Insurance and estate planning

A Financial Planning Guide

key financial planners
secure your future

Contents

Introduction	4
General insurance	4
Private health insurance	4
Personal insurance	5
Business insurance	7
Estate planning	8

Protecting yourself and your family from financial loss is one of the key roles of any comprehensive financial plan. That is why your financial plan should include recommendations on how insurance can help you. This guide explains the different types of insurances available to help protect you, your family and assets. It also covers estate planning, an essential part of your financial plan, to help ensure your family or other beneficiaries are looked after upon your death.

The following information is current as at 1 July 2017.

Introduction

Why we insure

Insurance is a very important part of any comprehensive financial plan, giving you financial protection against a range of risks like loss of property, loss of your ability to generate income and medical expenses. There are four main types of insurance – general insurance, private health insurance, personal insurance and business insurance. Each of these types of insurance are discussed below.

Regular review

There are many changes in personal circumstances that can affect the kind of insurance you should have and the level of insurance that is appropriate for you. As a result, it makes sense to review your insurance coverage regularly. When better than at your annual review with your financial adviser? Of course, some changes require immediate attention, including when:

- You change your marital status.
- You have children.
- You increase or reduce your debt significantly.
- You change your residence.
- You upgrade your motor vehicle.
- Your salary increases or decreases.
- You start your own business.
- You retire.

General insurance

Having insurance cover for valuable personal assets such as your car, your home and its contents provides both peace of mind and financial protection. It makes sense to arrange cover for at least the replacement value of your assets and to review your policies annually.

Home

If you are a homeowner, this will cover you for loss or damage to your home.

Contents

Contents Insurance covers you for theft, loss or damage to the items in your home. Homeowners often have a combined home and contents policy. Discounts can be gained by combining your home and contents cover.

If you are renting, you can take out a contents-only policy.

Contents insurance may include extended cover for the loss or damage of your personal and portable items anywhere in Australia and Public Liability cover for injury to other people on your property.

Motor vehicle

Comprehensive:

Covers you for damage to your own vehicle, as well as for any damage you may cause to the property of others. This is generally the best type of cover to have, but can be more expensive than the other types of motor vehicle insurance.

Third party property:

Covers you for damage your vehicle causes to another person's vehicle or property. Your own vehicle is not insured for damage.

Compulsory third party:

Compulsory Third Party (CTP) insurance or 'Greenslip' covers the owner and the driver of the motor vehicle for damage caused to another person.

Private health insurance

Your health is possibly your most valuable asset. If you fall ill or you are injured, and want to be able to afford the treatment and care that will get you back on your feet, you should consider private health insurance as many of the costs involved – hospitals, specialists, post treatment care and ancillaries – may not be covered by Medicare and can be considerable.

The Private Health Insurance Incentives Scheme offers an incentive for many individuals who have private health insurance in the form of a means tested tax offset (i.e. a rebate). Subject to their level of income, Australians who pay for health insurance which includes hospital cover or ancillary cover or a combination of these may be able to claim this tax offset. The rate of tax offset will depend on the oldest person's age covered by the policy and the family income.

The Medicare levy surcharge is an additional surcharge of up to 1.5% of taxable income imposed on people earning above defined income thresholds, who do not hold an appropriate level of private hospital cover. This surcharge is in addition to the normal 2% Medicare Levy.

For the 2017-18 financial year, the private health insurance rebate and Medicare Levy Surcharge will be income tested against the income thresholds in the table below.

Income for surcharge purposes*		Level of rebate based on age***			Medicare Levy Surcharge
Single	Families **	<65	65 to 69	70+	
$90,000 or less	$180,000 or less	25.934%	30.256%	34.579%	Nil
$90,001 – $105,000	$180,001 – $210,000	17.289%	21.612%	25.934%	1%
$105,001 – $140,000	$210,001 – $280,000	8.644%	12.966%	17.289%	1.25%
$140,001 or more	$280,001 or more	Nil	Nil	Nil	1.50%

*The income test used for both the Medicare Levy Surcharge and entitlement to the private health insurance rebate is called Income for (Medicare levy) surcharge purposes, and comprises taxable income plus reportable fringe benefits; exempt foreign employment income; reportable super contributions; total net investment loss less certain lump sums that may have been withdrawn from super. However, the surcharge is applied to taxable and reportable fringe benefits only.

**For Families with more than one dependent child, the relevant threshold is increased by $1,500 for each child after the first

*** Rebate levels applicable from 1 April 2017 to 30 March 2018.

People earning above the relevant threshold can avoid paying the Medicare levy surcharge by taking out an appropriate level of private hospital cover with a registered health insurer. An appropriate level of hospital cover is one which does not have an excess greater than $500 for a single member or greater than $1,000 for couples, single parents or family members.

