# Why an Investment Bond needs to be an integral part of your advice tool kit

## Advisers Big Day Out

July & August 2018

# Important information

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Examples are based on certain assumptions detailed at each example and current laws and guidelines. Changes to any of these would change the outcomes and no guarantees are provided that outcomes noted will be achieved.

# Change our thinking - the role of the Adviser

Individual MTR
0-45%*

Investment Bonds
30%
maximum

Super
15%
maximum

Account Based Pensions
0-15%

*Source: ato.gov.au

# INVESTMENT BONDS

ATI tax arbitrage

Super no-go

Estate planning

# Giving money meaning

- Lifestyle planning vs financial planning
- Strategy vs product
- Tangible vs intangible
- Complexity: "It's harder to **retire** now…"
- Superannuation Sole Purpose
- Nearly 80% of tax payers are currently on a MTR of 32.5% or higher**, and will remain so under the proposed tax revisions
- Increased Adjusted Taxable Income (ATI) means-testing for peripheral benefits

** Source: Federal Budget Overview, May 2018

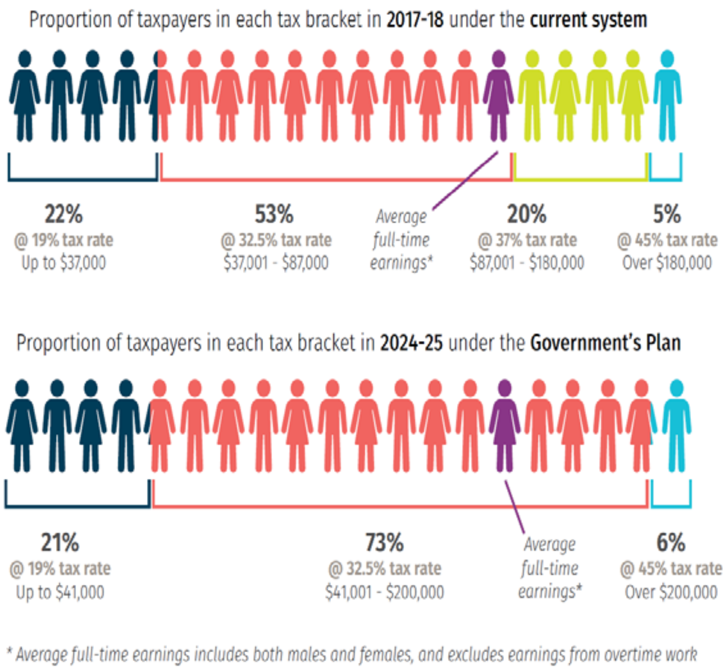



Image Source: Federal Budget Overview, May 2018, p14

# Giving money meaning

## Adjusted Taxable Income (ATI) and what it means for peripheral benefits

| | | |
|---|---|---|
| Seniors health care card | Family tax benefit parts A and B | Private health insurance rebate |
| Low income tax offset invested | Senior Australian and pensioner tax offset | Low income superannuation contribution refund |
| Super co-contribution | Super spouse contribution rebate | Childcare rebate |

# Giving money meaning

## How does an Investment Bond help with ATI?

- The annual earnings of an Investment Bond are excluded from ATI calculations whilst funds remain invested.
- Should a withdrawal occur in the first 10 years, only the taxable component of the withdrawal will be included in an ATI calculation.  Any taxable component of the withdrawal also qualifies for a 30% tax rebate. Capital not assessable.
- Additional levies or surcharges, for example the Medicare Levy, can also be reduced by minimising the client’s ATI within an investment bond strategy.

