



Private Placement Life Insurance Strategies to Cancel Debts and Liabilities – Post GFC

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We currently live in uncertain times. One of the major lessons emanating from the GFC is how quickly events can unfold to cause destruction and rapidly reduce the value of Assets. Similarly the unexpected death of a Principal can also reduce the value of an Estate or a particular Asset.

In the event of death, the value of the deceased's Estate can be significantly reduced if liquid funds are not available to enable the Legal Personal Representative (LPR) of the Estate to discharge debts and liabilities in a timely and appropriate manner without unnecessary delays, disputes and inappropriate timing or sale of Assets at liquidation values.

What follows is an overview of how life insurance death proceeds can be utilised to discharge debts and liabilities from the Estate without unnecessarily reducing the value of an Estate or a particular Asset.

1 The Responsibility for the Payment of Debts is with the LPR

Implication: The LPR being the Executor or Administrator has the duty to pay the debts of the deceased with due diligence which usually requires payment within the Executor's year. The requirement of the Executor's

year is only a general rule because due diligence may require that payment be made before the expiration of Executor Year. On the other hand, the circumstances of the particular situation and the availability of Assets may be such that payment cannot take place within the Executor Year in which event the LPR bears the onus of justifying the delay. The duty is owed not only to creditors but also to beneficiaries who may suffer consequential loss through a breach of the duty although the testator may relieve the LPR of the duty vis-à-vis the beneficiaries the testator cannot by the Will worsen the position of creditors who are always entitled to be paid as soon as possible after the testator's death.

In order to discharge the duty the LPR is entitled to use the first available Assets to pay Debts. If the first available Assets are not the Assets properly liable for the payment to creditors the Executor makes the necessary adjustment between the beneficiaries prior to distribution. That is, the beneficiaries are compensated out of the Asset which ought to have been used for the payment of debts. This is known as "marshalling the Assets among the beneficiaries".



It follows that where the Estate is solvent its administration will not concern the creditors but only the beneficiaries. That is, where there is no shortage of Assets the creditors will be fully paid and the administration of the Estate will only be concerned with which Assets, and thus which beneficiaries, are made to bear the debts of the deceased. It is only where the Estate is insolvent that the creditors will be concerned with the administration of the Estate because it is only in such a case that they will not all be fully paid.

Action Required: In order to prevent unnecessary disputes between creditors or beneficiaries of the Estate ensure as much as possible that debts and liabilities can be paid from liquid proceeds from the Estate. Therefore prevent where possible the unnecessary realization of Assets to repay debts of the Estate by having liquid funds.

2 The Personal Liability of the LPR for Funeral and Testamentary Expenses

Implication: Funeral and Testamentary Expenses that are incurred after the deceased's death may or may not be indemnified from the deceased's Estate Assets. Funeral and testamentary expenses can be distinguished from debts incurred during a deceased person's lifetime and include general expenses which are necessary for the proper performance of the duties of an LPR. Unless expenses are incurred in a reasonable and necessitous manner the LPR may not be indemnified from the Estate.

Action Required: Care should be taken that liquid funds are

available to meet all reasonable expenses.

3 The Personal Liability of the LPR for Debts

The LPR is liable for all debts and liabilities of the deceased, even if the LPR has no notice of them, to the extent that the LPR still holds Estate Assets.

If the LPR has notice of debts but fails to pay them and proceeds to distribute the proceeds of the Estate, the LPR is in breach of the duty to pay debts and becomes personally liable for the loss caused to the creditors. The LPR cannot in such circumstances seek a refund from the recipients or beneficiaries of the Estate. The general rule is that the LPR cannot recover from a recipient; a payment made with notice of a debt except in the case of possible and remote contingent liability because to disallow a refund in such a case would give rise to inconvenience by either delaying distribution for a long time or placing a large number of Estates into the administration of the Court.

If, on the other hand, the LPR has no notice of debts at the time of distribution; the LPR has at general law certain special defences which if established could avoid any personal liability. The essence of these defences is that the Assets of the Estate have been fully and duly administered or that any Assets remaining are required to meet claims having priority to that of the Plaintiff. The special defences are that, the Estate has been fully administered and there are no Assets remaining, the Estate has been fully administered except for a sum which is insufficient to fully



satisfy the claim, debts of a higher degree and no Assets, (that is, the Estate has been fully administered except for a sum which is insufficient to meet debts having priority to that of the plaintiff). However, if the LPR makes no plea at all if sued by a creditor of the Estate, the LPR is taken to have admitted the existence of Assets sufficient to be applied in satisfaction of the claim and if upon execution no Assets of the Estate are to be found, the LPR could become personally liable.

The general law defences are difficult to establish not only because the due and proper administration of the Estate must be proved in showing the lack or insufficiency of Assets but also because often the availability of Assets is dependent upon the outcome of other disputed claims against the Estate. In such circumstances the desirable course for the LPR is to seek a cost decree thereby relieving the LPR of liability because all creditors must come in and prove on the Assets over which the court has taken control. The court will fix a time within which creditors must come in, although the effect of the time limit has always merely been that if a creditor comes in late the creditor runs the risk of some or all of the Assets having been administered and disposed of in payment of other creditors.

