Wealth Creation

Investment Bonds

Aon Hewitt Financial Education Series

Investment Bonds

Investment bonds, also called insurance bonds, are long-term, tax-paid investments.

Investment bonds can be tax effective for long-term investors with a marginal tax rate higher than 30%, as long as certain rules are followed. They are also an effective way to put aside money in the name of young children, who are subject to additional taxes on other investments (like interest from savings for example).

Most investment bonds offer investment options such as cash, fixed interest, shares, property, infrastructure or a range of diversified investment options, with risk levels ranging from low risk to high risk. The value of the investment bond will rise or fall with the performance of the underlying investments.

In order to receive the full benefits of these investments, you will need to hold them for at least 10 years (the 10 year rule) and meet the contributions rules (the 125% rule).

10 year rule

Investment bonds are tax-paid investments. This means when earnings on the investment are received by the investment provider, they are taxed at the corporate tax rate (currently 30%) before being reinvested in the bond. The investors do not need to include earnings from insurance bonds in their tax returns unless withdrawals are made in the first 10 years. This can make insurance bonds a tax effective long term investment for those with a marginal tax rate higher than 30%.

If you hold the bond for at least 10 years the returns on the entire investment, including additional contributions made, will be tax free subject to the 125% rule.

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 in that time.

Year withdrawal made	Tax treatment
Withdrawals within 8 years	100% of the earnings on the investment bond are included in your assessable income and a 30% tax offset applies*.
Withdrawals in the 9th year	2/3 of earnings on the investment are included in your assessable income and a 30% tax offset applies*.
Withdrawals in the 10th year	1/3 of earnings on the investment are included in your assessable income and a 30% tax offset applies*.
Withdrawals after the 10th year	All earnings on the investment are tax free and do not need to be included in your assessable income.

** The 30% tax offset compensates for the tax already paid on earnings by the investment provider.*

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125 year rule

Investors in investment bonds can make additional contributions each year, as long as the contribution does not exceed 125% of the previous year's contribution. The investment treats all contributions under 125% as part of the initial investment amount. This means each additional contribution does not need to be invested for the full 10 years to receive the full tax benefits.

If contributions are made to the investment bond that exceed 125% of the previous year's investment, the start date of the 10 year period will reset to the start of the investment year in which the excess contributions are made. You will then have to wait a further 10 years from this date to gain the full tax benefits.

Benefits of investment bonds

- Can be a tax effective long-term investment
- Most investment bonds offer a range of investment choices
- Can be an effective way to save for a child’s future, given the long-term nature and tax advantages
- Can be used as an estate planning tool
- May be useful for people who are unable to contribute to super (like those over 65 and not working)
- Subject to meeting the two rules, investments are not normally subject to capital gains tax when redeemed as the tax on realised capital gains is paid by the bond issuer.

Risks of investment bonds

- They can be slower than some investments to convert the balance to cash and some investment bonds have minimum balances that must be maintained.
- If you need to withdraw some of your money before the 10-year period is reach, some of the tax benefits will be lost.
- You will pay fees, which can vary widely depending on the issuer of the investment bond and the investment options chosen.

Things to consider before investing

If you are considering investing in an investment bond, here are some things to think about:

- Are you in it for the long haul? The full tax benefits from investment bonds are only realised if no withdrawals are made for 10 years and you comply with the 125% rule.
- Are you able to make regular contributions? These investments are particularly tax-effective for people who make regular contributions over the life of the investment.
- What investment options are available? It is important to choose a product that offers investment options that are aligned with your risk tolerance and investment goals.
- What are the fees on the investment bond? Common fees you may pay include establishment fees, contribution fees, withdrawal fees, management fees, switching fees and adviser service fees. Shop around and compare the fees to similar products in the market.
- Are you using the product for estate planning purposes? Make sure it fits with your estate planning goals.

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This document, including all tax and super calculations, has been prepared using legislation in place as at 1 July 2018.

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