or mortgage payments, utilities, leasing costs, laundry/maintenance, accounting/billing and collection service fees, business insurance premiums, employee salaries, employee benefits, property tax and other regular monthly expenses.

Rule of thumb—business overhead insurance is only going to cover expenses actually incurred, so you should ensure that you have enough coverage for your current expenses. Business overhead expense is critical for solo-doctor practices. On the other hand, we have seen some of our multi-doctor practices "self-insure," meaning one doctor will increase their productivity to compensate for the loss in production while the other doctor is out on leave.

Reducing Term

Reducing term policies are specifically designed to insure loans. In the event that you were to become disabled, your reducing term policy would pay your monthly loan obligations.

Rule of thumb—don't make the mistake of purchasing an individual disability insurance product if your bank or lending institution tells you they require disability insurance before they will give you a loan. In the event of a disability, personal disability income insurance should be for your home mortgage, putting food on the table and paying your personal medical bills. If you are using your personal disability income policy to pay back a business loan you will most likely find you have strained your personal cash flow. Typically, reducing term insurance is the cheapest way to insure this portion of your lifestyle costs. Because the terms of the policy mirror the terms of your loan obligation the insurance company has a defined period of risk that reduces each year. As a result, they are able to provide lower premiums for this type of insurance.

Group Versus Individual Coverage

As a dentist you most likely have heard about group disability policies through institutions such as the American Dental Association (ADA). Although the initial premiums may appear more cost effective it is important to understand the difference in coverage and premium changes over time.

Group Policies

In a group policy, you are a “member” of the group and not the policyholder. Group polices are “optionally renewable,” which means the insurer can cancel coverage. Typically, group coverage is also not portable, meaning you cannot take the coverage with you when you leave the group.

Under the ADA program, the ADA is the policyholder and has possession of the “master policy,” which is issued and controlled by Great West Life & Annuity Insurance Company. Any dentist who buys this coverage is an insured “member” who is issued a “certificate of coverage.” According to the second paragraph of the member Certificate of Insurance, “Great West and the ADA reserve the right to amend the terms of coverage at any time, and such changes become effectively immediately.”

Rule of thumb—we typically only recommend clients obtain coverage under a group policy in the event they have been denied an individual policy, the purchase of an individual policy is cost prohibitive or they are purchasing as a supplement to an individual policy.

Individual Policies

When you purchase a private policy you, the insured, are the policy owner. As a result, you are in control of all policy changes after issue. Individual policies allow you to purchase and own the best definitions of coverage available in the marketplace.

Rule of thumb—we recommend that clients purchase non-cancellable and guaranteed renewable disability policies. These policies have features that obligate the insurer to continue coverage as long as premiums, which cannot be increased, are paid on the policy. Non-cancellable insurance policies give you, the policyholder, peace of mind that the cost, amount of coverage and term are known and you will not have to re-qualify for the policy at some point in the future when your health might have deteriorated.

When choosing between group and individual policies it is important not to let the current monthly premiums be the driver of your decision. Although group policies tend to initially offer lower rates they are subject to increase over time. Based on the current ADA rate schedule, a dentist who purchases ADA coverage at age 27 would pay three times the original premium rate upon reaching age 50 for the same coverage.[4]

Disability Defined

Now that we have covered the types of policies, it’s time to pull out the dictionary and define “disabled.”

Own-occupation disability insurance is the most comprehensive definition of total disability available. This type of policy will include language defining disability as the inability to perform the material and substantial duties of your regular occupation. The insurance company will consider your occupation to be the occupation you are engaged in at the time you become disabled. With this clause in place, your claim will be paid even if you are working in some other capacity.

Loss of earnings insurance policies make up the shortfall between what you earned before you were disabled and after.

Income replacement or any occupation insurance are some of the most restrictive definitions of disability and only pay benefits if you are unable to do any work. A typical income replacement definition will include language such as “Because of sickness or injury you are unable to perform the material and substantial duties of your occupation and are not engaged in any other occupation.”

Gainful occupation coverage is very common in an employer-sponsored group long-term disability insurance policy or with property and casualty insurance companies that decided to release a disability insurance policy. This definition essentially leaves the determination of whether or not you are disabled up to the insurance company. A typical definition in these types of policies will read “Because of sickness or injury you are unable to perform the material and substantial duties or your occupation or any occupation for which you are deemed reasonably qualified by education, training or experience.”

It is essential that you understand what type of coverage your policy actually provides. Since the premiums will vary dramatically depending on the overall coverage selected you should consider what you would like to do in the event you were unable to practice dentistry.

For example, do you love to teach? At CWA, we have several clients who have become disabled from practicing dentistry. However, they are impassioned to continue their legacy through teaching others. In this case, had these doctors purchased an income replacement/

any occupation or gainful occupation coverage policy, they would have been prohibited from earning an income stream from teaching without forfeiting the collection of their disability proceeds.

Rule of thumb—determining the policy that is best for you requires the calculation of a risk versus reward analysis. We recommend our clients work with an insurance broker to determine the estimated costs for each type of coverage. While reviewing these policies it is important to keep in mind that "you get what you pay for." In this case cheaper is never better.

