



PERSPECTIVES

Protecting Your Income with Disability Insurance

For most people, current income is the foundation of their financial plan. So it's important to make sure your income is protected in the event of a disability that could prevent you from working. Debilitating accidents or illnesses may seem unlikely, but in 2014, nearly 40 million Americans reported a disability.

Many employers provide group disability insurance, which covers a portion of an employee's income -- typically 60 percent of base salary. But that amount likely won't cover all current expenses, which could mean tapping into savings or reducing contributions to retirement accounts or education funds. This would likely have a significant impact on your long-term plan. It's a good idea to review your group plan and consider supplementing your potential benefits with individual coverage.

Business owners and professionals who rely on their physical skills to perform their jobs could face additional risk from a disability. Without proper coverage, a disability might force a dentist or a surgeon to sell their business to cover expenses. Some professionals could also find themselves working at a lower income.

UNDERSTANDING YOUR BENEFITS

If you have disability coverage from an employer, be sure to read the fine print. Many policies don't cover bonuses, commissions or stock grants. Benefits may also be taxable. Start by calculating the actual monthly payment your policy will provide and compare that to your expenses. High income earners in particular may have insufficient group coverage. In the example provided, the employee's group policy will pay only one third of his monthly income.

It's also important to understand how your policy defines disability. There are three primary definitions:

Own Occupation

Benefits are paid if you are unable to perform your own occupation. For example, a surgeon who lost use of a hand would receive benefits.

Any Occupation

Benefits are paid if you are unable to perform any job for which you are trained or educated. For example, a surgeon may still be able to teach, despite losing use of a hand.

Transitional Occupation

Covers up to 100 percent of your income, even if you go back to work. If your earnings equal your previous income, your benefits will be reduced.

BENEFITS EXAMPLE

Male, age 45

Benefit:

60% of salary + bonus

Salary:

\$150,000 (covered)

Bonus:

\$100,000 (covered)

Restricted Stock:

\$200,000 (not covered)

Annual Compensation:

\$450,000

Monthly Compensation:

\$37,500

Monthly Benefit:

\$12,500 (pre-tax)

Total Income replaced:

33%



Protecting Your Income with Disability Insurance (cont.)

OTHER VARIABLES

Employers typically receive a group discount on the policies they purchase, which means the premiums are typically lower than on an individual policy. Often the premiums paid by employers are not counted as taxable income. In that case, the employee would pay taxes on any benefits received. However, some employers offer the option for the employee to pay taxes on the premiums, which would mean that benefits paid under the policy would be tax-free. This is an excellent low-cost opportunity to increase your benefit amount without paying additional premiums.

The premiums on an individual policy will usually be higher. A typical policy might cost 2 to 3 percent of the income to be insured. In other words, a \$200,000 benefit might cost \$4,000 to \$6,000 in annual premiums. Group plans also tend to offer a more restrictive definition of disability. For example, they may provide benefits for own occupation for just the first two years, then switch to an any occupation definition for continuing benefits.

Individual policies offer more options and flexibility, including a choice of disability definitions, guaranteed renewals, coverage portability, and annual inflation adjustments. Individual policies also offer a choice of elimination periods – the waiting period between the onset of a disability and the start of benefits. And since the individual pays the premiums, the benefits are income tax-free.

	 GROUP	 INDIVIDUAL
Customization	None	Highly tailored to meet specific needs
Premiums (Costs)	Typically lower than individual and same rates for men and women	Higher rates for women and approximately 2-3% of income insured
Elimination (Waiting) Periods	90 /180 days to receive benefits	Option to choose: 30, 60, 90, 180, 365.
Taxation	If premiums paid by employer: benefits are taxable income	If premiums paid by employee: benefits income tax-free
Portable (Take it with you)	No	Yes
Monthly Benefit Amount	Typically 60% of base salary with a monthly cap Bonus and commission income may not be included in calculation	Can insure beyond group max up to 100% of pre-disability income Bonus, commission and stock income can be included
Definition of Disability	Typically limited to Any Occupation	Own Occupation, Any Occupation and Transitional Occupation

If you'd like to learn more about disability insurance or discuss your coverage options, your Paracle advisor would be happy to connect with you.

We'd like to thank Jeff Kerns and Megan Tay of [Truluma](#) for their assistance with this article.

Disclaimer: This article has been provided for informational purposes only and should not be considered as investment advice or as a recommendation. This material provides general information only. Paracle Advisors does not offer legal or tax advice. Only private legal counsel may recommend the application of this general information to any particular situation or prepare an instrument chosen to implement the design discussed herein. CIRCULAR 230 NOTICE: To ensure compliance with requirements imposed by the IRS, this notice is to inform you that any tax advice included in this communication, including any attachments, is not intended or written to be used, and cannot be used, for the purpose of avoiding any federal tax penalty or promoting, marketing, or recommending to another party any transaction or matter.

Paracle Advisors is an investment advisor registered with the Securities and Exchange Commission.