# Current strategic opportunities

- Superannuation ‘no-go’ clients
- Tax arbitrage/efficiency/health card/peripheral benefits
- Estate planning and streamlined wealth transfer
- Tax effective income (true transition to retirement)
- Managing superannuation death benefits for non-dependant beneficiaries
- First home buyer deposit accounts
- Education funding
- Family Trust members or off-farm equalisation strategies

# Case study 1

## Investment Bonds & Super no-go

# Superannuation should remain the cornerstone of retirement planning

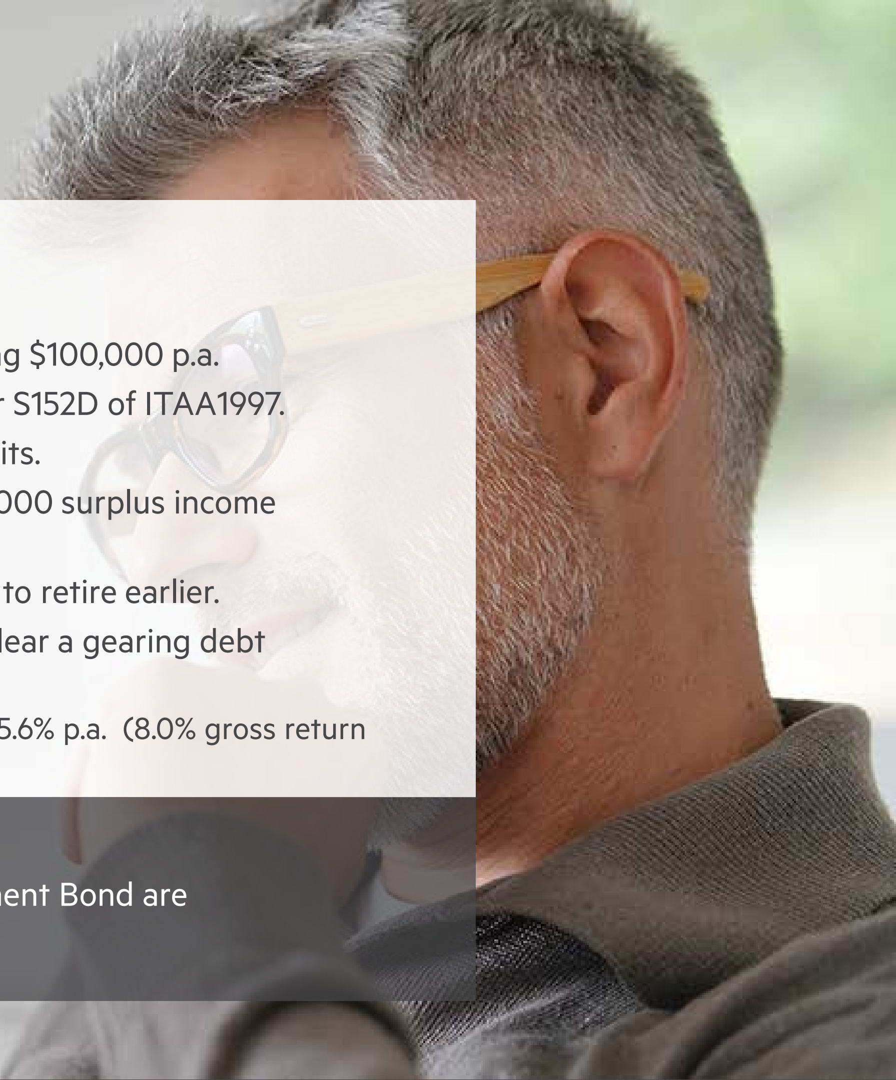
**But has the time come to consider further diversification?**

**Our research shows**

"46% of pre-retirees and retirees have no investments outside of their super"

Source: Australian Unity retirement funding survey, 2017

# Case study 1 : Mike



**Mike (Investment Bond TTTR)**

- 51, was self employed for 12 years.
- Recently sold a business and now full-time employed earning $100,000 p.a.
- CGT small business concessions contributed to Super under S152D of ITAA1997.
- Surplus of $500,000 currently parked in several term deposits.
- Mike invests his $500,000 in an Investment Bond, plus $20,000 surplus income annually.
- Aims to retire at 59 but retain access to funds if he chooses to retire earlier.
- Mike would like to withdraw $600,000 upon retirement to clear a gearing debt

Assumptions: Growth investor, Inv Bond net return after tax/fees of 5.6% p.a. (8.0% gross return less 30% tax)

**Key Benefit**

- Until a withdrawal is made, the earnings within the Investment Bond are quarantined from Mike's taxable income.

