Protecting professional practices

To protect your practice and partners, you may want to consider 2 types of insurance policies that are commonly available to businesses and business owners.

Business overhead expense insurance

A professional who is responsible for some or all of the monthly expenses required to keep an office open should consider purchasing a business overhead expense (BOE) policy in addition to individual disability insurance.

A BOE policy provides reimbursement for the expenses of operating a practice if one of the practice owners is disabled and cannot work. These expenses may include staff salaries, rent or mortgage payments, utility bills, professional liability insurance premiums and other fixed costs normal to the operation of a professional practice. In addition, some policies may even provide benefits for disabled professionals so they are able to hire a temporary replacement to fill in during their disability.

With this type of policy, the practice’s expenses are covered until the disabled partner returns to the practice or until the disabled partner’s share in the practice can be sold. Premium payments for BOE insurance are tax-deductible as a reasonable and necessary business expense (Revenue Ruling 55-264, 1955-1 C.B. 11).

Benefits received during disability, while taxable upon receipt, are used to pay practice-related expenses, which are tax-deductible. As such, the net tax result is a wash, meaning no taxes are owed by the practice on the money received from the policy.

Disability buyout insurance

Partners in a group practice will also want to consider a policy known as disability buyout (DBO) insurance, which is designed to help provide funds toward the purchase of a disabled partner’s ownership interest if that individual is no longer able to fully participate in the practice due to a lengthy disability.

Due to the specific skills each individual brings to a practice, attorneys often recommend a buy/sell
agreement that details what is to occur upon the death, disability or retirement of each partner or owner. Having a proper buy-sell agreement in place before disability occurs can avoid the hard feelings and the conflicts of interest that often result from a partner’s disability. The agreement should set forth the purchase price to be paid or should provide a formula for determining that price. Perhaps most importantly, the agreement must have a mechanism for providing the funds needed to make the purchase.

Working together with individual disability income insurance and BOE insurance, a DBO policy is specifically designed to fund the buyout of the disabled partner. It’s most common for the DBO policy to provide a lump sum payment—used to complete the buyout of the disabled physician in one payment. However, a DBO policy can be structured to provide the disabled partner payments through multiple installments. This should be determined when the policy is purchased and should align with the provisions in the actual buy-sell agreement. Premiums paid for DBO policies are generally not tax-deductible, whether paid by corporations, partnerships or individuals. The benefits, therefore, would not generally be subject to tax.