Investment Bonds

Investment bonds, or insurance bonds as they are also known, are issued by life insurance companies. They have features similar to a managed fund combined with a life insurance policy. They can be a tax effective way to invest if certain rules about contributions and withdrawals are followed.

Investment bonds are used for a range of purposes including:

- A medium to long term lump-sum or regular savings plan
- A tax effective investment for investors on high income earners
- Investment bonds can be taken out by parents, grandparents and the like on the life of a child. The bond can be structured to automatically be transferred into the child's name at a pre-determined age. This is referred to as 'child advancement'.
- Estate planning. Because an investment bond is in essence a life insurance policy, it is subject to life insurance rules. This includes the ability of the owner of the investment bond to nominate one or more beneficiaries to receive the proceeds of the bond in the event of the death of the bond owner. By nominating beneficiaries under an investment bond, the bond does not form part of the estate of the bond owner and may be administered separately to their estate.
- Deceased estates that are required to invest bequests that will vest with beneficiaries at a later date.

Parties to an investment bond

There three parties to an investment bond; the owner - who subscribes the investment funds, the life insured – who may be the bond owner, or someone else, and the issuer of the bond – the life insurance company.

Some bonds may include fourth party, being a nominated beneficiary. The bond owner may nominate a beneficiary to receive the bond proceeds in the event of the death of the life insured.

Child Advancement Conditions

Where a bond is issued on the life of a child, and its ownership is to vest in the name of the child at a future date, the bond is subject to Child Advancement Conditions. The owner of the bond may nominate an age, up to 25, at which the ownership of the bond will transfer to the child.

10 year rule

Insurance bonds are tax paid investments. This means earnings on the investment are taxed in the hands of the life insurance company at the corporate tax rate. Insurance companies are generally taxed at a rate of 30% however the actual rate of tax payable may be less than 30% when tax deductions, tax offsets, and tax credits available to the life insurer are taken into account.

Investment bonds can be tax effective for long term investors with a marginal tax rate higher than 30%. An investment bond is designed to be held for at least 10 years. If you hold the bond for at least 10 years, the returns on the investment, including additional contributions that meet the 125% rule, will be tax free. In some circumstances, investing in an investment bond for a shorter period may be an appropriate strategy.

Withdrawals

If you withdraw money before 10 years is up, some or all of the income will be taxable and included in the investor's assessable income. This amount is taxed at the investor's marginal tax rate - however a 30% tax offset is allowed to compensate for the tax already paid by the life insurance company. Where an investor's personal tax rate is

less than 30%, any unused portion of the tax offset can be used to reduce tax payable on other income in the same financial year.

If you make a withdrawal within the first 10 years, the rate at which earnings in the investment bond are taxed will depend on when you make the withdrawal.

Tax treatment of investment bond withdrawals

Year withdrawal made	Tax Treatment
Within 8 years	100% of the earnings on the investment bond are included in the investor's assessable income and a 30% tax offset applies.
In the 9th year	2/3 of earnings on the investment are included in the investor's assessable income and a 30% tax offset applies.
In the 10th year	1/3 of earnings on the investment are included in the investor's assessable income and a 30% tax offset applies.
After the 10th year	All earnings on the investment are tax free and do not need to be included in the investor's assessable income.

The investment earnings are calculated by referencing a formula contained in the Australian Taxation Office's Income Tax Ruling 2346.

125% Rule

While investment bonds are often described as a 'single premium' or lump sum investment, many investment bonds accept both regular and irregular additional investments. Provided the amount invested in any one year – based on the anniversary of the bond commencing – does not exceed the previous year's investment by more than 125%, it will be considered part of the initial investment.

If you exceeds 125% of the previous years' investment, the 10 year period will reset. If you do not make a contribution in any one year, a contribution in following years will reset the 10 year rule.

Investment Options

The life office issuing the investment bond may offer a range of investment options such as single asset funds i.e. cash, fixed interest, shares, property or a range of diversified options. Each option has different investment goals, timeframes, risk profiles and underlying assets.

Disadvantages and Risks of Investment Bonds

The key risks are largely determined by the nature of the investment chosen. Risks to be aware of include:

- Market risk: The performance of the investment bond will be affected by the assets and securities that it invests into.
- Fees: These may vary depending on the investment bond and investment options chosen and include management and administration fees and buy-sell spreads.