Disability Rider Options

In addition to the various types of disability policies offered in the marketplace, there are also riders that can be added to your policy for a premium. Below are a few of the riders that CWA recommends pricing into your policy:

A cost of living adjustment rider is an important feature of a disability insurance policy because it helps your benefits keep pace with inflation during a disability.

A residual or partial disability rider provides for benefits if you are not able to work full-time but are not completely disabled.

A benefit update option rider helps you keep your individual disability income insurance benefits up to date without requiring you to provide medical insurability or undergo any additional medical underwriting. These riders are typically added to your policy at no additional charge. However, if you are eligible for an increase and accept it then you will be charged a premium.

Case Study

Facts:

- Doctor becomes disabled from general dentistry partnership.
- Age 58.
- Operates out of a C corporation which owns an interest in a general dentistry partnership.
- Owns a personal interest in the building LLC.
- Lifestyle expenses - $12,000/month net of tax.
- Profit sharing plan in place.
- Total tax deferred assets - $1,500,000.
- Total personal assets - $150,000.

Goals:

- Maximize collection of all disability proceeds.
- Sell remaining interest in the dental partnership and building LLC to business partners.
- Utilize disability proceeds to continue saving in order to meet retirement savings goals.

Summary of Concerns:

- The doctor has a business overhead policy that will only pay expenses incurred while he is an owner of the practice.
- Now that he is no longer producing dentistry, the client's partners would like to purchase his remaining interest in the practice and building.

Phase I: Work as a Team

There are many advantages to working in a dental partnership. In most situations, one of these advantages is having a buyer readily available to purchase your practice interests in the event you become disabled or deceased. However, this advantage becomes complicated when a disabled partner is trying to collect on a business overhead policy.

As outlined above, business overhead insurance coverage reimburses a business for regular monthly expenses. In order to receive your benefit you must actually submit business expense receipts for reimbursement each month. Presumably, the dental partnership has more than enough expenses to submit for reimbursement. However, depending on the allocation of partnership profits, it is highly likely that your partners will want to immediately purchase your share of the practice when it is determined that you will no longer be able to produce dentistry. Once your practice share has been purchased, you can no longer submit partnership expenses for reimbursement.

At CWA we are committed to providing solutions that result in a win-win scenario for all parties. In this case, we were able to devise a plan in which our doctor would remain a business partner until all disability overhead proceeds had been collected. By including our doctor's reimbursement checks as production, our disabled doctor continued to pay a portion of the partnership expenses, thereby lessening the burden on his partners and entitling him to his share of hygiene profits. Additionally, our doctor agreed to pay outright several large expenses on behalf of his partners.

In reviewing the plan of action with all parties, CWA was able to mathematically prove that all would benefit from allowing our doctor to remain a partner in the dental practice.

Phase II: Work the Brackets

Upon retirement, selling your dental practice will presumably result in the largest one-time receipt of proceeds in a single year. Although you should revel in the fruits of your labor you must keep in mind that Uncle Sam wants to be included in the celebration. In order to minimize the tax due as a result of the sale, we recommend working with your planner to analyze your tax liability over a two-year time period.

In this case, our doctor's receipt of business overhead proceeds ended in the month of December. Rather than selling the practice on 12/31 we recommended our client make the sale effective 1/1 of the following year. By pushing the sale one day, our client was able to save thousands of dollars in taxes. Had the sale occurred in December the income from the sale, in addition to his profits received throughout the year, would have pushed our doctor well into the top tax bracket. However, since our doctor's personal disability income is not taxable, the only taxable income our doctor received the following year was the proceeds from transacting the sale on 1/1, thus keeping him in a much lower tax bracket.

Additionally, since our doctor had been a partner for over 20 years and had gained substantial equity in their building LLC, we devised a plan with all business partners to sell the personal building interest one year following the sale of the dental practice.

As you can imagine, spreading the income from the receipt of business overhead, sale of the dental practice and sale of the dental building over a three year time horizon allowed for more savings in the pockets of all business partners and less money in the hands of Uncle Sam.

Phase III: Work the Savings

Annual savings is a critical step in achieving financial freedom in retirement. At CWA we pride ourselves in helping our clients shelter their sale of practice proceeds in the most tax efficient manner.

In this case, our client had the opportunity to fund his pension plan to the maximum amount two years post disability. By making the sale effective 1/1 our client was able to keep his corporation open for an additional tax year thus allowing him to fund his pension plan and deduct any discretionary business expenses for the entire year. These deductions created lower taxable income further increasing our doctor's tax savings.

Commentary

The key to all of the above outlined transactions is open communication and making sure all parties benefit from the recommended plan. Maintaining a good working relationship with your business partners is essential to negotiating a plan of action that results in monetary savings in situations such as these.

Because he had a good working relationship with his partners and had the appropriate insurance plans in place, our client was able to ease into retirement, albeit early, with peace of mind knowing his family would be financially secure.

References

1. U.S. Social Security Administration, Fact Sheet April 2, 2014.
2. Odds of disability determined by Great-West Life in 2013 after studying years of disability claims submitted by insured ADA members. https://www.insurance.ada.org/ada-insurance-plans/disability-insurance.aspx.
3. U.S. Social Security Administration, Fact Sheet April 2, 2014.
4. Based on table premium rates in ADA group LTD plan sample certificate – Form 1105-IPC (2-06) – Semi Annual premium, 90 day waiting period.

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