# How it works

## Mike's taxable income – 2026 at age 59

| Projected Bond Value in 8 years | 2026 (age 59) | |
|---|---|---|
| Bond balance start of year | 974,161 | Investment Bond components *(IT2346)* |
| Additional annual Conts (ceases at retirement in 2026) | 20,000 | |
| Earnings (after tax) | 55,160 | |
| **Balance before drawdown** | **1,049,321** | |
| Ad hoc Drawdown to clear gearing debt | 600,000 | |
| Total Drawdowns | 600,000 | |
| **End of Year Bond Balance** | **449,321** | |

| | | |
|---|---|---|
| Tax | | Taxable income from bond |
| Relevant amount of drawdown | 211,177 | |
| Taxable amount of drawdown | 140,771 | |
| **Taxable income** | **140,771** | |
| | | |
| Primary Tax (excludes Medicare Levy) | 39,717 | |

| | | |
|---|---|---|
| Non refundable tax offsets/rebates | | Rebates and offsets received |
| Friendly Society Inv Bond Rebate | 42,231 | |
| Tax Payable/(Refundable) | - | |

| | | |
|---|---|---|
| Income (after tax) | 140,771 | Net income after tax |
| Non-Taxable Portion of Drawdown | 459,229 | |
| After Tax Cashflow | 600,000 | |



Source: Lifeplan Investment Bond calculator 2018

# Investment Bonds for retirement funding

## How does an Investment Bond strategy help with retirement planning?

- **Funds held within Investment Bonds are not preserved**, unlike Superannuation where a preservation age and condition of release must be met prior to withdrawal.
- Up until the policy's 10th anniversary, Investment Bond income streams consist of a **"non-assessable" amount which is not taxable**, and the earnings component which is taxable, but qualifies for a 30% tax Investment Bond rebate. Once an Investment Bond reaches its 10th anniversary, any income streams or withdrawals are non-taxable in the hands of the policy owner.
- **There are no contribution caps, nor any personal CGT consequences for withdrawing funds or switching fund options,** as would occur with traditional unitised managed funds.
- Investment Bonds have existed in an environment were **very little regulatory or legislative change** has occurred over the last 30 years, unlike superannuation which is tinkered with on a regular basis.
- **Estate planning** – removal of anti-detriment provisions? Dependant or non dependant beneficiaries?

# Case study 2

## Investment Bonds for wealth transfer

# How do we transfer wealth?

## Investment Bonds can provide a simple, low cost estate planning solution

| | |
|---|---|
| Superannuation/ account based income | ▪ Trust deed is governing document<br>– Reversionary beneficiaries<br>– Binding death benefit nomination |
| Companies | ▪ Constitution |
| Family trusts | ▪ Trust deed is governing document |
| Personal wealth | ▪ Joint tenancy<br>▪ Tenants in common<br>▪ Testamentary trusts |

# A quick recap: Investment Bond structure

| | Who | Feature |
|---|---|---|
| Bond Owner | ▪ Natural person<br>▪ Trust<br>▪ Company | ▪ Make all decisions<br>▪ Multiple owners |
| Life Insured | ▪ Natural person, any age | ▪ Multiple lives insured<br>▪ Cannot be revoked<br>▪ Can add another life insured[1]<br>▪ Survival determines investment term |
| Beneficiary[2] | ▪ Natural Person<br>▪ Dependant<br>▪ Non Dependant<br>▪ Trust | ▪ Receive death benefit proceeds<br>– Lump Sum<br>– Lifeplan Investment Bond Wealth Preserver[1]<br>▪ Multiple beneficiaries |

1 Unique to the Lifeplan Investment Bond

2 Bond owner and Life Insured must be identical

# Did you know

## $46.2 billion[1] is estimated to be transferred annually.

## Investment Bonds can be structured to be a non-estate asset

INSURANCE CONTRACTS ACT 1984 – SECT 48A

Policy for the benefit of third party beneficiary

(1) The following paragraphs have effect in relation to a contract of life insurance to the extent that the contract expressed for the benefit of a third party beneficiary (who may be the life insured):

(a) The third party beneficiary has a right to recover from the insurer any money that becomes payable under the contract even though the third party beneficiary is not a party to the contract;

(b) If the third party beneficiary is not the life insured, any money paid to the third party beneficiary under the contract does not form part of the estate of the life insured.

