

Aspects of Financial Planning

Ownership of insurance - personal

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Who will own your personal insurance policy is an important decision. This Aspect discusses the ownership options that are available and highlights the advantages and disadvantages of each.

Background

Australia's high level of under insurance, the gap between cover held and cover needed to protect against financial loss, has been well documented and publicised. This is an unfortunate state, even disheartening given that an adequate insurance portfolio is fundamental to a sound financial plan.

There are a number of important decisions to make when purchasing personal risk insurance including product type, provider, amount of cover, cost and ownership structure. This Aspect covers ownership of insurance, a primary consideration given that:

- Up to three people (or entities) may have an interest in a personal insurance policy: the owner, the life insured and the nominated beneficiary/s
- Making the right ownership decision upfront will determine who controls the operation of the policy, can help ensure the policy retains relevance in the long term and that intended tax, estate planning and asset protection results will be achieved; and
- One identical benefit can produce vastly different net results depending on the ownership structure.





There are a number of different ownership options available, including self-ownership, cross-ownership, joint ownership and ownership within a Superannuation fund, by a Trust or Company. These different ownership structures have distinct advantages and disadvantages. Given the legislative technicalities associated with insurance, you should seek advice from a qualified adviser to work through each of the alternatives to find the most appropriate ownership structure for you.

Self ownership

This form of ownership occurs where the life insured owns the policy, controls the operation of the policy and may receive the proceeds (or the proceeds are passed to their Estate). Please note: for the purposes of this discussion we are referring to ordinary life insurance policies, as opposed to life policies held through super (discussed below). Self ownership is a popular form of ownership for a number of reasons:

Portability

Insurance policies 'follow their owner' meaning that the owner retains ongoing control of the operation of the policy even when life or business circumstances change. A benefit of a self-owned policy is that it necessarily follows the life insured, as both are one and the same. This is favourable to the life insured in two ways:

- During the life of the policy, the life insured can determine to increase/decrease cover, cancel the policy, surrender the policy, assign the policy to someone else, add beneficiaries etc (depending on the contract with the life insurance company); and
- As the policy ownership does not have to be transferred or assigned by another party to the life insured when circumstances change (such as a break-up of relationship), it avoids administrative difficulties and possible capital gains tax (CGT) implications.

Flexibility

The ability to nominate (and revoke) a number of beneficiaries (anyone can be nominated) assists in ensuring the policy remains relevant to the policy owner when circumstances change. For example, where a policy owner gets married, he/she may benefit the new spouse by simply modifying the beneficiary nomination in favour of their new spouse. This avoids the complications and costs of changing Wills or assigning/transferring ownership of the policy.

A policy owner has discretion to change their nomination of beneficiary at anytime. It should be noted however that this provides scope to undermine the original intention or agreement underlying the policy. For example a wife who enters a business partnership may discretely change her beneficiary nomination to favour her business partner in order to meet business obligations or agreements. This potentially leaves her family under insured and exposed.





Fast claims

For ordinary life insurance policies, the payout process is simple as there is a defined person to pay the benefit. The proceeds can generally be paid quickly to the nominated beneficiary/s once appropriate evidence is received. This can provide much needed financial relief especially as death can bring sudden and substantial cash flow pressures, such as funeral expenses.

Taxation

The taxation of premiums and payouts on ordinary life insurance policies purchased by individuals is relatively straightforward. The premium on these policies is generally not tax deductible and any lump sum payouts are tax free in the hands of the beneficiaries.

Generally, total and permanent disability (TPD) and trauma insurances are self-owned as it ensures that tax free benefit proceeds are passed directly to the life insured.

The tax treatment on income protection policies is such that premiums are tax deductible and the proceeds (paid in the form of a regular income stream) are taxable to the owner.

Different tax implications may apply when the policies are purchased for business purposes or through trust arrangements.

Cross ownership

In cross-ownership the policy is owned and proceeds will be received by a party other than the life insured. It is a traditionally popular form of ownership used between spouses and also business partners.

In the case of a married couple each spouse becomes the owner on a life insurance policy in which their husband/wife is the life insured. If one spouse dies, the remaining spouse is paid the proceeds directly. As the death benefits are paid directly, rather than going through the Estate, it avoids the costs and delays associated with the granting of Probate. While the concept of a cross-owned policy is simple enough, in practice it does not always follow nor favour the life insured and to some degree the policy owner.

The disadvantages include:

- Unlike a self-owned structure, the life insured cannot continue to direct or control the policy. In a break-up of relationship the life insured may need to purchase a new policy because of the impossibility of adjusting or directing the benefits of a policy that continues to belong to someone else. Purchasing new insurances may be particularly difficult if the life insured's age or health status affects their insurability.





