Investment Bonds

Investment bonds, or insurance bonds as they are also known, are issued by life insurance companies. They have features similar to a managed fund combined with a life insurance policy. They can be a tax effective way to invest if certain rules about contributions and withdrawals are followed.

Investment bonds are used for a range of purposes including:

- A medium to long term lump-sum or regular savings plan
- A tax effective investment for investors on high income earners
- Investment bonds can be taken out by parents, grandparents and the like on the life of a child. The bond can be structured to automatically be transferred into the child's name at a pre-determined age. This is referred to as 'child advancement'.
- Estate planning. Because an investment bond is in essence a life insurance policy, it is subject to life insurance rules. This includes the ability of the owner of the investment bond to nominate one or more beneficiaries to receive the proceeds of the bond in the event of the death of the bond owner. By nominating beneficiaries under an investment bond, the bond may not form part of the estate of the bond owner and may be administered separately to their estate, subject to the governing rules of the product and applicable law.
- Deceased estates that are required to invest bequests that will vest with beneficiaries at a later date.

Parties to an investment bond

There are three parties to an investment bond; the owner - who subscribes the investment funds, the life insured - who may be the bond owner, or someone else, and the issuer of the bond - the life insurance company.

Some bonds may include a fourth party, being a nominated beneficiary. The bond owner may nominate a beneficiary to receive the bond proceeds in the event of the death of the life insured.

Child Advancement Conditions

Where a bond is issued on the life of a child, and its ownership is to vest in the name of the child at a future date, the bond is subject to Child Advancement Conditions. The owner of the bond may nominate an age, up to 25, at which the ownership of the bond will transfer to the child.

10 year rule

Insurance bonds are tax paid investments. This means earnings on the investment are taxed in the hands of the life insurance company at the corporate tax rate. Insurance companies are generally taxed at a rate of 30% however the actual rate of tax payable may be less than 30% when tax deductions, tax offsets, and tax credits available to the life insurer are taken into account.

Investment bonds can be tax effective for long term investors with a marginal tax rate higher than 30%. An investment bond is designed to be held for at least 10 years. If you hold the bond for at least 10 years, the returns on the investment, including additional contributions that meet the 125% rule, will be tax free. In some circumstances, investing in an investment bond for a shorter period may be an appropriate strategy.

Withdrawals

If you withdraw money before 10 years is up, some or all of the income will be taxable and included in the investor's assessable income. This amount is taxed at the investor's marginal tax rate - however a 30% tax offset is allowed to compensate for the tax already paid by the life insurance company. Where an investor's personal tax rate is less than 30%, any unused portion of the tax offset can be used to reduce tax payable on other income in the same financial year.

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.

Tax treatment of investment bond withdrawals

Year withdrawal made	Tax Treatment
Within 8 years	100% of the earnings on the investment bond are included in the investor's assessable income and a 30% tax offset applies.
In the 9th year	2/3 of earnings on the investment are included in the investor's assessable income and a 30% tax offset applies.
In the 10th year	1/3 of earnings on the investment are included in the investor's assessable income and a 30% tax offset applies.
After the 10th year	All earnings on the investment are tax free and do not need to be included in the investor's assessable income.

The investment earnings are calculated by referencing a formula contained in the Australian Taxation Office's Income Tax Ruling 2346.

125% Rule

While investment bonds are often described as a 'single premium' or lump sum investment, many investment bonds accept both regular and irregular additional investments. Provided the amount invested in any one year - based on the anniversary of the bond commencing - does not exceed the previous year's investment by more than 125%, it will be considered part of the initial investment.

If you exceed 125% of the previous years' investment, the 10 year period will reset. If you do not make a contribution in any one year, a contribution in following years will reset the 10 year rule.

Investment Options

The life office issuing the investment bond may offer a range of investment options such as single asset funds i.e. cash, fixed interest, shares, property or a range of diversified options. Each option has different investment goals, timeframes, risk profiles and underlying assets.