1. Source: http://www.morningstar.com.au/smsf/article/giving-financial-plan

# How it works

**Peter**
- Lump sum $5,250,000
- Paying annual income of $120,000
- Retained SHCC

**John**
- Lump sum $5,250,000
- Paying annual income of $160,000
- Retained SHCC

**Ronald**
$21 million

**Pauline**
- Lump sum $5,250,000
- Paying annual income of $80,000
- Retained SHCC

**Malcolm**
- Lump sum $750,000
- WP Income stream 4% of account balance as at anniversary date

Assumptions and tax calculations assume opening balance of $5,250,000 each; no additional income; no additional deposits; no lump sum withdrawals in excess of nominated pension payments; net earnings rate of 4.90% for a moderate investor.

# John's taxable income

| | | |
|---|---|---|
| **Bond balance start of year** | | Investment Bond components *(IT2346)* |
| Existing Bond – Balance at beg of Year 1 | - | |
| New Bond – Initial Contribution | 5,250,000 | |
| New Bond – Additional Contributions in Year 1 | - | |
| New Bond – Additional Contributions Year 2+ | | |
| 0 | - | |
| Earnings (after tax) | 257,250 | |
| Balance before drawdown | 5,507,250 | |
| Annual Drawdown | 160,000 | |
| Ad hoc Drawdowns | - | |
| Total Drawdowns | 160,000 | |
| **End of Year Bond Balance** | **5,347,250** | |

| | | |
|---|---|---|
| **Tax** | | Taxable income from bond |
| Relevant amount of drawdown | 7,474 | |
| Taxable amount of drawdown | 7,474 | |
| Other taxable income (includes franking credits) | - | |
| Taxable super pension/annuity | - | |
| Taxable income | 7,474 | |
| **Primary Tax (excludes Medicare Levy)** | - | |

Source: Lifeplan Investment Bond income calculator advisers.lifeplan.com.au
Assumptions: net earnings rate of 4.90%pa for a moderate investor

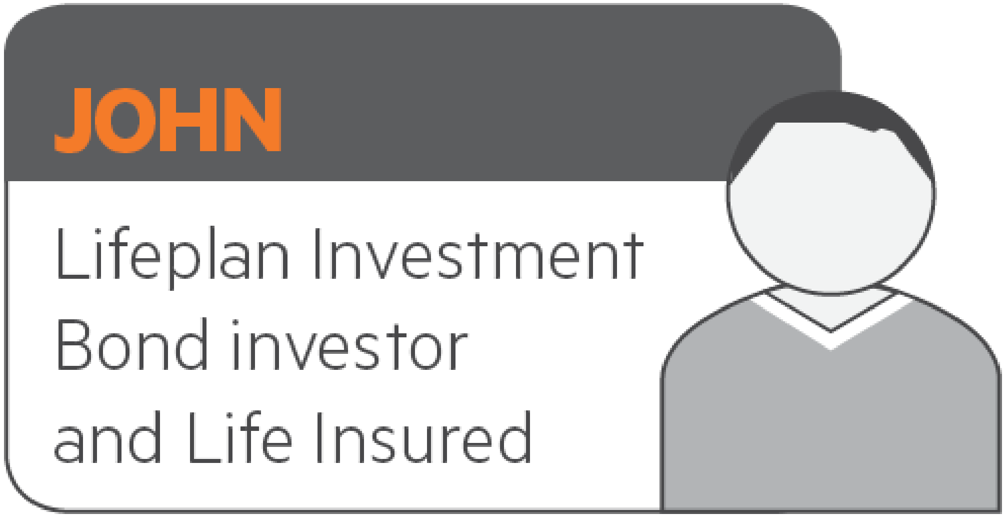
# John's taxable income cont'd

| | | |
|---|---|---|
| ***Non refundable tax offsets/rebates*** | | Rebates and offsets received |
| Friendly Society Inv Bond Rebate | 2,242 | |
| Low Income Rebate | 445 | |
| Super pension or annuity tax offset | - | |
| SAPTO for single taxpayer | - | |
| SAPTO for married taxpayer | 1,602 | |
| SAPTO for married taxpayer separated due to illness | - | |
| Other tax offsets | - | |
| ***Refundable tax offsets/rebates*** | | |
| Franking tax offset | - | |
| **Tax Payable (Refundable)** | - | |

