



# Taxation of Disability Benefits

**In general**, disability benefits are taxable if the insurance premium was non-taxable to the employee during the year of the disabling event. On the other hand, disability benefits are non-taxable if the insurance premium was taxable to the employee during the year of the disabling event.

Insurance Premium Taxation	Benefit Taxable	Amount of Benefit Taxable
Employer Paid: Tax-Free to Employees	Yes	100%
Employer-Paid: <b>Taxable to Employees (No Gross Up)</b>	No	N/A
Employer-Paid: <b>Taxable to Employees (Gross Up)</b>	No	N/A
Employee-Paid: <b>Pre-Tax Contributions</b>	Yes	100%
Employee-Paid: <b>After-Tax Contributions</b>	No	N/A
Employer and Employee Pay: <b>Taxable Premium</b>	No	N/A
Employer and Employee Pay: <b>Non-Taxable Premium</b>	Yes	100%
Employer and Employee Pay: <b>Employer-Share Tax-Free, Employee-Share After-Tax</b>	Yes	Calculated Using Three-Year Look-Back Period

## Tax Choice Election

If the company offers employees the option to choose the tax treatment of the disability premium, the taxation election must be made prior to the start of the plan year, and it must be irrevocable for the duration of the plan year. There are no permitted election change events that would allow a mid-year change to the taxability election.

## How do taxes affect the benefit amount?

Whether the premium is taxable to the employee has a significant impact on the net monthly benefit payable to the employee out on disability and the overall wage replacement ratio (the percentage of the employee's monthly income paid during a claim divided by the take home pay).

	60% Taxable Benefit	60% Tax-Free Benefit
<b>GROSS MONTHLY INCOME</b>	\$5,000	\$5,000
<b>TAKE-HOME PAY (25% TAX BRACKET)</b>	\$3,750	\$3,750
<b>GROSS MONTHLY BENEFIT</b>	\$3,000	\$3,000
<b>TAX ON BENEFIT (25% TAX BRACKET)</b>	\$750	\$0
<b>PAYABLE MONTHLY BENEFIT</b>	\$2,250	\$3,000
<b>TAX-ADJUSTED REPLACEMENT RATIO (NET BENEFIT %)</b>	60%	80%

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