Resolution Life

Issue date: 1 July 2023

Tax-Effective Investing

Investment Growth Bond strategy paper

Adviser use only

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At a glance

This paper illustrates how Resolution Life's Investment Growth Bond can be used for tax effective investing.

This technical paper focuses on:

- What are investment bonds?
- Resolution Life's Investment Growth Bond
- Tax effective investing
- Case studies

What are investment bonds?

Investment bonds, also called insurance bonds (bonds) are a flexible, tax-paid product that suits a wide range of needs and different situations. Investment bonds combine features of a managed fund and a life insurance policy, with the added benefit of the investment bond provider paying 30 per cent tax on any earnings in the bond rather than an individual paying tax on earnings at their marginal tax rate.

Like a managed fund, clients can select from investment options that invest in assets such as shares, fixed income, property and cash.

About our Investment Growth Bond

The Resolution Life Investment Growth Bond (the Bond) has been awarded the AFA Investment Bond of the Year award for the last 15 years running[1] and offers benefits beyond those of most investment bonds.[2]

Guarantees that protect capital from market risk

- **Investment option guarantees** are designed to provide certainty around the minimum value of a client's holding in an investment option. These are offered on four of the nine investment options. The nature of the guarantee differs across the Cash, Global Fixed Income, Conservative and Diversified investment options.[3]
- The **Death Benefit Guarantee** provides certainty as to the minimum amount that will be paid on the death of the last surviving life insured. If the last surviving life insured dies on or prior to their 99th birthday, Resolution Life will pay the greater of the following amounts:

  a) The cash value of the bond, or

  b) The lesser of the Net Contribution Value and the maximum amount (The maximum amount is $1 million per life insured).[4]

  In addition to the guarantee features described above, our product offers a number of additional features.

A range of investment choices

- Suitable for a wide range of investment risk profiles with four multi-sector and five single-sector investment options.
- Switch investment options at any time with no fee and no personal capital gains tax impacts.
- Clients can tailor their own diversified portfolio from a mix of the single-sector options.

Easy investing and withdrawals

- There is a minimum initial investment of $1,000 and minimum $200 for additional contributions.
- Access to funds at any time (withdrawals may trigger a tax liability on the profit element of the investment, although clients may be able to take advantage of the 30 per cent tax offset).
- Minimum withdrawal of $1,000 ($500 for automatic withdrawals).
- Automatic withdrawal facility for balances over $10,000.

Competitive fees

- No establishment, withdrawal or switching fees.
- Management fees range from 0.85 to 1.5 per cent depending on the investment option chosen.
- Adviser Service Fees, agreed between you and your clients, may be deducted from the Bond as a one-off and/or an ongoing fee.

Investing for children

- Children as young as 10 can invest with parental/guardian consent.
- An adult can establish a Child Advancement Policy on behalf of a child under 16 years of age with the ownership of the Bond transferring to the child at a nominated age up to 25 years.

Certainty for estate planning and wealth transfer

- Death benefits are tax-paid to a nominated beneficiary regardless of other estate planning arrangements, reducing the risk of estate disputes.[5]

Our awards

Our Investment Growth Bond has won the AFA Investment Bond of the Year award 15 years running, from 2008 through to 2022[6]. We're also proud winners of the 2022 AFA Investment Bond Excellence Award.

1 AFA Investment Bond of the Year winner from 2008 through to 2022. Benchmarked on scores for financial, market and product strength factors.

2 Based on Strategic Insight's 2022 Benchmark report.

3 If you withdraw or switch units out of the investment option after they've been held by you for a minimum period (two years for Global Fixed Income and three years for the Conservative and Diversified options), the unit price used to calculate the withdrawal or switch will be at least equal to the price at the time you were allocated those units or switched into this option. The Cash option offers a guarantee that the unit price will never fall irrespective of the length of time the Resolution Life Investment Growth Bond has been held.

4 To qualify for the Death Benefit Guarantee, the younger Life Insured on the policy must be aged less than 85 at policy commencement. The Net Contribution Value is the total of all deposits less withdrawal during the life of the policy and less any switching fees, withdrawal fees and adviser service fees. The maximum amount payable under the Death Benefit Guarantee is $1 million per life insured.

5 Where a beneficiary is nominated, the bond proceeds will not be subject to challenges to the client's estate, as they will not form part of the estate assets (except possibly in NSW where a bond may form part of a 'notional estate').

6 Benchmarked on scores for financial, market and product strength factors.

Tax effective investing

When compared to superannuation at 15 per cent and a marginal tax rate of up to 47 per cent (including Medicare Levy), tax on earnings in an investment bond, when it is held for 10 years and the 125% rule is met, sits firmly in the middle at 30 per cent.