Disadvantages and Risks of Investment Bonds

The key risks are largely determined by the nature of the investment chosen. Risks to be aware of include:

- Market risk: The performance of the investment bond will be affected by the assets and securities that it invests into.
- Fees: These may vary depending on the investment bond and investment options chosen and include management and administration fees and buy-sell spreads.

Australian Unity - Lifeplan Education Bond

Lifeplan Education Bond

The Lifeplan Education Bond is a special type of investment which is classified as a scholarship plan under the Income Tax Assessment Act 1997. This allows us to claim a tax benefit, which is passed on to you, when earnings are used to pay education expenses.

The Lifeplan Education Bond has a unique design and is made up of two parts:

- Investor contributions - these are the amounts you invest and you can withdraw these funds tax-free at any time for any reason.
- Investor earnings - these are tax-paid earnings plus an education tax benefit which is available when earnings are withdrawn to pay education expenses.

Each investment covers a lifetime of education - from pre-primary, special needs through to vocational learning, university and beyond. The student can be full time or part time and the education does not need to be continuous - the student is free to take a break from studies.

There are no age restrictions on the age of the student however, you do need to be aged 16 or over to be the investor.

Education Tax Benefit

The Education Tax Benefit (ETB) is a special type of tax concession that we are able to claim and is passed on to you. This ETB can be worth up to $30 for every $70 of tax-paid earnings when they are used to pay education expenses.

What is an Education Expense?

The range of expenses that qualify as education expenses are very broad but must be relevant to the study being undertaken and be supported by a tax invoice. The following are examples but by no means an exhaustive list:

Course and tuition fees including course related private tuition from recognised education providers.

- University funding - student contribution amount.
- Uniforms, books, materials, equipment such as lap-tops or tablet and tools of trade, education related internet costs, music lessons and instruments, swimming lessons and education related sports equipment.
- School outings and foreign education.
- Travel expenses to and from school.
- Residential boarding costs, rent and other accommodation expenses for students living away from home.
- A living away from home allowance for full time students of up to $12,000 per calendar year as an education expense without proof of expenditure. This living allowance resets each year on 1 October and the new limit applies from 1 October to 30 September. This means students can claim the full new entitlement each year, regardless of how much they claimed in the 12 months before.

There is no annual maximum claim limit however there is a minimum claim limit of $500 per withdrawal but this can be an accumulation of any number of small expenses. Unclaimed education expenses may be carried forward to another year.

Maximum contributions

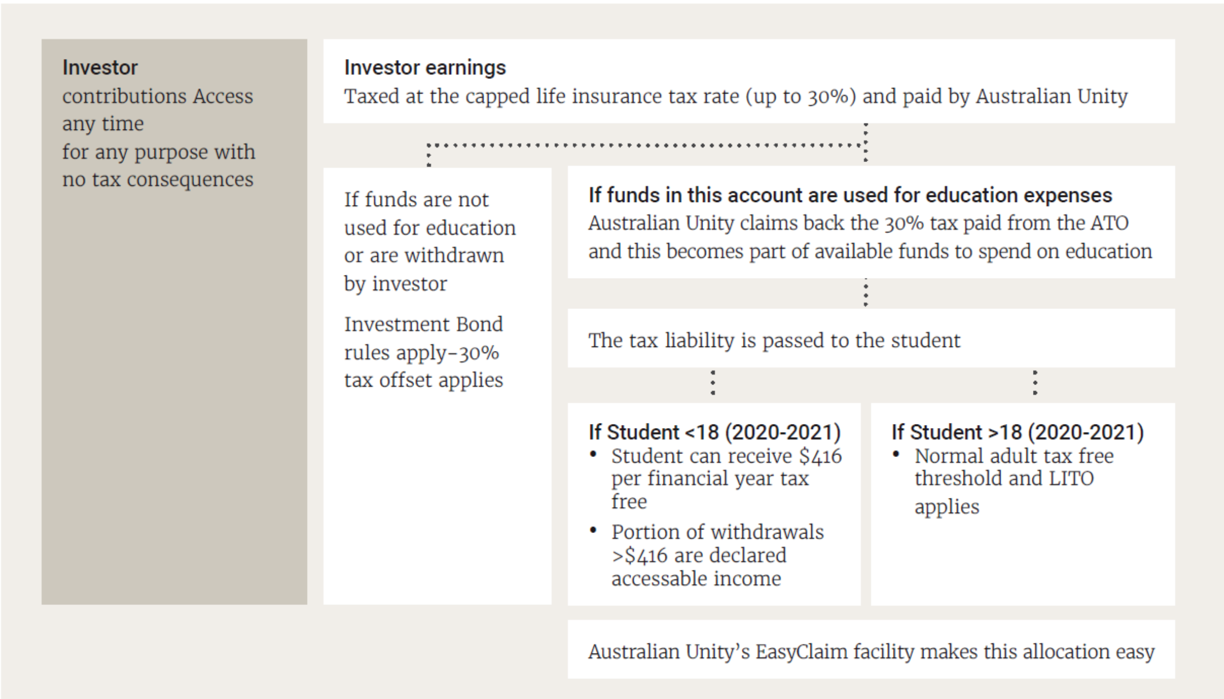
The maximum contribution(s) that can be made for each student or child is currently $850,000. We review this limit annually and may increase it with effect from 1 October each year to reflect rises in the cost of education. If the limit is increased you can make additional contributions up to the new limit.