- There may be a disproportionate cost of premiums on respective policies, especially where there is an age or health difference.

The difficulty that lies in cross owning an insurance policy(s) therefore is that policies have to be restructured each time there is a change in the relationship! Restructuring may also give rise to unforeseen tax implications (this is especially true in the case of business arrangements).

Note: For cross-owned TPD and trauma insurance the owner also receives the proceeds. In this situation the proceeds may not be exempt from capital gains tax as the person receiving the proceeds is not the same person suffering the disability or trauma.

Joint ownership

A policy can be owned jointly as joint tenants. The underlying principle is no different to how this ownership structure applies to other assets, such as property. In a joint tenant's arrangement if one owner (life insured) dies, the policy automatically becomes owned by the joint owner. The proceeds do not form part of the Estate of the deceased.

Insurance inside superannuation

Life/TPD Insurance

Life/TPD insurance may be purchased through superannuation, enabling a benefit to be paid by the insurer to the trustee of the fund who effectively owns the policy. The amount is then added to the member's (life insured's) super account balance in the fund, with the total amount available to be paid.

Due to the trustees' obligations under superannuation law and the fund trust deed, the payment process for term life in super is more complicated than that of ordinary life insurance. The trustees will determine the recipient of the proceeds by either exercising discretion to pay dependants and/or the Estate or by following a valid binding death benefit nomination(s). It should be borne in mind that:

- While the scope of who can be nominated as a beneficiary has changed to cover a broader range of people, as compared to ordinary life insurance, super trustees remain limited by legislation as to whom a superannuation death benefit may be paid;
- Inherent time delays exist as trustees approve benefit settlement through reasonable yet possibly invasive enquiries and processes; and
- Provisions and processes exist to give potential beneficiaries an avenue to have their claims properly considered. Not only may settlement of claim take longer than that associated with ordinary life insurance, but the proceeds could potentially end up in the hands of those unintended.





Life insurance in super remains a popular form of ownership because insurance premiums within superannuation are funded from superannuation balances and/or contributions rather than 'out-of-pocket expenses'. Moreover tax concessions and other benefits normally associated with making superannuation contributions are available to those who contribute to super (and meet relevant conditions) to fund insurance premiums. For example, self-employed people can claim a tax deduction for personal contributions to super, which are subsequently used to fund insurance premiums.

Life and TPD proceeds paid from superannuation however may be tax implicated. This will depend on a number of factors and should be discussed with your adviser. Due to the removal of reasonable benefit limits (RBLs) from 1 July 2007, there has been an increase in life and TPD insurance purchased inside superannuation. However, due to the potential time delays or uncertainty of trustee discretion, it may be prudent to hold some life insurance outside of super.

Trauma insurance

Trauma insurance is normally purchased as an ordinary policy rather than through superannuation. This is because of the difficulties associated with meeting the superannuation 'sole purpose test' and 'conditions of release' and therefore having access to the proceeds.

Income protection insurance

Previously, where income protection (or salary continuance) was purchased through superannuation, the benefit period was limited to two years. A March 2007 Australian Taxation Office (ATO) taxation determination however confirmed that superannuation funds were able to claim a tax deduction for income protection insurance premiums where the benefit period was longer than 2 years. This has resulted in an increase in the number of funds offering income protection insurance through superannuation.

For income tax purposes income protection benefits are treated as salary and wages in the hands of the recipient as they are intended to be a direct compensation for salary in the period of temporary disablement. In order to access the benefit, a member will need to meet (and continue to meet) the superannuation temporary incapacity condition of release and if so will be paid a non-commutable income stream from the superannuation fund. The salary continuance benefits are considered as 'replacement income' as opposed to 'retirement income' as they are payable on the assumption that the disablement is in fact temporary and the recipient will return to work.





Conclusion

Deciding on the correct ownership structure is a consideration often glanced over in favour of the more attractive 'tax deductibility of premium' issues. As ownership structure has a direct impact on tax, estate planning, asset protection and ultimately net benefit results, it is important to seek advice in making the right decision. In this respect, it is important to remember that:

- Insurance portfolio's are determined on a case by case basis
- Personal insurance needs and business insurance needs should be clearly distinguished
- Documentation (whether it be minutes, file notes, Wills) are indispensable
- It is difficult to generalise outcomes due to legal and tax complexity of insurance matters; and
- There is an ongoing action or review of insurance matters by the Government and the ATO.





Centric Wealth Advisers Ltd may be able to be of assistance

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