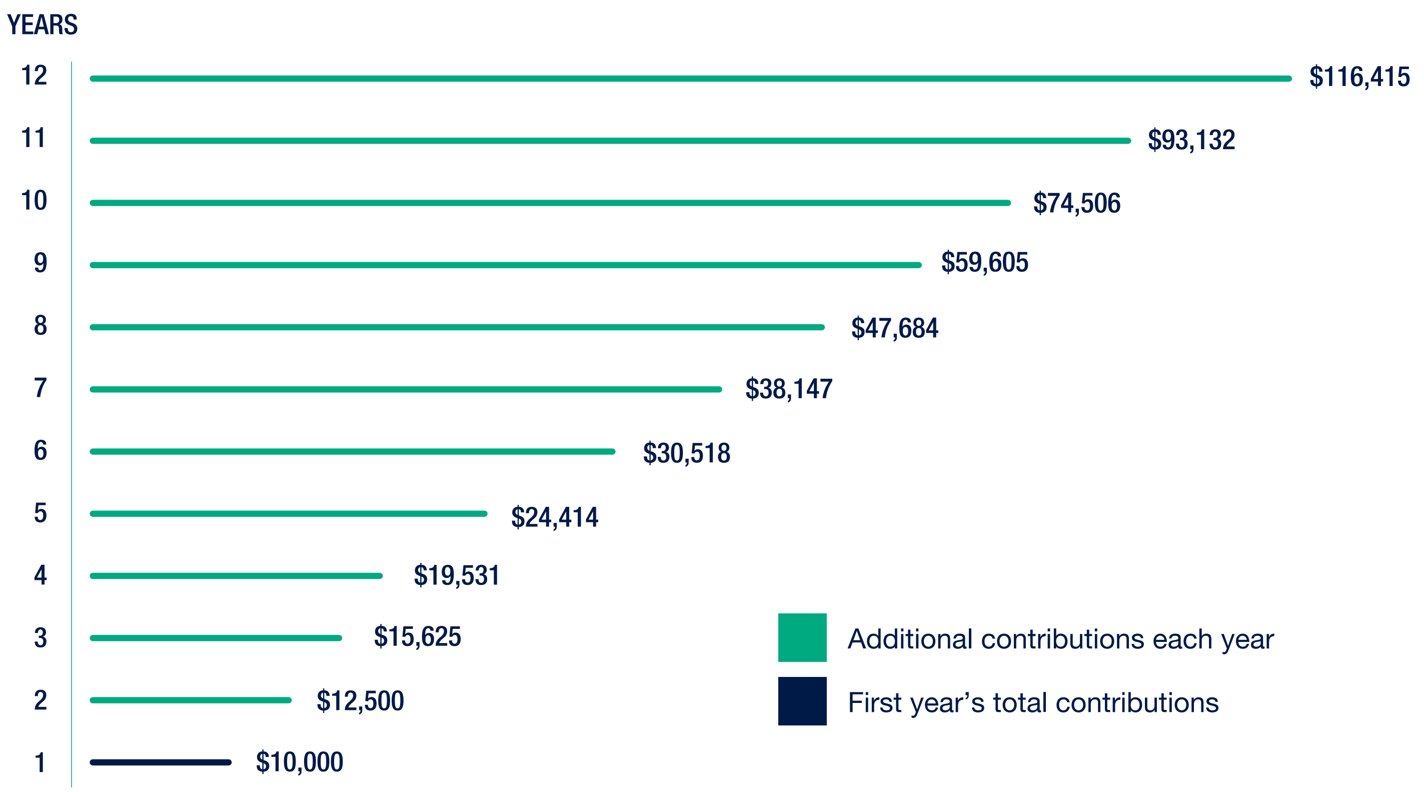
In addition, there are no capital gains tax implications if clients switch between investments or transfer ownership of the bond.

The 125% rule

So long as the additional contributions made to the bond each year are not more than 125% of the contribution made in the previous year, they will be considered part of the initial investment (i.e. not every contribution has to be invested for 10 years). If the client makes contributions that are more than 125% of the previous year's investment, then the 10 year period resets.

Figure 1 below shows the maximum annual contributions that can be made in the first 10 years if the client starts with a $10,000 initial contribution.

Figure 1



Tax treatment of withdrawals

If a client holds the bond for 10 years and satisfies the 125% rule, they are not required to pay any personal income tax on the investment when they make a withdrawal, regardless of how long beyond the 10 years they hold the investment and whether they make any contributions or withdrawals.

For clients who do withdraw before the 10 year period is satisfied, all or part of the profit portion or investment earnings may be assessable for tax. If so, a life insurance policy tax offset of 30 per cent is available to compensate for the tax-paid by the investment bond provider.