Personal insurance

There are four main types of personal insurance, to protect you in various circumstances:

- Term Life;
- Total and permanent disability;
- Trauma (also called Critical Illness or Living Insurance); and
- Income protection (also Salary Continuance Insurance).

Term Life (or Death)

Term life insurance pays a lump sum benefit if the life insured dies during the term of the insurance.

Purpose

- To enable the beneficiary – such as a spouse or child – to repay debts (e.g. mortgages, credit cards, margin loans, personal loans).
- To cover capital gains tax liabilities that may arise from the settling of your estate.
- To provide for your dependants after the loss of their income provider.
- To secure a business interest.

Available through super?

Term Life insurance can be included in most superannuation funds. The Trustee of the fund will own the policy on your behalf and pay the premiums using part of your balance or you can fund the premiums via super contributions. The benefit will generally be paid in accordance with your death benefit nomination.

Tax treatment

Stand-alone policies – Premiums are generally not tax deductible, and the proceeds are generally paid to the beneficiary tax free. This depends on the circumstances under which the policy is held.

Term life through super – Premiums may be tax deductible to the super fund. The way in which the proceeds are taxed will depend on the beneficiary who receives the death benefit. You should discuss this with your tax adviser for more information.

Total and Permanent Disability Insurance (TPD)

TPD cover provides a pre-agreed amount of money, payable as a lump sum, if you suffer an illness or injury that makes you totally and permanently unable to work. You can take out TPD cover either separately or as part of a Term Life insurance policy.

Purpose

- Cover your mortgage or other debts.
- Protect your business against loss of sales and profits.
- Maintain business lines of credit.
- Provide an income stream to live on.
- Provide money for home modifications required due to an accident or illness.

Available through super?

TPD (any occupation) insurance can be included in most superannuation funds. The Trustee of the fund will own the policy on your behalf and pay the premiums using part of your balance or you can fund the premiums via super contributions.

Tax treatment

Stand-alone policies – Premiums are generally not tax deductible and proceeds paid to you or your relative are generally not subject to tax. Otherwise the tax treatment depends on the circumstances under which the policy was taken out and on who receives the proceeds.

TPD through super – Premiums can be tax deductible to the super fund depending on the terms and conditions of the policy. If certain conditions are met, the payment of the proceeds to the member may have a portion that qualifies as a disability payment and will be received tax free.

Income Protection (also known as Salary Continuance Insurance)

If you become unable to work because of sickness or injury, this type of insurance will typically pay you up to 75% of your earnings for a certain period, until you are able to return to work.

Purpose

Most people who work depend on their income to provide for themselves and their family. This makes the ability to earn income your most valuable asset. If, like most of us, you work for a living, then this type of insurance is extremely important.

Available through super?

Income protection insurance can be included in most superannuation funds. The Trustee of the fund will own the policy on your behalf and pay the premiums using part of your balance. While you can include Income Protection insurance in super, you need to be aware that the proceeds can only be accessed if the Trustee is satisfied that you are temporarily or permanently disabled.

Tax treatment

Premiums for this type of policy are generally tax deductible and any proceeds that you receive from this policy are considered assessable income for income tax purposes.

Trauma (also known as Critical Illness or Living Insurance)

This type of insurance pays you a lump sum if you suffer one of the major health traumas specified in the insurance policy. Specified traumas typically include certain cancers, heart disorders, nervous system disorders, various accident conditions, specific organ disorders and loss of speech. Detailed definitions are contained in the product disclosure statement for the relevant insurance policy.

Purpose

What if you suffer a serious illness or injury, but are not totally and permanently disabled? Your TPD cover does not apply and even if you have income protection cover to pay your general living expenses, it may not be enough to cover all the additional expenses associated with a serious illness or injury – eg medical bills. This is why Trauma Insurance is so important.

The benefits of trauma insurance include:

- Pay for specialist medical attention.
- Cover the cost of modifications to the home.
- Avoid financial stress in recuperation.

Available through super?

Since 1 July 2014 it has not been possible to purchase new critical illness policies through superannuation.

Tax treatment

Premiums are generally not tax deductible and the proceeds are generally paid tax-free if paid to yourself or your relative. The tax treatment may be different where the trauma insurance is part of key person insurance policy (described in the next section of this brochure).

Business insurance

As well as personal insurance, business owners need to protect their business operations and cashflow. Key person and buy/sell insurance are vital policies for your business.

