



Harmony Wealth Strategies

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**Harmony Wealth
Strategies**

BUILDING AND SAFEGUARDING
YOUR FINANCIAL WORLD

Business Overhead Expense Insurance

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What is it?

Business overhead expense insurance can ensure your business survives your disability

As a business owner, you can protect your business income by purchasing a business overhead expense insurance policy. The business pays the premiums for the coverage, and you are the insured. If you become disabled, your policy will pay the monthly operating expenses of your business for a certain number of months (usually 12 to 24). This will allow your business to survive until you recover and return to work, or sell your business.

Business overhead expense insurance pays the actual monthly expenses of the business

Business overhead expense insurance is designed to reimburse you, the business owner, for the actual monthly expenses your business incurs. Like an individual disability insurance policy, business overhead insurance will pay you benefits for a certain number of months, or until you recover. However, instead of receiving a fixed monthly benefit, you will receive a different benefit every month, based on your actual monthly overhead expenditures. The policy will pay no benefit at all in a month in which you had no overhead expenses to pay.

Receiving benefits from a business overhead expense policy

To receive benefits under a business overhead expense policy, you must be unable to perform your duties in the business (the own-occupation definition of disability) and satisfy the elimination period (waiting period) outlined in your policy. This period is commonly 30, 60, or 90 days, depending upon the option you selected. Then, the policy will pay your monthly business overhead expenses, up to a certain monthly maximum. This maximum is determined when you buy the policy by looking at what monthly expenses you normally have. In general, you will receive a benefit equal to either the amount of your actual expenses or the amount of your monthly maximum, whichever is less. Some policies will allow you to carry over the difference between your actual expenses and your monthly maximum. If your monthly expenses ever exceed the monthly maximum, you will then have extra funds to offset your extra expenses. Other policies will pay benefits to you past the end of your benefit period until your balance is depleted. Since several methods are used to pay out benefits to the business owner, check the terms of your policy.

Example(s): *The maximum monthly benefit payable under Martha's business overhead expense policy was \$3,000. In August, Martha's actual overhead expenses totaled \$2,400. Since her actual expenses were less than her maximum monthly benefit, she received this amount. However, in September, Martha's monthly overhead expenses totaled \$3,150, more than her monthly maximum benefit. In this case, she received \$3,000, the amount of her monthly benefit, and the remaining \$150 was carried over. In October, the last remaining month of her benefit period, she also received \$3,000, her monthly maximum. However, since she still had \$150 in her "account," she received a benefit equal to this amount in November.*

Tip: *Although some policies require you to be totally disabled before receiving benefits, others use a partial or residual definition of disability as well.*

Other policy options and provisions

- **Renewability**--Most contracts are noncancelable to age 65, which means that the policy premium and coverage is guaranteed and will not change. Some contracts, however, may be guaranteed renewable, which means that the insurance can be renewed as long as the premiums are paid, but that the premium may be increased if the insured is notified at specified times. Coverage, however, will not change.
- **Waiver of premium**--Once you have been disabled for 90 days (in some cases less if your elimination period is shorter), your insurance premium will be waived as long as you continue to be disabled.
- **Options available**--A business overhead expense policy may be personalized with certain options and riders. For instance, you may purchase a substitute salary expense benefit rider that will pay you a monthly benefit you can use to offset the salary you pay to a substitute employee. You can also purchase a guarantee of insurability rider that will allow you to purchase additional coverage without undergoing additional medical underwriting. This will cover the likelihood that your

business expenses will increase as your business grows. In addition, you can purchase a return of premium rider that will refund part of the policy premium you have paid after a certain amount of time has passed. Other options may also be available.

Example(s): Ken, a sole practitioner dentist, purchased a business overhead expense policy and added a substitute salary expense benefit rider to ensure that if he became disabled, he could afford to hire a dentist who could replace him temporarily until he recovered.

Tip: If you purchase a rider, it will add to the cost of your policy. However, some companies include options in the base portion of the policy, without additional cost to you. Check the policy language carefully.

When can it be used?

You own a business, have overhead expenses, and want to make sure that the business continues operating profitably if you become disabled

Could your business survive if you could no longer work? Even if your disability only lasted a few months, it's likely that the financial impact on your business would be great. Although you may have enough money to support yourself (from your savings, perhaps, or from an individual disability income policy), you'll also need money to pay the expenses of your business. If you are a business owner who works from home, and you have no employees, you may not need to purchase a business overhead expense insurance policy, because your business overhead expenses are likely minimal. However, if you rent or own a building or office space, pay one or more employees, and have to pay utility charges, taxes on business property, and other miscellaneous operating expenses of your business, you may want to purchase a business overhead expense policy.

