WHAT IS
an investment bond?

An investment bond is a managed investment, usually operated by an insurance company or friendly society, where your money is pooled with money from other investors and invested in the investment options each investor chooses.

Most modern investment bonds offer a broad range of investment options such as cash, fixed interest, shares, and property, or a range of diversified investment options. The value of each investor's bond rises or falls with the performance of the underlying investments.

An investment bond is known as a 'tax paid' investment

Earnings on the underlying investments are received by the insurance company or friendly society and taxed at the corporate tax rate (currently 30%) before being reinvested in the bond. This means that insurance bonds can be a tax effective investment for investors with a marginal tax rate higher than 30%.

If you make a withdrawal within 10 years from inception, how much of that withdrawal is assessable for tax will depend on which year you make the withdrawal. See Table 1 for more information.

How the 125% rule works

Investors should make additional contributions to their investment bond each year to optimise the benefits.

Importantly, as long as the contribution does not exceed 125% of the previous year's contribution, it will be considered part of the initial investment. This means each additional contribution not exceeding the 125% limit can receive the full tax benefits even though it hasn't been invested for the full 10 years.

If additional contributions exceed the 125% limit at any time, the start date of the 10-year period will reset. If you do not make any contribution in a given year, you cannot make any further contribution to the bond without resetting the 10-year period.

WHAT IS
an investment bond?

Benefits of an investment bond

- Tax effective if your marginal tax rate is higher than 30% (i.e. $37,000 taxable income each year)
- Investment returns do not need to be included in your personal income tax return while ever you are invested in the bond, nor upon withdrawal after the ten-year tax period
- The investment is not impacted by the ever-changing superannuation rules
- It may help to provide certainty for your estate planning because you can nominate a beneficiary to receive the money directly if you pass away (that is, it will bypass your estate)
- There are generally a wide range of investment choices available within the bond, and
- You can switch between the available investment options without any personal capital gains tax consequences.

Did you know...

If the bond is held for at least 10 years, the returns on the investment will be tax free in the investor's hands.

Education bonds

Education bonds (also known as education savings plans or scholarship plans) are a type of tax-effective investment that is used to save funds to meet education expenses.

They are similar to investment bonds in that they are a tax paid investment with earnings taxed within the plan at the rate of 30%.

However, unlike an ordinary investment bond, this tax may be refunded if the money is ultimately used for the child's education expenses, including tuition fees, uniforms, books, travel expenses, residential boarding costs or a living away from home allowance. Where the tax is refunded by the ATO, it is added to the amount withdrawn, and the combined amount is paid as the education benefit.

If funds are withdrawn within the first 10 years and not used to cover education expenses, the same tax treatment described below will apply.

Table 1: Taxation treatment of withdrawals from an investment bond

Year of withdrawal	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[1]
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.

1. The 30% tax offset compensates for the tax already paid on earnings by the insurance company or friendly society