Action Required: To prevent the LPR being personally liable for debts or to plead difficult defences ensure the Estate has liquid funds available to meet payments of debt.

4 Life Insurance Death Proceeds are generally not available to Repay Debts of the Estate

Implication: Under the Life Insurance Act (1995) and the Bankruptcy Act (1966) Life Insurance death proceeds are not available to creditors unless it is for payment to the Crown e.g. to repay tax, there is a release within the Will of the deceased to pay or the Life Insurance policy has a charge or there is a mortgage against the Life Insurance policy. Furthermore in *Re McCallum* (1907) 7 S.R. (NSW) 523 it has been held that funeral expenses may be paid from Life Insurance policies.

Action Required: Carefully structure the Life Insurance policy to ensure that policy proceeds are utilised for the desired intentions, otherwise policy proceeds may or may not be available to discharge Assets and Liabilities of the Estate.

5 Superannuation Death Proceeds Creditor Protection depend on the Superannuation Fund

Implication: Certain Commonwealth Acts such as Sec 43 (3) of the Superannuation Act (Cth) (1922) and certain State government Acts such as Sec 55 (3) of the Supreme Court Act (NSW) (1916) protect superannuation payments from being used to pay the deceased's debts.

Note the above two Acts are applicable to the public sector and state superannuation schemes. As such the Superannuation Industry (Supervision) Act (1993) (SIS Act) together with associated regulations (SIS Regulations) do not provide any protection for the use of a superannuation payment to satisfy a liability or debt of the deceased.

Hence if the particular proceeds are from a Self



Managed Superannuation Fund or a Public Offer Fund death payment could be used in the payment of debts and liabilities.

Action Required: Given that in certain circumstances Superannuation Death Proceeds may be available to creditors if paid to the deceased Estate consideration should be given to having the Superannuation Proceeds paid directly to a creditor free Dependant and not to the Estate of the deceased member. Furthermore if there is a concern that payments should have been made to minor Dependants consideration should be given to have payments made from the Superannuation Fund to a Superannuation Death Benefits Trust.

6 Payment of Debts from the Estate

Implication: The payment of debts from the Estate must be done with care and diligence.

To commence payment, the LPR must publish a notice of intended distribution allowing one month for creditors or offers to provide information in respect to claims against the Estate unless claims are disputed by the LPR. Once all claims have been established the LPR has a duty to pay the debts of the Estate.

Nevertheless there is an order whereby funeral, testamentary and administrative expenses are paid as well as debts and liabilities of the Estate. If liquid funds are not made available to pay the testamentary and administrative expenses as well as debts and liabilities of the Estate then capital gains tax (CGT) may inadvertently be triggered to pay for the debts of the Estate.

Action Required: Have liquid funds available to pay for debts and liabilities of the Estate to prevent unnecessary CGT but not at the expense of remaining creditor protection benefits from Life Insurance proceeds in favour of creditors as against beneficiaries.

7 Correctly Assess and Calculate all Debts and Liabilities of the Estate

Implication: Debts and Liabilities of the Estate include:

- Personal Expenses;
- Loans;
- Business;
- Personal Guarantees.

Action Required: Carefully calculate and fund for all liabilities of the Estate. Otherwise a shortfall may occur in which the Executor maybe personally liable.

8 Carefully Structure the Payment of Debts and Liabilities

Implication: If a debt is incorrectly labelled and the funding mechanism for payment is incorrectly structured unintended consequences may occur.

Action Required: Correctly structure payments by identifying the correct need and fund appropriately.

9 Distribution of the Assets and Minors

Implication: When the LPR has collected the Assets and discharged the debts and liabilities, of the deceased, the remaining duty of the LPR is essentially to distribute the Assets to the persons beneficially entitled under the



Will or Intestacy of the deceased. Where, however, the whole or part of the Estate is to be held in succession then the LPR, unless the testator has appointed separate trustees, holds the Estate upon the trusts contained in the Will subject to the powers and duties conferred by the State Acts unless these have been modified or excluded by the Will. If, however, the LPR desires to be discharged from the trust, he may appoint a new trustee. Similarly, where the beneficiary is a minor, and there is no effective appointment of any other trustee of the property to which the minor is entitled, the LPR will; by operation of law hold the minor's interest as trustee during the infancy because the minor cannot generally give a good discharge for the property. However in such a case the LPR may avoid the trust by paying the money either into court, Public Trustee, appointing trust corporate entity by a registered deed or two or more individuals (not exceeding four) to be the trustee of the gift or interest under the Will or Intestacy.

Action Required: Where there is the possibility of trusts arising under the Will, consideration should be given to the adequacy of the trustee powers. To maintain minor's income, the power to use capital is generally regarded as too restrictive and a wider power should be expressly granted by the Will. In such situations liquid funds maybe needed.

Conclusion

For more information about how ili can assist you to adopt skills and implementation tools in respect to Estate Preservation Planning and Business Succession Strategies please visit our website www.ili.com.au.

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