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Life Insurance ownership

Life Insurance & ownership issues to consider

Helping clients put life insurance solutions in place meets a critical risk management need and not only requires that the Adviser have specialist knowledge of the solutions available but must also be able to match them to the client's particular needs. From an estate planning perspective there are also issues to consider around where the proceeds will be directed. As with all advice in the financial arena, this must be tailored to the individual client's needs and as such, there is no one, answer. There are a number of options including payment direct to a spouse or child (the nominated beneficiary), to the insured's superannuation fund or to the deceased estate. In this edition we look at some of the issues surrounding these options.

Ownership options	Some issues to consider
Nominated beneficiary	**Are testamentary trust benefits lost?**
Superannuation Fund	**Will tax be payable by the recipients?**
Super owned & to estate	**Is there a Death Benefits Proceeds Trust?**
Self owned & to estate	**Is it binding? Is that the best outcome?**

Nominated beneficiary

If the policy is paid to an individual they will be able to spend or invest those funds (or a trustee will on their behalf if they are under 18) and earn income. Any income earned on those funds will be taxed at marginal rates.

To consider: Would it be better for the beneficiary to receive the funds via the estate and have access to the benefits of testamentary trusts including on-going tax benefits, assistance in identifying asset contributions for potential family law disputes and being able to nominate an age above 18yo for when a beneficiary can get access?

Superannuation owned

The life insurance proceeds would form part of an individual's death benefits proceeds which under the SIS Act can be paid to a spouse, children, financial dependants, inter-dependents or the deceased estate. However from a tax perspective, it is only the "death benefits dependants" who can receive lump sum death benefits tax free. This means for example that non-financially dependent adult children may be required to pay 31.5% tax on the insurance lump sum component of any death benefits proceeds.

To consider: Before recommending that life insurance be held within superannuation you should check to identify who will be eligible to receive the death benefits proceeds and what the tax consequences will be. Explain any tax “trade-off” to the life insured as they may prefer the policy to be self-owned.

Superannuation owned & directed to the estate

Superannuation can also be paid into an estate which could be an appropriate option if special provision has been made within the Will. For example, a special purpose testamentary trust can be established to receive the death benefits proceeds which not only ensures tax benefits are maintained but also provides some of the extra benefits attached to testamentary trusts.

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An important issue to consider however, in relation to putting life insurance in superannuation (rather than being self-owned) and directing it to the estate, is that it is highly unlikely the tax office will allow "double-dipping". What do we mean?
Whilst the lump sum into the estate is not taxed, any income earned thereafter via the Death Benefits Proceeds Trust that is paid to children would probably not be eligible for the S102AG provision as a tax benefit has already been received.
On the other hand when non-superannuation assets are allocated to testamentary trusts it is possible for children under 18 to earn income that will be taxed at normal adult rates unlike income earned by children from a normal family trust which is taxed at penalty rates. One of the core advantages testamentary trusts provide is that they allow income to be distributed to family members, including children, and thus save what can be a significant amount of tax.

Another issue to consider is whether the beneficiary would be better off receiving the death benefits proceeds direct rather than via the estate. For example, it may be better to receive a reversionary pension or a child allocated pension.
To consider: What beneficiaries are able to take advantage of superannuation benefits? Spouse or young children? Older children? Determine the financial implications in each client’s case and diarise to review it each year.

Self-Owned & directed to the estate

If life policies are self-owned the proceeds may be directed into the estate to be distributed into a beneficiary's testamentary trust. Any income earned can then be shared with family members to take full benefit of tax advantages. They will also have a vehicle that allows this asset contribution to be clearly identified in a family law dispute and, if required, restrict access until the beneficiary is considered old enough to be responsible to manage it ie beyond 18 yo.
To consider: If there are dependant beneficiaries eligible for a reversionary pension or child allocated pension, would superannuation be a better option?

Managing Estate Challenges

While there may be compelling reasons for life policies to be self-owned and directed into the estate as described above, an exception to this would be where there is a possibility of an estate challenge or where the estate may be involved in litigation.
It is worth noting however that whilst estate challenges for example, tend to generate a lot of publicity, they are uncommon. Neverthless they can occur and this points again to the need for the ownership question to be considered on a client by client basis.

Caution: Using the same approach for all clients …

If, for example, you had a ‘blanket policy’ approach and were recommending a nominated beneficiary to avoid challenges we would suggest caution. The disadvantages of directing a life policy to an individual and thus losing the benefits of testamentary trusts could provide grounds for a *beneficiary* to sue you for negligent advice. Similarly, you could be liable if you recommend a binding nomination to the estate and it transpires that the beneficiary would have been better off with a reversionary pension at the time rather than receiving it via a testamentary trust.
As with any financial advice, you need to consider the consequences of your advice around ownership of life insurance to ensure it is appropriate for each individual client.

If your clients are looking for advice in planning their estates, we would be pleased to help. After consultation, our experienced lawyers will provide advice on the best solutions to suit their needs. Contact us for more information on our fixed fee services.

Attention Alliance Partners: Login to download a copy of our "decision tree" for insurance ownership.

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