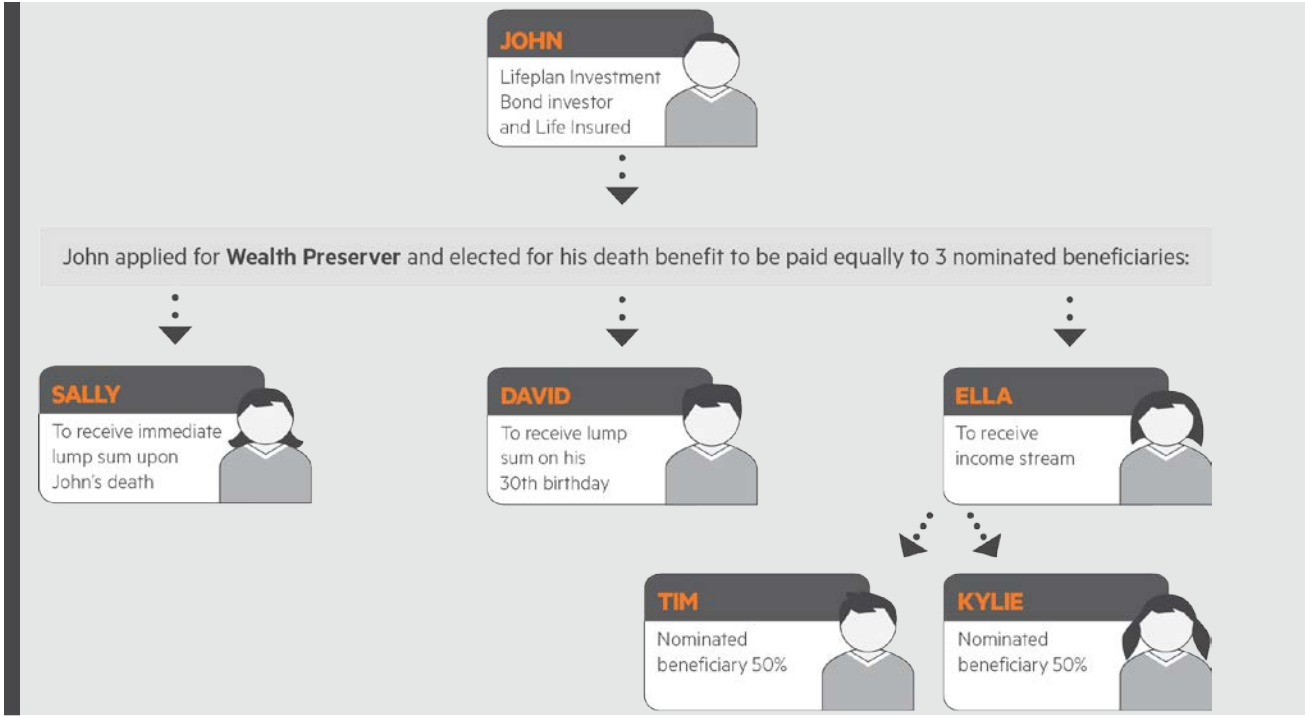
| | | |
|---|---|---|
| **Income (after tax)** | **7,474** | Net income after tax |
| Non-Taxable Portion of Drawdown | 152,526 | |
| Tax-free Pension/Annuity (60yrs+) | - | |
| **After Tax Cashflow** | **160,000** | |

Source: Lifeplan Investment Bond income calculator advisers.lifeplan.com.au
Assumptions: net earnings rate of 4.90%pa for a moderate investor