Example(s): When Martha became disabled, her four employees were afraid that she would no longer be able to pay them. However, Martha had purchased a business overhead expense policy that paid her \$8,000 per month, the amount she needed to meet payroll. After six months, Martha was back at work, and her company was debt free.

Strengths

Your business will remain profitable, or debts will be kept to a minimum, if you become disabled

Numerous businesses fail when the owner becomes disabled, because the owner is the driving force behind the business. Without you bringing in business and earning income for the business, it's quite possible that the business will fail. Even if you are able to return to work after a short period of disability, your business may be so debt-ridden that financial recovery will be difficult, if not impossible. However, if you own a business overhead expense insurance policy, many of the expenses of your business (including your employees' salaries) will continue to be paid, and your business will remain financially sound.

Owning a business overhead expense policy will enable you to take the time to find the right buyer for your business if you decide to sell it

If your temporary disability turns into a permanent one, you may need to sell your business. If you are receiving benefits from a business overhead expense policy, you can keep your business going until you find the right buyer rather than sell your business at a loss, as unprotected business owners are sometimes forced to do. Furthermore, a financially sound business may be easier to sell than one that is financially shaky.

Premiums paid are tax deductible to the business

Even though you are the insured, your business usually pays the premiums of a business overhead expense policy, so the premiums can normally be deducted as a business expense.

Tradeoffs

Benefits received are taxable income

Since the business receives the benefits from the policy, benefits are treated as taxable income to the business. However, this

income is offset in part if the business uses the benefits to pay deductible expenses of the business.

How to do it

Determine your need for a business overhead expense policy

If you are the owner of a large company, you may not need to purchase a business overhead policy, because you may have income from many sources. However, if you own a small- or medium-size company, you may be unable to pay your overhead expenses if you become disabled, because most of your income is generated by a single source: you. Before deciding to purchase a business overhead policy, consider your revenue needs and your expenses. In addition, consider your complete business protection plan. You may want to purchase other forms of business disability insurance as well. For instance, you could buy both a business overhead expense policy to pay your business expenses, and an individual disability income insurance policy to pay you personal income. If you want to make sure funds are available in case you need to sell your business interest, consider purchasing disability insurance to fund a buy-sell agreement .

List your monthly business overhead expenses

When you apply for business overhead expense insurance, you will need to list your anticipated monthly overhead expenses to determine the amount of benefit you will need to pay your monthly overhead costs. Most of your expenses can be covered with overhead insurance. These expenses include employee salaries, your utility costs, property taxes, rent or mortgage payments (including principal and interest), installment payments on furniture and equipment, professional or trade association dues, payroll taxes, fees paid to professionals such as accountants and lawyers, and other miscellaneous expenses. Some expenses, however, are excluded from coverage. These usually include your salary, or salaries paid to family members hired after the onset of your disability, compensation paid to an employee or partner who does the same work as you, and the cost of goods sold or used in the business.

Purchase a policy from a reputable company

Before buying any insurance policy, you should investigate the financial standing and reputation of the company. You can do this by examining how the insurance company rates with one or more of the insurance rating services, such as A. M. Best, Standard & Poor's, Moody's, and Fitch (formerly Duff & Phelps). These services assign a grade to insurance companies based on criteria such as claims-paying ability, financial strength, and past performance.

Tax considerations

Income Tax

Premiums are deductible as a business expense

If the business pays the premiums, then the premiums should be deductible as a business expense.

Benefits are treated as taxable income

Since the business receives the benefits from the policy, benefits are treated as taxable income to the business. However, this income may be offset in part when the business uses the money to pay the expenses of the business, because some (if not all) of these expenses may be deductible business expenses.

Gift and Estate Tax

None

Questions & Answers

What happens if the insured individual dies while receiving benefits?

The contingent beneficiary specified in the policy will continue to receive benefits for a month or two, allowing time for the business to be sold.

Can a business overhead expense policy be converted to a different type of policy?

If the insured owner sells the business, the policy may be converted into an individual disability income insurance policy, as long as the insured is not disabled at the time.

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