Disability-Proof Your Business

Business owners, who typically take great care to protect their businesses in the event of death, may, in fact, face a greater threat from disability. Along with addressing **life insurance** concerns through **buy-sell agreements**, business owners should also address the problems a lengthy disability can present.

Few business owners may be aware that the risk of suffering a prolonged disability may be greater than the risk of dying. Not many businesses, however, have a plan that addresses the *continuation* of the business in the event of a disability of one of the owners.

Realizing the potential for disability exists is just the beginning, because the next question business owners must address is twofold: First, how will personal income be maintained or replaced? Second, what about ownership interest? The form in which the business is run—as a **sole proprietorship**, a **partnership**, or a **corporation**—will dictate the way in which the answers to these questions are formulated.

The Sole Proprietorship. In the case of a sole proprietorship, the owner *is* “the business;” if he or she is disabled, business profits suffer as a consequence. The sole proprietorship differs from a partnership or a corporation in that, although it may have employees, it typically lacks a management group that can direct operations in a coordinated manner in the absence of the owner. Thus, a permanent disability in a sole proprietorship is often tantamount to the cessation of the business. In order to provide the proprietor with needed some income, in addition to relief from the responsibilities of running the business, there may be little choice but to close the doors and liquidate the assets.

The Partnership. A partnership may be more protected from the effects of one partner’s disability than a sole proprietorship. With one or more partners left to continue partnership business and make management decisions, one owner’s disability may have a less severe impact on the business. If the other partners cannot carry on the specific tasks of the disabled individual, a replacement generally can be hired. In addition, and fortunately for the disabled partner, unless the partnership agreement stipulates otherwise, the laws of most states say that a partner is entitled to his or her share of partnership profits on an equal basis with the co-partners, whether disabled or not.

The Corporation. In contrast to a partner, a stockholder-employee of a closely- held corporation generally has no rights to a share of corporate profits unless he or she actually performs services for the corporation. While other stockholders may be willing to continue a disabled stockholder’s salary, even when needing to hire a possible replacement, their willingness may lessen over the course of a long disability. In addition, a disabled stockholder of a closely-held corporation may be in a bind due to the rare issuance of dividends typical of this form of business. Even if a disabled stockholder makes an appeal through the courts to force dividend payments, the courts are rarely willing to force corporations to pay dividends.

Protect *Yourself* As Well

While the solution to the loss of services in a partnership or corporation may be to hire a replacement for the disabled individual, this does nothing to replace the income of the disabled individual, and fails entirely to address the issue of what to do with his or her ownership interest. Clearly a better solution is needed, and for most professionals, it is often a two-step process.

The first step involves replacing the disabled individual's lost income at a level appropriate to meet his or her personal needs. This can be accomplished through the continuation of the individual's salary out of business cash flow for an agreed-upon time period, through the purchase of **disability income policies** by the *business* as set out in a formal disability income plan, or through disability income insurance policies that are *individually* paid for and owned. Many businesses may find the third alternative to be the least expensive.

The second step addresses how to handle the ownership interest of the disabled person. Insurance professionals generally recommend purchasing a fully protected, **disability buy-out** policy. Either the business can purchase the policy, and use the proceeds (which are received income tax free) to buy out the owner's interest if the disability becomes permanent. Or, the partners or co-owners can purchase disability income policies on each other. If one person becomes disabled, the remaining owners can use the policy proceeds to buy out his or her interest.

Disability income insurance can help solve the problems of replacing a permanently disabled business owner's income, and provide funds to buy out his or her ownership interest. In the process, it can smooth a difficult transition for all. A consultation with a qualified insurance professional can help your business establish a disability income protection plan.

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