# Case study – unintended consequences



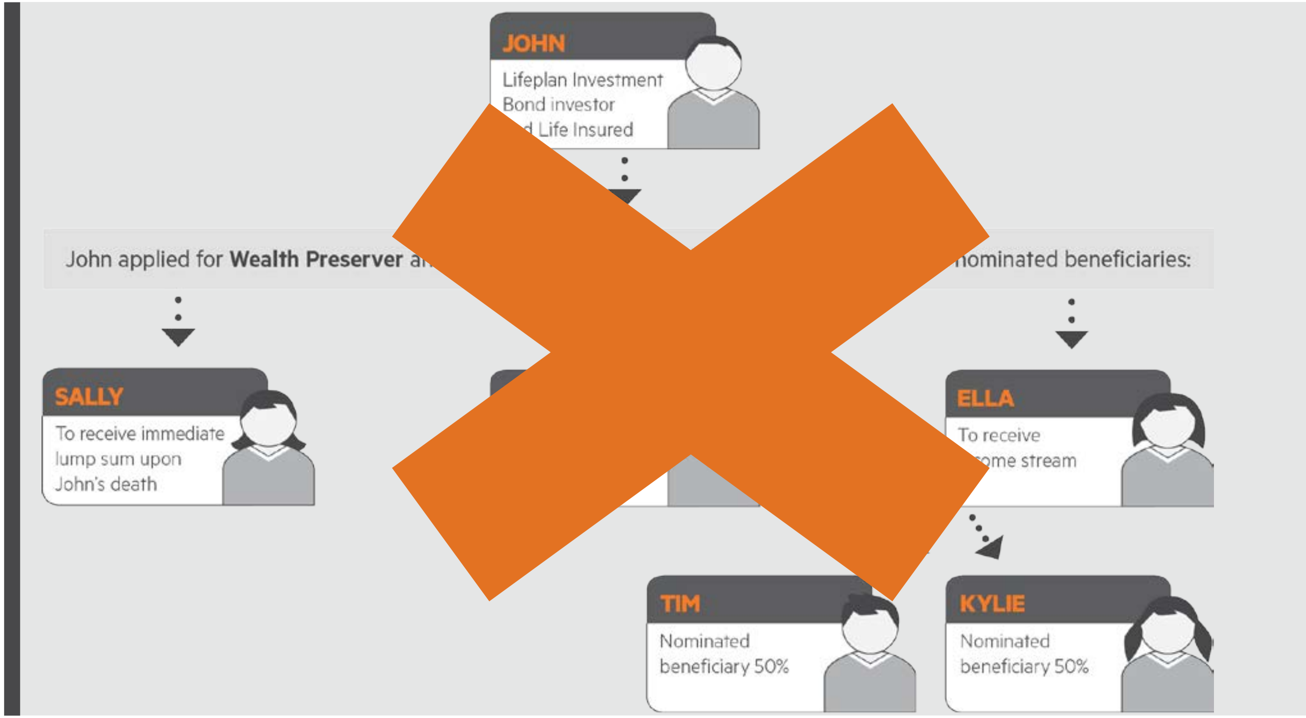
# Case study – unintended consequences



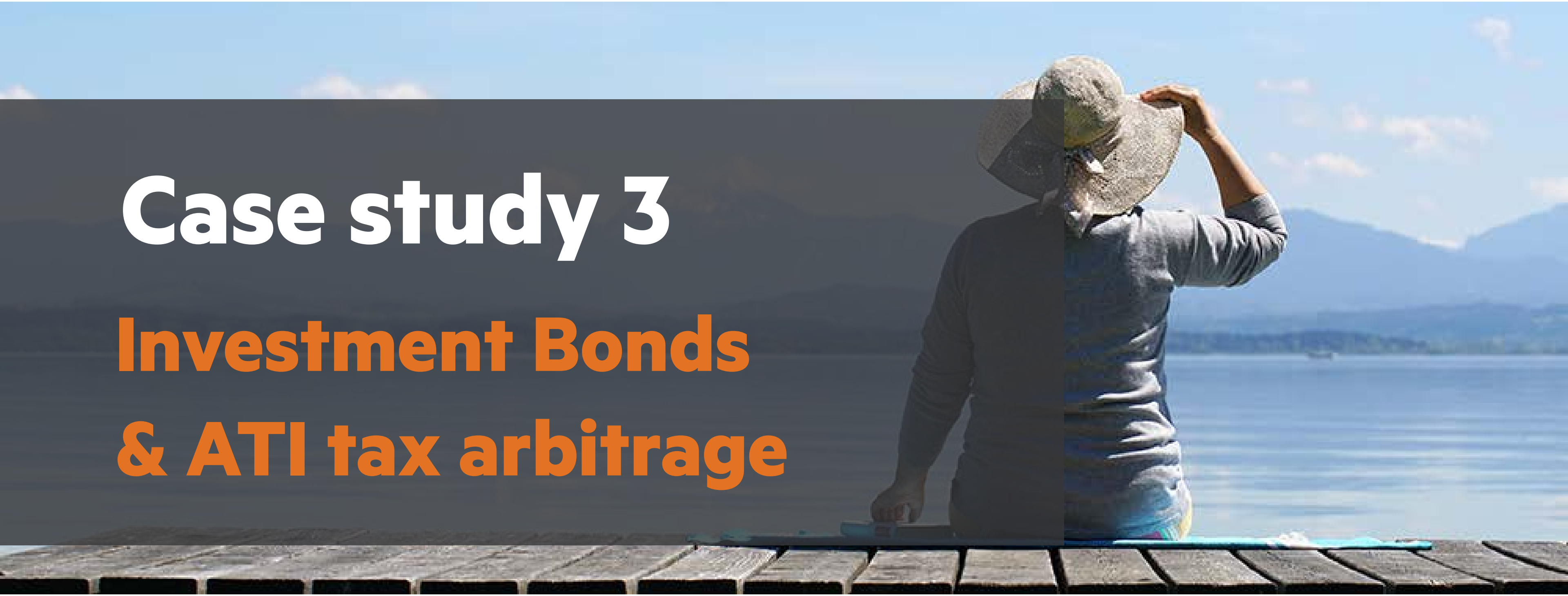

When the ownership structure and the Lives Insured match, beneficiaries can be nominated to achieve strong estate planning objectives*

*Insurance Contracts Act 1984 – Sect 48a

# Case study – unintended consequences




When a change is made to the ownership structure and Life Insureds do not match, any previously nominated beneficiaries are null and void, proceeds upon death are paid to the estate or legal personal representative.



# Case study 3

## Investment Bonds & ATI tax arbitrage

Health | Wealth | Living

# Case study 3 : Dot

- 72, widowed and in average health; requires pharmaceuticals & regular check ups
- Has just inherited $300,000 from her late mother’s Estate.
- Already receives $45,000 of taxable income from a variety of sources
- Currently parked in an on-line investment account whilst seeking advice
- Considering a conservative managed fund, or an Investment Bond with similar asset allocation.
- Does not require any additional income.
- Wants access to funds if required.

**Key Benefit**

- Until a withdrawal is made, the earnings within the Investment Bond are quarantined from Dot’s taxable income.

# Outcome snapshot EOY1

## Managed Fund @ 3% p.a. gross

| | |
|---|---|
| **Tax** | |
| Relevant amount of drawdown | - |
| Taxable amount of drawdown | - |
| Other taxable income (includes franking credits) | 54,000 |
| Taxable super pension/annuity | - |
| Taxable income | 54,000 |
| **Primary Tax (excludes Medicare Levy)** | **9,097** |
| ***Non refundable tax offsets/rebates*** | |
| Friendly Society Investment Bond Rebate | - |
| Low Income Rebate | 190 |
| Super pension or annuity tax offset | - |
| SAPTO for single taxpayer | - |
| SAPTO for married taxpayer | - |
| SAPTO for married taxpayer separated due to illness | - |
| Other tax offsets | - |
| ***Refundable tax offsets/rebates*** | |
| Franking tax offset | |
| **Tax Payable (Refundable)** | **8,907** |

Effective personal tax rate of 16.5% + $1,080 MCL
No Comm Senior Health Care Card

