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DISABILITY RESOURCE GROUP

Passion. Purpose. Protection.

After tax season presents opportunities for Financial Advisors.

While many advisors time calling on their existing clients to review in force coverage on an annual basis, the date generally coincides with policy anniversaries or birthdays. However, for certain clients, there may be a more advantageous time to do so.

For your self-employed or business owner clients with existing income protection, overhead expense, and disability buy/sell contracts, timing their annual review just after their taxes have been filed, may actually be in their best interest.

As you may know, for the self-employed, those that own their own business or are a partner in a closely held firm; their insurable income, the determination of their business value, and the amount of their insurable business operating expenses are all predicated by their filed personal and or business tax return. To determine the actual amount of coverage that an insurer will offer, their underwriters must review your client's completed tax return.

Over the course of a year (or since the last time that you were able to review their current coverage), things could have changed for your self-employed clients. They may have signed a new lucrative long-term contract, they may have received full payment for a completed job, taken on some new major clients; any these circumstances could have a positive effect on their cash flow and their insurable income. The only way to determine if this has been the case is to review their filed personal return.

For small business owners, other changes may have occurred: perhaps they have taken on a new partner, purchased some major equipment, taken out a business loan, hired a key person, expanded or conversely, may have reorganized. Any of these changes could have a major effect on their operating expenses or their business valuation. Again, the only real way to determine the bottom line affect these occurrences could have had on your client's business is to review their filed business and personal returns.

You do not necessarily have to be an accountant or a CPA to determine your client's insurable income. Here are a few simple pointers that can help you locate the pertinent information on several types of tax forms:

For sole proprietors or unincorporated small business owners, look at line 31 on Schedule C of their personal return. This figure should match line 12 on page 1 of their 1040. The figure on these lines is, typically, the amount the can be insured for disability income protection. However, if that figure is negative, that indicates a business loss and can prevent the insured from purchasing additional benefits or may prevent them from purchasing new coverage. Rental income, excessive capital gains or losses may also have some effect on the amount of coverage they may be able to obtain.

For those that are incorporated and file Form 1120 (Corporation Shareholder or C-Corp.), first look at line 28 on page 1 of 1120, to determine total income or loss. Multiply that figure by your client's ownership percentage, which you will find on form 1120 E. The result is, typically, your client's insurable income. Once again, if there are negative numbers here, your client may not be eligible to purchase additional benefits or may be prevent them from purchasing new coverage. Capital gains or losses may also have some effect on the amount of coverage they may be able to obtain.

Owners or shareholders of an S-Corporation file Form 1120S and the officers are typically paid a W-2 salary. To determine their insurable income, first look at line 1 of Schedule K-1 (Ordinary income) of their 1120S. Add that figure to their W-2 income. (View the actual W-2 itself.) That result less the amount on line 11 from the Schedule K-1 (Section 179 Expense deduction) is, typically, your client's insurable income.

Partnerships generally file Form 1065 and each partner receives their own Schedule K-1. Each K-1 indicates the income or loss based on the partner's percentage of ownership. To determine each partners insurable income, use line 1 from their Schedule K-1 (ordinary income) plus line 5 (guaranteed payments to partner) and subtract line 9 (section 179 expense deductions).

Regardless of how your client files, if their returns show an increase in insurable income from the previous year, they may be able to purchase additional benefits to protect their income.

Why is this important to address this information now? For several reasons: First, if there are guaranteed insurability options on their contracts, your clients may be able to increase their coverage without going through medical underwriting. If your client does have some medical concerns, they may still be allowed to increase their benefits. God forbid, if they do have to go out on a disability claim, they could then be able to receive a substantially higher amount in benefit than they were able to obtain when they took the coverage out originally. While the exercise dates of these options may not coincide with the current date, some carriers allow you to change the exercise date. This could also allow them to purchase these additional before they have an insurance age change, which could result in a lower premium. Other carriers may allow a fully underwritten adjustment before the exercise date or if they do not have a guaranteed insurability option on their policy. Since rates are age based, the sooner the can increase their coverage, the lower the premium will be. They can also rest assured that they have the most in benefit their current income can support should they become too sick or hurt to work and have to file a claim.

For business overhead expense coverage and disability buy/sell contracts, financial underwriting can be more intricate and it may be more difficult to extrapolate the insurable amounts from the tax forms, especially for disability buy/sell funding. With buy/sell expressly, there are other factors involved, therefore: even if you are an accountant or CPA, it may be a good idea to submit a copy of your client's business returns to underwriting at the issuing company for a preliminary review. Doing this before taking a formal application will let your client know exactly how much more they can increase or apply for, and if they are going to have to go through full underwriting, the underwriting requirements can be determined as well. It is still definitely worthwhile to find out if your clients can increase their coverage sooner rather than later.

For clients that have complex business returns or own multiple businesses, having an underwriter review their tax returns to see if they are eligible for additional income protection is also an excellent idea.

While 2022 was not a banner year for everyone, your clients may have done better than you thought. With their tax returns still fresh in their minds (and most likely, still rather handy), you have the opportunity to see if their current coverage is adequate and if they are eligible for any additional coverage, before they need it most.

This time of year is also a good time to address the need for coverage with those that are currently without protection. Once you have a copy of their returns, you can determine how much income protection they need, are eligible for, and I would recommend getting a copy over to an underwriter to determine if business overhead expense coverage, loan protection, key person, or disability buy/sell coverage may also be appropriate.

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Benjamin K. Perez
Senior Vice President/Chief Operating Officer
Disability Resource Group, Inc.