SAVING FOR CHILDREN AND GRANDCHILDREN

Investment Growth Bond strategy paper

Issue date: 14 September 2021

Adviser use only

HEALTHIER, LONGER, BETTER LIVES

aia.com.au

At a glance

This paper illustrates how investment bonds can help families provide children and grandchildren with a positive financial start in life.

It covers:

- What are investment bonds?
- AIA Investment Growth Bond
- Saving for children and grandchildren
- Case studies

What are investment bonds?

Investment bonds, also called insurance bonds ("bonds") are a tax-paid product that suit 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.

They're easy to establish and if the client has satisfied the 125% rule (where each year's contributions do not exceed 125% of the previous year's contributions) and held the investment for 10 years ("10 year period"), any withdrawals made will not attract personal income tax or capital gains tax. In addition, the ownership of the investment can be transferred at any time without capital gains tax implications.

There is also no obligation to withdraw after the 10 year period and clients are still able to continue their investment. If a withdrawal is made during the 10 year period, all or part of the investment earnings may need to be declared in the client's tax return. The amount of tax payable on the earnings will depend on when the withdrawal is made.

The table 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.

AIA Australia's Investment Growth Bond

AIA's Investment Growth Bond (AIA IGB) has been awarded the AFA Investment Bond of the Year award for the last 13 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, AIA 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, the AIA IGB 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 before the 10 year period 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 years of age 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 13 years running, from 2008 through to 2020[6]. We're also proud winners of the 2020 AFA Investment Bond Excellence Award.

1 AFA Investment Bond of the Year winner from 2008 through to 2020. Benchmarked on scores for financial, market and product strength factors.

2 Based on Strategic Insight's 2016 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 AIA IGB 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.

Saving for children and grandchildren

Tax considerations

To deter adults from investing in children's names to minimise tax, high tax rates apply to children's unearned income from investments and family trust distributions, as follows:

- the first $416 of investment income is tax free
- income between $417 to $1,307 is taxed at 66 per cent
- income from $1,308 is taxed at 45[7] per cent.

If the adult is in a tax bracket above 30 per cent, it may be more tax effective to invest specifically in an investment bond (owned by the adult investor) as potential tax offset entitlements may reduce some tax liabilities from other income. Investment bonds' earnings in the life company are taxed at a maximum rate of 30 per cent. The proceeds are tax paid to the investor after the 10 year period (subject to the 125% rule being satisfied) and then there is nothing to include in the investor's tax return.

Options for investing in an AIA IGB

The investment bond can be structured in a number of different ways. It is important to understand though that when an adult invests on behalf of a child, the adult will need to comply with gifting rules and will generally be regarded as owning the asset for Centrelink purposes.

1. **Adult as owner and child as life insured**

   An AIA IGB can be set up with a parent or grandparent (or any adult) as the owner and the child as the life insured. At a time determined by the adult, ownership can be transferred to the child for no consideration (i.e. as a gift), without any tax consequences while also retaining the tax paid status of the AIA IGB.

   Example: 10 years ago Trevor, 41, established an AIA IGB with himself as the policy owner and his eight year old son Noah as the life insured. After 10 years, Trevor decides to transfer ownership of the AIA IGB to Noah, without any tax consequences. Noah can choose to continue the IGB or access the proceeds at any time without any personal income tax payable on the withdrawal.

2. **Adult as life insured and policy owner, and child as beneficiary**

   Alternatively, an AIA IGB can be set up with the adult as the life insured and policy owner, with a child (or children) as the nominated beneficiary (or beneficiaries). Should the policy owner die, the AIA IGB proceeds would be paid to the nominated beneficiary tax free.

   Example: Trevor establishes an AIA IGB with himself as the policy owner and life insured and nominates his son Noah as the beneficiary. Unfortunately six years later, Trevor passes away. The benefit would be paid to Noah as the beneficiary, without incurring any additional tax.

3. **AIA IGB within a family trust**

   A family trust[8] can be the owner of an AIA IGB, with children (or grandchildren) as the lives insured. After 10 years, the proceeds can be directed tax paid to the children, so long as the 125% rule has been met.

   Example: Trevor and his wife Victoria establish an AIA IGB with the family trust (with Trevor and Victoria as beneficiaries) as the policy owner and their son Noah as the life insured. After 12 years, having met the 125% rule, Trevor and Victoria decide to make a full withdrawal and transfer the proceeds to Noah, without any personal income tax or capital gains tax consequences.

