Investment Bonds

Investment Bonds are a type of managed investment product, where funds are pooled with other investors and invested into investment options chosen by the investor. These long-term investments are attractive for their potential tax efficiency, depending on investors circumstances, such as high marginal tax rates or those looking to invest for children or grandchildren. All information discussed is factual in nature and for educational purposes only.

Investment bonds offer a broad range of investment options such as cash, fixed interest, shares, and property, or a range of diversified investment options, that are a combination of these asset classes. Just like most managed funds or exchange traded funds, the value of each investors bond will rise or fall with performance of the underlying investments.

The most common similarity to an investment bond is an Education bond. In our next weekly we will delve a bit deeper into the nuances of Education bonds, but this week, we will share an overview of the main considerations with Investment bonds.

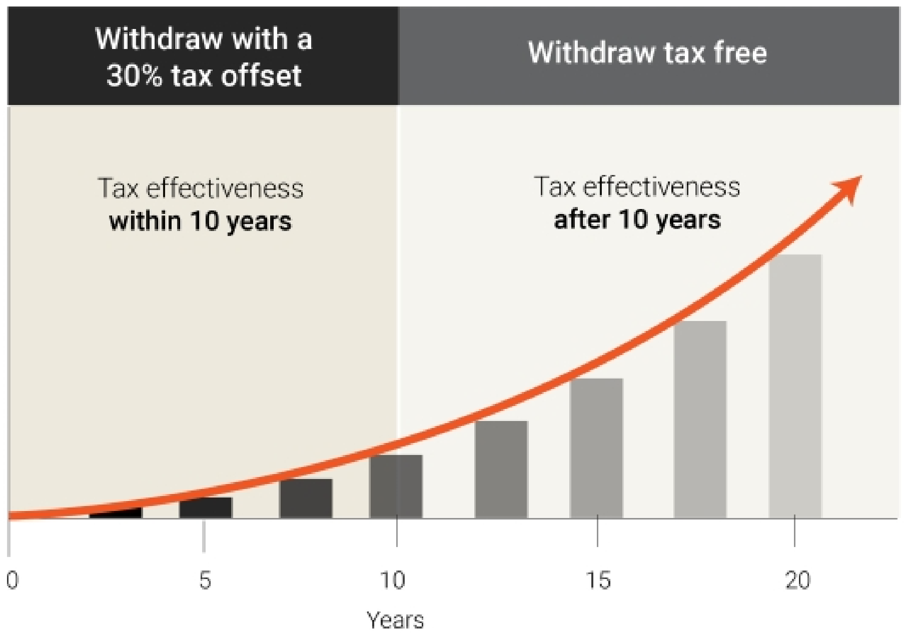
"Tax paid" on Investment Bonds

Earnings on underlying investments are taxed at the corporate tax rate (currently 30%) before being reinvested back into the bond.

The 10-year rule

The 10-year provision is a unique benefit investment bonds offer. When the bond is held for at least 10 years, the returns on all the investment become tax free in the investor's hands. This means you can withdraw money after this period with no tax liability.

However, if you decide to withdraw within the 10 years from inception, how much of the withdrawal is assessable for tax, will depend on the year you made the withdrawal.



The 125% rule - Contributions

You are allowed to contribute additional funds to the investment bond each year, as long as it does not exceed 125% of the previous years' contribution. This is an important consideration, because if you exceed this threshold the 10-year rule start date resets to the policy anniversary date in the year excess contribution was made. Also, if you contribute $0 in a year then contributing the following year will cause the 10-year rule to reset. Albeit, you can avoid this re-set by investing into another bond.

Benefits of an Investment Bond

- Can be tax effective, depending on your marginal tax rate.
- All returns from the investment while invested, and upon withdrawal after the 10-year rule, do not need to be included in personal income tax returns.
- Creates a long-term savings plan, which can be great for estate planning.
- Wide range of investment choices that can be switched at any time, without any personal capital gains tax implications.
- The government has not (yet?) attempted to interfere in the mechanics of bonds like they have for superannuation and personal income.

Drawbacks of an Investment Bond

- To realise the potential tax benefits, you have to be locked in for at least 9 years.
- Investment bonds do not receive the 50% capital gains tax discount individuals get on assets owned for longer than 12 months.
- Some offerings may have higher fees than alternative investment options.
- Bonds can be complex products and can be difficult to understand to the novice investor, which may make it difficult to form a decision.

Taxation treatment of investment growth from an investment bond

Year of Withdrawal	Assessable portion of growth
Withdraw within 8 years	All earnings on the investment are included in the holders' assessable income
Withdraw within 9 years	2/3 of earnings on the investment are included in the holders' assessable income
Withdraw within 10 years	1/3 of earnings on the investment are included in the holders' assessable income
Withdraw after 10 years	All earnings on the investment are tax free and do not need to be included in the holders' assessable income.

~30% tax offset applies due to tax already paid on earnings.

Final thoughts

Investment bonds can be most beneficial for those with a long-term focus, looking for alternative investment vehicles, or simply wanting to pass on wealth to the next generation.

Contact us on 03 9268 1118 or ahenderson@shawandpartners.com.au if you would like to know more about Investment Bonds.

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