(Limits are reviewed annually. As of the latest available Australian Unity update, these limits are $12,000 and $850,000, respectively.)

How does the tax work?

A significant feature of the Lifeplan Education Bond is that while your investment grows, neither the investor nor the student is required to pay any personal tax on the annual earnings.

When an investor withdraws their contributions, these are treated as a tax-free return of their investment. The only time a potential personal tax liability will occur is when a withdrawal of the accrued earnings is made and, in certain circumstances, there may be no personal tax liability.



Source: ato.gov.au

Taxation - Education Withdrawals

All withdrawals of investor contributions are treated as a tax-free return of your invested capital.

Education expense withdrawals from investor earnings become assessable to the nominated student and are treated as investment income for tax purposes. However, various tax-free thresholds apply depending on the age of the nominated student and their personal circumstances:

Students under 18 years of age:

- Provided the taxable investment income from all sources (including from the Lifeplan Education Bond) is below $416, there will normally be no tax liability. Limited circumstances exist when the higher adult tax thresholds may apply.
- Part-time employment earnings of a student are not subject to this threshold.

Students aged 18 or over may receive income of up to approximately $22,867 before income tax becomes payable, after allowing for the tax-free threshold and the Low Income Tax Offset. This amount is based on current resident individual tax rates and offsets and excludes Medicare levy considerations.

Withdrawals made for other or unspecified purposes do not qualify for the ETB and the proceeds are assessed as investment income in the hands of the investor as though it were a regular Investment Bond.

Taxation - Non-education Withdrawals

Funds can be accessed at any time for any purpose. Withdrawals are made in the following order unless directed otherwise:

- Investor contributions which are a tax-free return of your investment; then
- Investor tax-paid earnings.

The ETB is not available for non-education withdrawals.

The withdrawal of tax-paid earnings are required to be included in your tax return as follows:

Withdrawn in	Declarable Amount
Years 1-8	**All earnings**
Year 9	**2/3rd of earnings**
Year 10	**1/3rd of earnings**
After Year 10	**Nil**

A 30% tax offset is available on the declarable amount of these earnings and, for many investors this may eliminate or significantly reduce your tax liability. This income is not included when calculating PAYG tax instalments.

Source: ATO IT2346

The 125% rule

This rule applies specifically and only to withdrawals for non-education purposes. Withdrawals for education purposes are unaffected by the 125% rule.

