Did you know?

Alex Koodrin
National Technical Manager

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Nomination of beneficiaries: frequently asked questions

We continue to receive adviser queries via our adviser hotline regarding how nominations of beneficiaries work for ordinary term life policies. These nominations continue to be a valuable estate planning tool for clients and their advisers. Here are a few frequently asked questions.

Q: Can the life insured who is also the policy owner nominate his wife and estate as equal beneficiaries for his term life cover?
A: No, not on the same policy. Section 48A of the Insurance Contracts Act 1984 "applies to a contract of life insurance effected on the life a person but expressed to be for the benefit of another person specified in the contract (the third party).

"(2) The following provisions have effect in relation to a contract to which this section applies:
(a) any money that becomes payable under the contract is payable to the third party, even though he or she is not a party to the contract;
(b) money paid under the contract does not form part of the estate of the person whose life is insured."

To overcome this prohibition, the policy owner can have two policies: one with no nomination of beneficiary, where the process proceeds will pass through his estate, and another, where he nominates his spouse as beneficiary.

Q: Can a life insured who is also the policy owner nominate her son, who has Child Cover, as a beneficiary on her term life policy?
A: No. Even though Child Cover is a rider to the term life policy, the son is still a life insured under the policy and, for the reasons mentioned above, cannot be nominated as beneficiary. A separate policy would need to be put in place.

Q: If a husband and wife are lives insured and owners on the same term life policy, and they nominate their two children as beneficiaries, who will receive the benefit if either of them dies – will it go to the surviving policy owner or to the children?
A: The children would receive the benefit, as the nomination would supersede the ownership. Upon the death of the first life insured, the surviving policy owner is able to change the nominees for his or her remaining benefit as required.

Q: What if the nominated beneficiary dies before the life insured/policy owner, who will the policy proceeds be paid to?
A: It depends on the contract of that particular insurer. CommInsure states on page 16 of its CommInsure Protection Product Disclosure Statement: "if a nominated beneficiary predeceases the life insured, then that beneficiary's legal personal representative will receive any money payable on the life insured's death". There is no time restriction between the death of the insured and that of the beneficiary. If the beneficiary has died and the estate has been wound up, it will be reopened in order to make the claim payment. Most other insurers treat the nomination as invalid if the beneficiary has pre-deceased the life insured, and that portion of the benefit is generally paid to the policy owner or his/her estate. It is prudent to carefully read the PDS and policy document to determine who will be receive the benefit in this circumstance.

Q: Can beneficiaries be nominated for TPD or trauma benefits or only for term life?
A: We know of only one insurer that allows TPD or trauma benefits to be paid to a person other than the policyholder through beneficiary nominations. All other life offices, including CommInsure, limit beneficiary nominations to death benefits only.

Q: Are term life proceeds paid to a beneficiary tax free?

A: Under section 118-300 of the Income Tax Assessment Act (ITAA) 1997, the proceeds of a life policy payable on the death of the insured is exempt from capital gains tax (CGT). They are also exempt if paid to someone who was not the original beneficial owner, but who did not pay any money or give any other consideration for the acquisition of the rights or interest in the policy. It is our understanding that under a beneficiary nomination, the proceeds are still payable to the original beneficial owner and the nomination is merely a direction to pay a third party, thereby making the proceeds tax free in most circumstances.

Q: Can nominations of beneficiaries be challenged by family provision claims or other claims against the estate?

A: Amounts paid under ordinary term life beneficiary nominations bypass the Will and are therefore non-estate assets. They are therefore not subject to challenges to the provisions of a deceased's Will in all states and territories, apart from NSW, where family provision legislation gives the court the power to declare property owned or controlled by other persons to be notional assets of the deceased and subject to provision orders. Nominations can be challenged in all jurisdictions on the basis that the policy owner was not of legal capacity (sound mind) or that the nominations were made under duress.

Summary

Clients and their advisers should be aware of legislative restrictions surrounding nominations of beneficiaries, as well as the individual product provider's contractual terms and conditions for the payment of insurance proceeds to nominees.