Key Person Insurance

This insurance protects a business in the event of the loss of a person who makes a significant contribution towards the profitability or stability of the business. People who fall into this category would normally have some particular ability, which is difficult to replace. There are many ways to determine and quantify the need for key person insurance. When determining the need, it may be necessary to take into account:

- The length of time it would take for the business to achieve the revenue level enjoyed prior to the key person's death or disability.
- The salary required to pay a replacement.
- Any anticipated reduction in profit.

The following is a guide to the ownership of key person insurance policies.

Life Insured	Owner
Sole trader	Spouse or self
Partner	Other partners as joint owners
Principal of one man company	Company
Employee (including a director of a company which will continue after the death or disability of insured)	The employer (ie sole trader, partnership, company or trust)
Person outside of business	Sole trader, partnership, company or trust

Tax treatment

If the purpose of the policy is to replace revenue then premiums for this type of policy are generally tax deductible and any proceeds received from this policy are generally considered assessable income.

Buy/Sell Insurance

Business partners often enter into an agreement which provides that when a 'trigger event' happens (e.g. as a result of death, long-term disability, retirement or bankruptcy), the continuing partners are required to buy out the other partner's interest in the business and the exiting partners are required to sell their business interest to the continuing business partners. This is called a buy/sell agreement (or may be provided for in partnership agreement).

A buy/sell insurance policy provides the continuing partner(s) with the money to buy out the other partner's interest in the business in the event of death, trauma or total permanent disability.

A business interest may be transferred on the death of an owner by selling the business as provided for in a buy/sell agreement.

The agreement must identify the owner of the interest being disposed of and the type of interest disposed of (ie shares, units, partnership). The agreement must also specify who is to acquire the interest (ie business partners, key personnel).

There are two main types of buy/sell agreements:

- ***Cross-purchase agreement***

  This is an arrangement where the remaining owners are to be the purchasers of the business interest. Upon the death or serious illness of an owner, the other business owner(s) shall purchase the outgoing owner's share. In a common scenario where the business interests are owned personally, the executor of the estate may be required to sell the deceased's share, or the co-owners may be required to purchase it. The agreement may provide for either mandatory or optional purchase arrangements.

- ***Corporate entity redemption agreement***

  Under this agreement, the company will buy back the interest of the deceased/disabled owner. The owner, or their estate, will receive cash from the company, and the company will purchase and cancel the shares.

Policy ownership

The buy/sell agreement is normally funded through an insurance policy. Depending on the parties and circumstances the policies can be held under any of the following arrangements:

- Cross ownership, where the owners of the business hold policies on each other.
- Self ownership, where the owner holds the policy on himself/herself.
- Trust ownership, where a trustee holds the policies on behalf of each of the owners.
- Company ownership, where the company holds the policies.

The buy/sell agreement will need to state how the value of the business interest is to be determined when a 'trigger event' happens and the business interest is sold.

Tax treatment

For buy/sell insurance premiums are generally not tax deductible and the proceeds paid may or may not be taxed. In addition, as an asset (i.e. the business interest) is sold a capital gains tax liability may arise.

Estate planning

Is estate planning for you?

If there are people or causes you would like to look after when you die, then estate planning is for you – regardless of how wealthy you are or how old you are.

Effective estate planning:

- Ensures your assets go to the people you want to leave them to.
- Maximises the after-tax value of your assets.
- Makes it as easy as possible for the people you leave behind to handle your affairs without you.

You should seek professional legal advice in relation to estate planning from a solicitor specialised in this area of the law in light of your personal circumstances.

Wills

A will is a legal document that enables you to direct who is to receive what from your estate, and on what terms, after your death. To ensure that your will continues to reflect your wishes, you should review your will regularly and update it as your circumstances change. You can do this either by revoking your will and replacing it with a new one, or by amending it.

A will is a key part of effective estate planning but it is not the only part. As you can see from the list below, you may own or control assets that can not be governed by a will.

Assets governed by a will

A will can only dispose of assets that form part of the deceased's estate. These include:

- Assets you own personally.
- Your shares in a company.
- Your share of any asset you own as tenant-in-common.
- Any superannuation death benefit or life insurance policy proceeds paid to your estate.
- Your interest in any partnership assets, unless agreed otherwise.
- Life insurance proceeds where you own the policy on your life and no beneficiary has been nominated.
- The right to recover any funds owed to you.
- Any rights you hold under any contract or agreement.

Assets not governed by a will

- Assets you own as a joint tenant, as these pass automatically to the surviving joint tenant(s).
- Assets held in a trust of which you are a beneficiary; the trust deed governs what happens to these assets.
- Assets owned by a company (even if you are a shareholder) as only the company can deal with its assets.
- Superannuation death benefits or life insurance policy proceeds paid directly to a beneficiary.