The 10-year tax period (used to determine whether non-education withdrawals are characterised as assessable income), begins from your policy's original start date. However, the 10-year period calculation can be reset if, in an investment year, your total contributions exceed 125% of the amount contributed in the previous investment year. If this occurred, the 10-year period would restart to be calculated from the date that this limit was exceeded.

Here are some important things to note with the 125% rule:

- an investment year is considered each 12-month period from your investment's original start date. This date is referred to as your anniversary start date.
- if you make an additional contribution in excess of the 125% limit, the 10-year period will start again for the entire investment, from the anniversary start date within the year you have breached the 125% rule.
- if you do not make any contribution in a particular year, any contributions in following years will reset under the 10-year tax period rule.
- if you wish to invest more than 125% of the previous investment year's contributions, it may be more appropriate to start a new investment.
- after the 10th year, earnings on each additional contribution receive immediate tax-free withdrawal status.

To assist you in adhering to the 125% rule, we will provide in your annual statement details of the previous year's contributions, and the allowable contribution for the following year.

<table>
<tr><th></th><th>Education</th><th>Non Education</th></tr>
<tr><td>Contributions</td><td colspan="2">Tax Free - contributions can be withdrawn at any time for any reason</td></tr>
<tr><td>Investment returns</td><td rowspan="2">Income of student - assessed at student's marginal tax rate

Tax thresholds (including LITO)
• Under 18 - $416
• Over 18 - approx. $22,867</td><td>Income of tax investor - 10 year tax paid investment bond rules

Additional concessions:
• Year 9 - 2/3rd taxed
• Year 10 - 1/3rd taxed</td></tr>
<tr><td>Education Tax Benefit</td><td>Not available</td></tr>
</table>

Portfolio Switching

Under current taxation legislation, portfolio switching within an education bond does not create any potential tax liability for you, unlike many other investments that may cause a capital gain and possible tax consequences.

This feature is ideal for those wishing to regularly rebalance their portfolio to their chosen risk profile and allows for changing lifestyle objectives and circumstances.

Realised Gains

Your investment earnings are retained within the Bond rather than being paid on a regular basis to you. This means that any trading activity by the underlying fund manager does not give rise to a personal tax liability from the distribution of short or long-term capital gains.

What happens if I move interstate or overseas?

Your investment is portable and continues if you move interstate or overseas and whether the student moves with you or stays behind.

What happens when the student has finished their education?

If there are funds remaining there are a number of options available, these include:

- Leaving the plan in place should the student want to further their education.
- Nominating another student on the policy
- Withdrawing the remaining balance of contributions and tax-paid earnings. If the investment has met 10-year tax paid status there will be no personal tax liability. It is important to note that the ETB will not be available as this would be considered a non-education withdrawal.
- Transfer the investment to the nominated student, and they will continue to have the same investment start date as you (important for non-education withdrawals) and they can then use it for whatever purpose they choose.

As this is likely to be some time into the future, it would be appropriate to seek further advice at that time.

Plan Guardian - Optional Feature

There is a Plan Guardian facility that provides greater certainty about who will look after your plan should you pass away or become intellectually disabled before the student has finished their education. A Plan Guardian may be nominated at any time and can also be changed at any time. The Plan Guardian has limited capacity to alter your investment arrangements.

A Plan Guardian may operate independently to and is not subject to the terms of your Will or a Power of Attorney.

If you do not have a Plan Guardian then:

- In the event of your death, before the student completes their studies, your plan is transferred to your estate and your nominated Executor will become responsible for looking after your investment. Similar to the powers of a plan guardian, they will have limited capacity to amend the investment.
- If you become intellectually disabled, your Power of Attorney (or Court appointed representative) will take over the running of the investment and has limited capacity to amend the investment. Should your intellectual disability be temporary, on your recovery, full rights and powers will revert back to you.

Estate Planning - Beneficiary Nomination - Optional Feature

You can nominate a beneficiary to receive, tax-free, any remaining balance should your nominated student passes away after your own death. If no plan beneficiary has been nominated, the remaining balance will be paid tax-free to your estate and dealt with via your Will.