BONDS

Apt.
WEALTH PARTNERS

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Bonds are investments made with a single (or regular premium) payment and have a nominal 10 year term. The range of bonds includes investment bonds, friendly society bonds and insurance bonds which have access to a range of investment options. While bonds are most suitable for accumulating money, this type of investment does not provide regular income payments.

Unlike traditional investment products, such as unit trusts, bonds are a 'tax paid' investment. This means that the tax is actually paid on investment earnings, at the applicable company rate of 30 per cent, by the financial institution before the earnings are added to your account.

A bond does not 'distribute' regular income. Instead, growth is allocated to the bond account periodically (either each year as 'bonuses' or daily if the bond's value is expressed as a unit price). This growth is effectively reinvested to deliver a compounding effect.

125% rule

Bonds have a valuable taxation status; as long as any additional investments you make do not exceed 125 per cent of the investments made in the previous year, then the taxation status will not be jeopardised. This is called the 125% rule.

By using the 125% rule, a bond investment becomes even more tax effective because it gives you the opportunity to make additional investments (or contributions to a savings plan) and, each year, the level of additional contributions you can make continues to increase until the end of the tenth anniversary, after which all withdrawals from the bond are tax-free. For example, if you invest $10,000 in year one, then, using the 125% rule, $12,500 (125%* 10,000) may be invested in year 2, and so on.

If the term of the bond is extended beyond 10 years, you can continue to take advantage of the 125% rule. However, if a contribution is not made in any one year, then the next contribution will restart the 10 year period for the whole invested amount.

Estate planning

From an estate planning perspective, when you purchase a bond, you become the policy owner and generally the life insured. When a bond is taken out, the life to be insured and the beneficiary(ies) are nominated. If the life insured dies, then the balance is paid tax-free to the policy owner unless a nominated beneficiary exists.

As the owner of the bond, you are able to nominate a beneficiary who, on the death of the life insured, will receive the proceeds tax-free. This way the proceeds are paid directly to the nominated beneficiary/ies and will not form part of the deceased owner's estate assets. This provides certainty as to who will receive funds on death. For the beneficiary(ies), the proceeds will be tax-free regardless of how long the bond has been held.

Alternatively, if no beneficiary has been nominated, upon death of the owner, who is also the life insured, the proceeds will form part of the deceased owner's estate, and will be distributed to the beneficiary(ies) in accordance with the Will.

Taxation

A tax offset is available for withdrawals made before the end of the tenth anniversary of the original investment into the bond. If withdrawals take place before the 10 years is up, then a percentage of the earnings will be assessable for personal income tax. You only pay personal income tax when you withdraw your money and this will depend on your tax rate, the 30 per cent tax offset and the timing of the withdrawal.

Time of withdrawal	Result
In the first 8 years	All earnings taxed at your marginal tax rate with tax offset of 30%
In the 9th year	2/3rds of earnings taxed at your marginal tax rate with tax offset of 30%
In the 10th year	1/3rd of earnings taxed at your marginal tax rate with tax offset of 30%
After the 10th anniversary	Free from personal income tax
Death	Free from personal income tax

After the tenth anniversary, you may sell the investment tax-free or you can keep the insurance bond in place. There is no requirement to make withdrawals from the bond.

Security and risk

The level of security depends upon the type of bond and the strength of the institution in which you invest.

- **Capital guaranteed bonds** provide a guaranteed return of money and may guarantee earnings once credited to the bonds. There is usually no guarantee of the earnings rate. This type of investment is suitable if you only have a small amount to invest or cannot replace lost capital.
- **Managed or growth bonds** are market linked bonds and their value will rise and fall with market changes. This type of investment usually invests in higher risk assets, such as shares, which have a potential for greater gain as well as loss.
- **Capital secure and capital stable bonds** are also market linked but mainly invest in lower risk assets, such as government bonds, and have limited exposure to shares. This type of investment is not guaranteed as the value can rise and fall.

Ask your Apt Wealth Partners financial planner for more information.