Who can make a will?

To make a valid will generally requires "testamentary capacity." In Australia, this means you must be:

- Of sound mind, memory and understanding at the time the will is made or when instructions are given to the lawyer to prepare a will.
- Generally a person must also be 18 years of age or over. There are exceptions to this requirement under special rules for:
  - Members of the Armed Forces in active military service.
  - Minors who are married or about to get married and minors permitted by the court to draw up a will.

Revoking your will

A will, or part of it, may be revoked at any time. For a voluntary revocation to be effective, the will-maker (testator) must have the intention to revoke the will and have the same testamentary capacity as is required for the making of a will.

A will may automatically be revoked, in part or in full depending on the jurisdiction, in the following situations:

- Upon marriage;
- Upon divorce;
- By the making of another will, or part of a will;
- By written declaration; or
- If the will is destroyed with the intention of revoking the will.

If you die without a will

If you die without a will, you are said to die 'intestate' and your estate will be administered according to the intestacy laws of the applicable state or territory. Where there are no surviving relatives, your estate may pass to the relevant state and territory government. This means that your assets could pass to a beneficiary that you would not have wanted to benefit from your estate.

Appointing your executor

Your executor is the person who will be responsible for administering your estate after your death. When you make your will, you nominate the person who will perform this role. It is advisable to ask the person first and be sure the burden and responsibility of this role is clearly understood. If the person you have in mind is also a beneficiary, that is not a problem as beneficiaries are not excluded from acting as executor.

Nominating a guardian

Nominating a guardian to care for your minor children is an important choice. This role is generally performed by a family member or someone that you would trust with the upbringing of your children and who would be prepared to take on this responsibility.

Power of Attorney

A power of attorney is a document empowering another person to act on your behalf. It should only be given to someone you trust since it involves you passing on important and legally recognised powers, rights and entitlements. All powers of attorney may be revoked by the maker (donor) at any time whilst they have mental capacity. You should ask your solicitor if a power of attorney is appropriate for your circumstances.

There are different types of powers of attorney, including:

- **General** – where the attorney is able to do all of the things in relation to your property and financial affairs on your behalf. However, this power ceases if you lose mental capacity.
- **Enduring** – where the attorney is able to do all the things in relation to your property and financial affairs on your behalf. This power continues if you lose mental capacity.
- **Limited** – where you restrict the things that the attorney is able to do on your behalf, or you restrict the time for which that person will be your attorney.
- **Medical** – where you authorise someone to make medical decisions on your behalf when you are unable to.
- **Guardianship** – where the guardian is able to make personal and lifestyle decisions on your behalf when you are unable to.

  Each state has its own rules for powers of attorney. Some states also have Advanced Health Directives that enable you to give directions about your medical treatment if you are ever unable to.

Will your estate be taxed?

The tax that may potentially have the greatest impact on the value of your estate and its distribution is capital gains tax (CGT).

CGT is payable when you dispose of certain assets which have increased in value. The transfer of assets to your executor or a beneficiary on your death does not trigger CGT, however a CGT liability may be triggered when the executor or beneficiary of your estate sells the asset.

There are strategies that can minimise the CGT liability. You should discuss these with your tax adviser.

Binding death benefit nominations

As previously mentioned when a person who has been a member of a superannuation fund dies, the amount payable from the fund does not generally form part of their estate and as such is not distributed via their will. Where there is no death benefit nomination or a non-binding death benefit nomination, the trustee of your superannuation fund will use their discretion to distribute your benefits, in accordance with the superannuation fund's trust deed. This includes to whom and in what form, i.e. as a lump sum, pension, etc.

Most superannuation funds now allow for binding death benefit nominations, which give the members the ability to nominate who receives their benefits. This is binding on the trustee of the fund.

Binding death benefit nominations provide that a superannuation death benefit, including any life insurance owned within your superannuation fund, is paid to your nominated dependant or the legal personal representative of your estate, not at the trustee's discretion.

Death benefits may be paid as a lump sum or a pension or a combination of both. However after 1 July 2007 death benefit pensions can no longer be paid to non tax-dependants.

Testamentary Trusts

A testamentary trust can be useful in producing tax effective income for minors.

A testamentary trust is established by your will and only comes into effect upon your death. Its purpose is to manage estate assets in accordance with your objectives and the needs of the beneficiaries. It offers flexibility as well as taxation and asset protection benefits. You should obtain legal advice from a solicitor specialised in estate planning on the benefits of testamentary trusts.

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Contact Key Financial Planners for further information on 08 8561 2400 or visit www.keyfinancial.net.au