Investment Concepts – Insurance/investment bonds

An insurance bond (also called an investment bond) is a managed fund investment provided by a life company. Earnings from the bond are taxed by the life company (or friendly society) at the rate of 30%. This may be lower than your marginal tax rate.

Benefits

- Insurance bonds are a 'set and forget' type of investment, because earnings generally do not have to be included in your tax return.
- The tax paid on your investment earnings will be less than your marginal tax rate if your marginal tax rate is higher than 30%. This helps to increase your overall return on investment to boost your wealth accumulation.
- Insurance bonds can provide estate planning benefits because the bond can be paid directly to a nominated beneficiary instead of having it go through your estate.
- access to a range of investment options across a range of asset classes
- can be established by parents, grandparents, godparents, uncles and aunts to provide a child with a helping hand at the start of their adult life

How it works

Insurance bonds are generally considered 'tax paid' investments. The life insurance company pays tax on earnings within the bond and, after 10 years, you are able to withdraw the value of the bond with no further tax payable. This makes an insurance bond a simple investment structure because there is no requirement to declare interest or capital gains in your tax return.

Withdrawals can be made from an insurance bond at any time, however you may be liable to pay some tax if a withdrawal is made within 10 years from commencement of the insurance bond.

Upon your death, the balance of your account is paid to the nominated beneficiary or your estate with no tax implications.

Taxation

All earnings in an investment bond are taxed at the life insurance company rate of 30%. The life insurance company may also receive the benefit of franking credits and tax deductions that may reduce this effective tax rate.

No amount is included in your assessable income unless a withdrawal is made within 10 years from the date of commencement, in which case you may be eligible for a tax offset on a portion of the assessable income.

Tax offset

If you make a withdrawal within the 10 year period a portion of the investment growth is included in your assessable income as shown in the table below:

Withdrawal	Amount of growth included in tax return
Within 8 years	Full amount

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Between 8 and 9 years	Two-thirds
Between 9 and 10 years	One-third

You are then entitled to a 30% tax offset on this assessable portion to allow for the tax already paid by the life insurance company. This offset helps to reduce your tax payable on taxable income, but cannot be used to pay the Medicare levy or be refunded as cash.

This means:

- If your marginal tax rate is higher than 30%, you will generally benefit from holding the bond for the full 10 years before making a withdrawal to take advantage of the lower tax rate.
- If your marginal tax rate is lower than 30%, you could benefit from withdrawing some or all of the bond before 10 years and as a result receive a tax offset that can reduce tax on your other income.

Additional contributions and the 125% rule

Insurance bonds provide flexibility for you to make additional contributions at any time, but it is important to note that if your contributions in any year are more than 125% of the previous year's contribution, this will restart the commencement date under the 10 year rule.

For example, if you make a contribution of $1,000 in one year, the 10 year period will recommence if the next year's contribution is more than $1,250. However, if in one year you make no contribution, the next year's and future contributions would be $0. In this case, contributions could still be made but the 10 year period would recommence.

Estate planning and insurance bonds

An insurance bond is a life policy. The death of the life insured will trigger the payment of bond either to the nominated beneficiary or to the policy owner if no beneficiary is nominated. If the life insured is the policy owner and there is no nominated beneficiary, the balance will be paid to their estate. Any amount received as a result of the death of the life insured is completely tax-free, irrespective of the 10 year rule.

Department of Human Services assessment

Insurance bonds are considered financial assets for Department of Human Services/Veterans' Affairs purposes, which means the full account value is asset tested and deemed under the income test.

Risks and Consequences

- Investing into an insurance bond can reduce your cash flow because all earning are captured in the bond as growth.
- If the life insurance tax rate of 30% is higher than your marginal tax rate, investing into an insurance bond may result more tax being paid than if you invested into other investments.
- Withdrawals within the 10 year period that are assessable to you can impact your entitlement to certain tax offsets or other benefits or liabilities.
- Fees may be charged on investments. You should check the details in the fee section of your Statement of Advice and the Product Disclosure Statement (PDS) for your selected investment.
- The Government may change tax legislation in the future.

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