Figure 2 below highlights the tax treatment of withdrawals over the 10 year period.

Time of withdrawal	Tax payable
Within 8 years	**All earnings** are taxed at the client's marginal rate with a **tax offset of 30 per cent.**
During the 9th year	**Two thirds of earnings** are taxed at the client's marginal rate with a **tax offset of 30 per cent.**
During the 10th year	**One-third of earnings** are taxed at the client's marginal rate with a **tax offset of 30 per cent.**
After the 10th year	**None of the earnings** are taxable.

A more technical description of the taxation of withdrawals is explained by using the ABCDE methodology, with 'Assessable Profit' = (A / B) * [(B + C) – (D + E)]. This methodology is explained in the case study on page 6.

Case study - taxation of withdrawals from an investment bond

Kenneth, 38 years

Kenneth earns $200,000 and is on the top marginal tax rate of 47 per cent (including two percent Medicare Levy). Let's assume he invests an initial $100,000 into an investment bond for five years.

Methodology	Calculation
A = amount of current withdrawal B = surrender value of the entire policy (not just the relevant investment option) immediately prior to the withdrawal C = amount of any previous withdrawals D = gross premiums paid to the date of withdrawal E = sum of previous amounts included in assessable income	Gross investment earnings = $28,571 Insurance company tax: $28,571 x 30% = $8,571 **Withdrawal value:** $100,000 + $20,000 = **$120,000** **Kenneth includes in his taxable income:** ($120,000/$120,000) x [($120,000 + $0) – ($100,000 + $0)] = **$20,000** **Kenneth also receives a tax offset @ 30%:** ($20,000 x 30%) **= $6,000** **Kenneth's tax:** ($20,000 x 47%*) - $6,000 = **$3,400** **Total tax paid:** Insurance co. $8,571 + Kenneth $3,400 = **$11,971** **Effective tax rate on withdrawal from bond:** $11,971 / $28,571 = **42%*** *Including two per cent Medicare Levy

Outcome

Kenneth would benefit from the life insurance policy tax offset of 30 per cent that is available to compensate for the tax-paid by the investment bond provider. So even if Kenneth withdraws from the investment bond after five years, the effective tax rate applied on the assessable income is only 42 per cent, compared to his actual marginal tax rate of 47 per cent.

Investment bond versus a managed fund

If there have been no withdrawals from a bond during the 10 year period (subject to the 125% rule being satisfied), there is no need for any tax reporting. Whereas for a managed fund, any earnings accumulated (such as distributions paid or re-invested), are assessable for personal income tax, irrespective of whether the client makes a withdrawal from the managed fund.

There are further potential tax benefits when investing in an asset class via a bond versus a managed fund. This is illustrated in the case study below.

Case study - investing in the Australian Share option

David, 43 years

David is on the highest marginal tax rate of 47 per cent (including two per cent Medicare Levy). He is wanting to invest part of his savings in the Australian Share option, but wants to know if it is more tax effective to invest via a bond or a managed fund.

To assess, David's adviser compares the difference in tax treatment of earnings in a bond versus a managed fund. He assumes that 90 per cent of the Australian share option is held for over 12 months and generates a total return of $100,000 of which, 46.3 per cent is dividend income and 53.7 per cent realised capital gains.

Investment Bond		Managed Fund	
Grossed up dividends^	$61,236	Grossed up dividends^	$61,236
Realised capital gains	$53,659	Realised capital gains	$53,659
Gross Taxable income^	$114,895	Gross Taxable income^	$114,895
		Less 50% capital gains tax discount	($24,146)
Net Taxable income	$114,895	Net Taxable income	$90,749
Tax paid by the Bond (tax at 30% less franking credits)	$19,573	Tax paid by investor at marginal tax rate (tax at 47% less franking credits)	$27,757
Net return ($100,000 - $19,573) =	**$80,427**	**Net return** ($100,000 - $27,757) =	**$72,243**

^ Income grossed up to include $14,895 in franking credits. Franking ratio is 75 per cent.

Outcome

David's adviser proposes that David invests in the Australian shares option via a bond as it would generate an $8,184 higher net return. This is because all earnings in a bond are tax paid by the bond provider at a rate of 30 per cent. Whereas in a managed fund, despite a 50 per cent capital gains tax discount being applicable on the realised capital gains, the tax payable on the net taxable income is still at his marginal tax rate of 47 per cent (including two per cent Medicare Levy).

For more information about how our Resolution Life's Investment Growth Bond could help your clients, please contact your Retirement Business Development Manager.

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Issued by Resolution Life Australasia Limited ABN 84 079 300 379, AFSL No. 233671 (Resolution Life).

010723 RLA_00028