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LTD payment guidelines for employers

Why (and how) you need to pay premiums with post-tax dollars

Long term disability insurance (LTD) is a critical benefit that protects 60% of your employees' income if they can't work due to a disability.

Here's what you need to know about LTD insurance premiums and how premium payments are handled:

- LTD **premiums are included in the employee's taxable income** so that future disability benefits are tax free.
- Premiums **must be paid with post-tax dollars.**
- **Your organization is responsible for sending all LTD premium payments to RPB**, even if the employee is paying the full premium. Employees cannot send payments directly to RPB.

Why post-tax LTD premium payments help both you and your employees pay less taxes

When you make post-tax premium payments

- Employees' disability **claims are paid out tax-free.**
- Your organization has **no FICA liability** on disability claims.

When you make pre-tax premium payments

- **Employees pay taxes** on disability benefits.
- **Your organization continues to pay FICA taxes** while the employee is on disability.

WHAT ARE DISABILITY BENEFITS?

Disability benefits replace a portion of an employee's income if they have a serious illness or injury and can't work. Employees will receive 60% of their monthly earnings (up to $17,000 per month) after their benefit waiting period. Once disability benefits begin, they stop paying premiums. See rpb.org/ltd for full details.

WHAT ARE POST-TAX LTD PREMIUM PAYMENTS?

Post-tax LTD premium payments are payments made with money that's already been taxed. This can happen through payroll tax withholding, W-2 reporting, or employee reimbursement. See the details on setting up post-tax payments below.

Tax liability details

The table below shows how paying LTD premiums with post-tax or pre-tax dollars affects total tax liability for both employees and employers. The example uses Rachel, who earns $100,000 and pays a $671 annual LTD premium. Paying with post-tax dollars means minimal taxes now—and none later if she becomes disabled.

Taxation of disability benefits depends on how premiums are paid*

		Post-tax premiums	Pre-tax premiums
Annual taxes on premiums	Employee	$219.08	$0.00
	Employer	$51.33	$0.00
Annual taxes on benefits each year employee is disabled	Employee	**$0.00**	$19,590.00
	Employer	**$0.00**	$4,590.00

Paying LTD premiums with post-tax dollars prevents future taxes on disability benefits for both the employer and employee.

RPB's research shows that even after 40 years of paying taxes on LTD premiums with no claim, the total premium taxes paid are still less than the taxes on one year of taxable disability benefits.

Using Rachel from the example above, the combined employer and employee total premium tax paid over 40 years ($10,816.40) is less than the combined employee and employer taxes paid on just one year of taxable disability benefits ($24,180).

**Assumes the following: 90-day waiting period; disability benefit of $60,000; federal income tax rate of 25%; no state or local tax rate; individual FICA tax rate of 7.65% and employer FICA tax rate of 7.65%. For clergy paying SECA tax, the examples assume that half is reimbursed by the employer, which equates to the same tax rate for the individual and employer as the FICA scenario. Taxable disability benefits will be subject to FICA tax regardless of clergy status.*

Setting up post-tax payments

How you pay LTD premiums depends on whether the benefit is employer- or employee-paid. The options below show how post-tax payments work for Rachel, who earns $100,000 and has a $671 annual LTD premium.*

Employer-paid benefit: Employees ***do not reimburse you*** for their LTD premiums

OPTION 1

Payroll gross-up and deduction

(Recommended)

WHAT TO DO

- Increase employee's gross salary by the premium amount
- Withhold the same amount as a post-tax deduction

EXAMPLE

- Increase Rachel's gross salary by $671 to $100,671
- Deduct $671 from her after-tax pay
- Rachel's net pay is reduced by the amount of tax paid on the LTD premium

OR

OPTION 2

W-2 reporting

WHAT TO DO

- At year-end, include the premium amount in the employee's taxable wages on their W-2 to ensure they pay tax on the premium

EXAMPLE

- Add $671 to the $100,000 in Boxes 1, 3, and 5 on Rachel's W-2 †
- Rachel pays tax on the LTD premium on her federal income tax return

† *Applies only to employees whose earnings are subject to FICA taxes. Clergy who earn SECA wages would have only Box 1 adjusted since Boxes 3 and 5 don't apply to them.*

Employee-paid benefit: Employees reimburse you for their LTD premiums

OPTION 1

After tax payroll deduction

WHAT TO DO

- Withhold the premium amount as a post-tax deduction

EXAMPLE

- Deduct $671 from Rachel's net pay (after taxes)

OR

OPTION 2

Direct payment

WHAT TO DO

- Employees write personal checks to your organization for the full premium amount

EXAMPLE

- Rachel writes a $671 personal check to your organization

NEED HELP?

If you have questions along the way, RPB is here to help. Email askus@rpb.org or call 212.681.1818.