



Why Your Business Needs A Qualified Sick Pay Plan

Two Minutes On Internal Revenue Code Section 105

A salary continuation plan – also known as a Qualified Sick Pay Plan – is a written plan spelling out whether and how a business will continue to pay the salaries of owners or employees who become unable to work due to illness or injury.

Without a written plan in place prior to a disability, the Internal Revenue Service considers salary payments to disabled employees or owners to be gifts or dividends, rather than compensation for services performed. These payments are taxable to the recipient, and non-deductible for the business.

What Is A Qualified Sick Pay Plan?

In order for payments to qualify as wages under a salary continuation (sick pay) plan, a business must:

1. Establish a salary continuation plan in writing before any disabling event occurs,
2. Have the business formally adopt the plan, using normally accepted business documentation, such as a corporate resolution for a corporation, and
3. Communicate a description of the plan in writing to covered employees.

The Advantages Of Insurance Funding

Funding a salary continuation plan with insurance is a proven way for business owners to control the financial risks associated with disability. Advantages include level premiums and disability definitions and policies that take the burden of decisions about benefits — and most of the paperwork — off the owner or management team.

Frequently Asked Questions And Answers

When can money paid to a person be considered wages?

Only when a person is an employee.

When is a person considered an employee?

When the person is currently performing services or when the person is receiving benefits under the terms of a Qualified Sick Pay Plan.

What kind of employer may adopt such a plan?

Any corporation, professional corporation, partnership, LLC or sole proprietorship.

Is the money paid to a disabled employee under a plan classified as wages?

Yes, and such plan payments are tax-deductible by the employer as a business expense (under Section 162 of the Internal Revenue Code).



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When must a plan be adopted by the employer?

Before the employee becomes disabled.

Should a plan be in writing?

Yes, and the employee must be aware of its terms (as required by the Employee Retirement Income Security Act of 1974).

Is it complicated to provide the necessary documentation for a plan?

No, the documentation process may consist of a business resolution and then providing the employees with a simple plan letter.

What would be the status of a disabled person who is not currently covered by a plan before the disability begins?

Such a person would be considered an ex-employee.

If money is paid to an ex-employee, can it be deducted by the employer as wages?

No, because deductible wages can only be paid to employees.

What term would be applied to money paid to a disabled ex-employee?

The money has been described by the Federal Tax Court as non-deductible ad hoc payments.

Are ad hoc payments deductible to the employer?

No, and the Federal Tax Court has not recognized such payments as a business expense, denying any deduction to the employer.

What types of tax and/or legal problems can arise for employers who do not have a sick pay plan in place?

Here is one example. Suppose an employer does not have a plan, and a key employee becomes disabled. Also suppose the employer continues to pay some income to the disabled ex-employee, but fails to disclose the "wages" to the IRS. When the ex-employee applies for Social Security disability benefits or when the IRS conducts an audit, the failure to disclose payments will become apparent. The employer may be subject to penalties, interest and/or other legal and financial consequences.

For answers to questions about your particular business needs, talk to your insurance representative or attorney.

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