## Investment Bond @ 2.1% p.a. net

| | |
|---|---|
| **Tax** | |
| Relevant amount of drawdown | - |
| Taxable amount of drawdown | - |
| Other taxable income (includes franking credits) | 45,000 |
| Taxable super pension/annuity | - |
| Taxable income | 45,000 |
| **Primary Tax (excludes Medicare Levy)** | **6,172** |
| ***Non refundable tax offsets/rebates*** | |
| Friendly Society Investment Bond Rebate | - |
| Low Income Rebate | 325 |
| Super pension or annuity tax offset | - |
| SAPTO for single taxpayer | 640 |
| SAPTO for married taxpayer | - |
| SAPTO for married taxpayer separated due to illness | - |
| Other tax offsets | - |
| ***Refundable tax offsets/rebates*** | |
| Franking tax offset | - |
| **Tax Payable (Refundable)** | **5,207** |

Effective personal tax rate of 11.6% +$900 MCL
Not inclusive of Inv Bond tax @30%
Comm Seniors Health Care Card retained



Source: ato.gov.au and Lifeplan Investment Bond Calculator

# Improving outcomes with lower ATI

- Seniors
  - Commonwealth senior health card
- Families
  - Family tax benefits A & B
  - Childcare rebate
- Super
  - Co-contribution
  - Low income super contributions refund
  - High income contributions levy
  - Seniors supplement

- HELP repayments
- Levies and offsets
  - Medicare levy and MCLS
  - Private health insurance rebate
  - Seniors and pensioners tax offset
  - Low income tax offset
- Marginal or effective tax rates
- Pre and post tax returns
- Shift the tax liability
- Time the tax liability

# Current strategic opportunities

# Current strategic opportunities

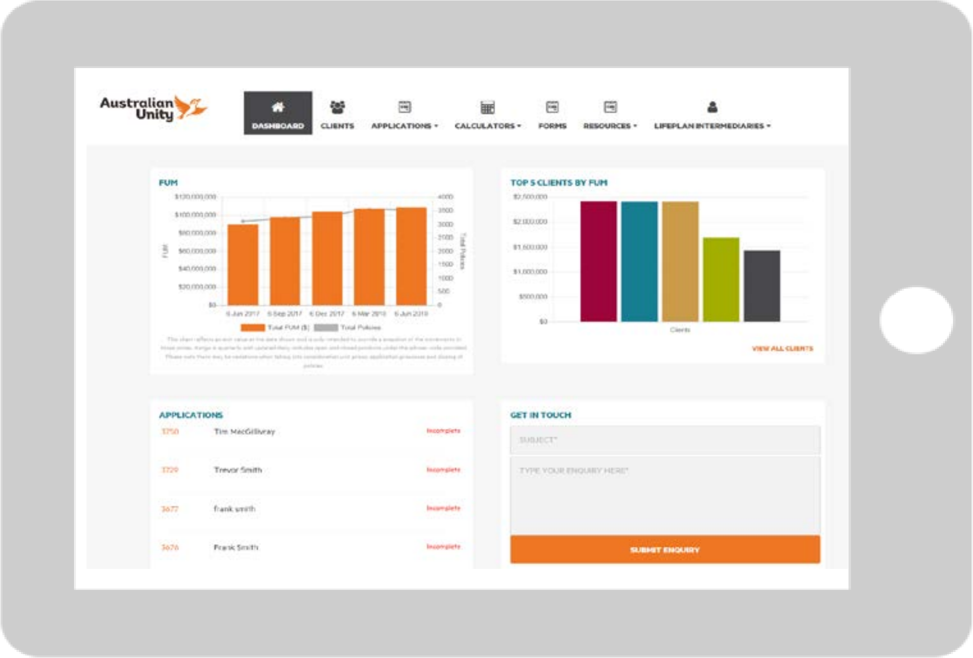
- Superannuation ‘no-go’ clients
- Tax arbitrage/efficiency/health card/peripheral benefits
- Estate planning and streamlined wealth transfer
- Tax effective income (true transition to retirement)
- Managing superannuation death benefits for non-dependant beneficiaries
- First home buyer deposit accounts
- Education funding
- Family Trust members or off-farm equalisation strategies

# Who are my clients?

- Tax payers
- Super ‘no-go’
- Retain or maximise entitlements and offsets
- Reduce personal tax
- Family trusts
- Young children
- Wealth transfer

# Resources

# Adviser Portal



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# Thank you.

Australian Unity