LORREQUER
Wealth & Advisory

Insurance bond in a private trust

Investing in an insurance bond through a private trust such as a family or discretionary trust may increase your Centrelink/Veterans' Affairs (DVA) entitlement and reduce aged care fees due to a reduction in assessable income.

Benefits

- Your assessable income may be reduced which may increase your Centrelink/DVA entitlement under the income test
- The daily care fees you pay for aged care services may decrease as a result of the reduction in assessable income
- Your personal taxable income may be reduced which may reduce your tax liability (in some cases) and/or help you to qualify for a Commonwealth Seniors Health Card if you are a self-funded retiree
- The private trust may provide estate planning benefits, such as asset protection.

How it works

If you already have a private trust it is generally more effective to start a new trust for this strategy. You can then arrange to have money transferred into the trust which is recorded as a gift in the trust accounting records.

You need to nominate someone to act as Trustee of the trust.

The money transferred into the trust is used to invest into an insurance bond, sometimes also known as an investment bond. Insurance bonds do not distribute income unless a withdrawal is made, which means there is no taxable income generated by the trust for distribution to beneficiaries.

If the bond is the only investment held by the trust there is no assessable income for the Centrelink/DVA income test. This reduces assessable income compared to some other investments.

Centrelink/DVA assessment

Centrelink/DVA attribute the assets and income of a private trust depending on who controls the trust and the source of the money. As a general rule, if you transferred the money into the trust, or if you are associated in any way with the trust it is likely that Centrelink/DVA will attribute all assets to you.

Under the asset test, Centrelink/DVA will count the full value of the trust assets, so using a trust does not help to reduce your assessable assets.

But under the income test, Centrelink/DVA assess only the taxable income generated by the trust. If the only asset is an insurance bond and no withdrawals are made in the first 10 years (or before the death of the life insured) there is no assessable income created. This may reduce your assessable income.

Aged care assessment

The daily care fees payable for either government subsidised home care or residential care depends on your financial situation. For home care, it is generally based on Centrelink/DVA assessable income. For residential care it is generally based on Centrelink/DVA assessable income as well as your assets.

So reducing the income assessed by Centrelink/DVA may reduce your care fees.

Withdrawals

You can withdraw money from the insurance bond at any time. These amounts will be paid to you from the trust as a distribution.

A portion of the withdrawal may be classified as taxable income and this is assessed as income for Centrelink/DVA and aged care purposes for the following 12 months. So for the strategy to be most effective you need to leave the money in the insurance bond (and therefore within the trust) for at least 10 years or as an estate benefit upon your death.

Taxation

Earnings from the insurance bond are reinvested into the bond to increase the account balance. The insurance company pays tax on the earnings at the rate of 30%.

If you make a withdrawal from the trust within the first 10 years, a portion of the earnings are included as taxable income of the trust and then are passed on as taxable income to the beneficiary who receives the distribution.

The taxable portion is calculated as:

- Within first 8 years – all earnings withdrawn are taxable income
- Within the 9th year – two-thirds of earnings withdrawn are taxable income
- Within the 10th year – one-third of earnings withdrawn are taxable income
- After 10 years or upon death – none of the earnings withdrawn are taxable income

Consequences

- Earnings from an insurance bond are taxed internally at a rate of 30%. If this rate is higher than your marginal tax rate your net return from the insurance bond may be less than what could be achieved from other investments.
- If your Centrelink/DVA entitlements are assessed under the assets test this strategy will not increase your entitlements.
- If you are likely to pay the maximum aged care fees this strategy may not provide any benefit to reduce fees.
- Assets held in a private trust do not form part of your estate. You should seek legal advice to review the nomination of a beneficiary on the insurance bond and how this will interact with the trust deed for your private trust. It is also advisable to review your Will.
- You are required to tell Centrelink/DVA within 14 days about any change to your financial situation that may affect your payment.
- You may incur fees to set up the trust and for ongoing accounting requirements.
- Fees may also be charged for the investment into the Insurance Bond. You should check the details in the fee section of your Statement of Advice and the Product Disclosure Statement (PDS).

Date: 1 April 2018