4. **Child Advancement Policies**

   Child Advancement Policies (CAP)s are designed for anyone, such as a parent, grandparent, other family member or friend, who would like to invest for a child's future financial needs and are subject to specific rules:

   - CAPs must be set up by one policy owner (i.e. no joint ownership) for the benefit of only one child (the life insured).
   - The child must be under the age of 16 at the start of the policy.
   - The nominated vesting age (the age at which ownership of the policy automatically transfers to the child) can be set at any age between 10 and 25. If no vesting age is nominated, the automatic vesting age will be 25.
   - If ownership vests to the child while the child is under age 16, a parent or guardian's signature is needed for all contributions and withdrawals while the child remains under the age of 16.

7 The tax rates shown do not include Medicare levy of 2 per cent, payable where taxable income exceeds a certain level. The rates shown do not apply to a child's employment income.

8 A family trust is a legally created ownership structure whereby an individual or organisation (a 'trustee') manages certain business assets or investments that it holds for the benefit of other people, such as family members ('beneficiaries'). Most family trusts are established for asset protection and tax purposes.

Control of Child Advancement Policies before vesting age

Before the child reaches vesting age, the policy owner (including a trustee, if applicable) has full control over any dealings in relation to the policy. If the owner of a CAP dies before the child reaches vesting age, ownership of the policy will transfer to the policy owner's estate. The policy owner can stipulate in their will that the policy is to be held on trust for the child until they reach the vesting age.

Case study - investing for children now

Rohan and Jenny, both 38-years-old

Rohan earns $200,000 and is on the top marginal tax rate of 47 per cent (including two per cent Medicare levy), while his wife Jenny earns $50,000 and is on a marginal tax rate of 34.5 per cent (including two per cent Medicare levy).

They have a daughter, Zara, 6 years. Rohan and Jenny have received a windfall of $100,000 and would like to invest it to provide for Zara's future.

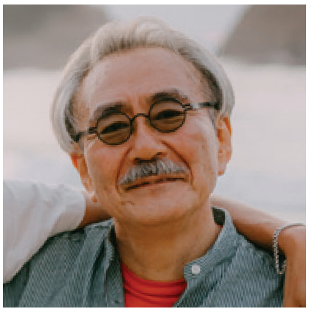
Rohan and Jenny have a number of options, including:

1. They can leave the money in a bank account or invest it in a Term Deposit. However, any earnings are subject to tax at the parent's marginal tax rate.
2. They can invest the money in a managed fund. Any earnings will be subject to tax at the parent's marginal tax rate. A capital gain or loss will arise if the investment in a managed fund is disposed of to transfer the proceeds to Zara, or if the units in the managed are transferred to Zara at a future date.
3. They can set up a trust with themselves as the trustees and Zara as the beneficiary of the trust. However, any earnings will be treated as unearned income for a child and likely be subject to up to 66 per cent tax (refer to the Tax Considerations section above for more details).
4. They can deposit the money into their mortgage offset account were it will effectively earn an after-tax return equal to their home loan rate. However, unless they are highly disciplined in cordoning off this money (plus any notionally earned interest) there is a real risk that over time this money may be absorbed into paying for other commitments (e.g. home renovations or purchase of a new home).
5. They can invest in an education fund, but this will mean that Zara could not use the money for non-education related expenses like a gap year overseas or to put towards her first home.
6. They can invest in an investment bond, which is tax paid at 30 per cent (subject to the 10 year and 125% rule), does not require any tax reporting while the money stays invested and no capital gains tax are payable on switches or transfer of ownership.

Rohan and Jenny decide on option six and choose to invest in the AIA IGB as it offers the added benefit of an investment option and death benefit guarantee, which will protect their capital from market risk. The AIA IGB will be set up as a Child Advancement Policy with Rohan as the policy owner and Zara as the life insured, with the policy to vest in Zara's name once she turns 21 years of age. The funds are to be invested 100 per cent in the No Commission (NC) -Diversified option, which provides an investment option guarantee. Once Zara reaches vesting age, the policy will transfer to her without incurring any personal income tax or capital gains tax liability.

Case study - Strategies for grandchildren

Usman, 70-years-old and Sabrina, 69-years-old



Usman and Sabrina are self-funded retirees, who have two children and five grandchildren aged between 5 and 10.

Usman and Sabrina's goal is to provide for their grandchildren's future. They have chosen the AIA IGB as it offers the added benefit of investment option guarantees and a death benefit guarantee, which will help protect their capital against market risk. They have a number of options as to how they can invest in an AIA IGB:

1. Set up five bonds owned by themselves, with each grandchild nominated as the life insured. They can decide on the appropriate time to transfer ownership to each grandchild. Should either of them die, ownership will automatically transfer to the surviving grandparent. Usman and Sabrina may also stipulate in their wills the timing of any future transfer of ownership to the grandchildren.
2. Set up one insurance bond owned by Usman and Sabrina with themselves as lives insured, and nominating each grandchild as a 20 per cent beneficiary. Upon the death of the last surviving life insured (Usman or Sabrina), the bond proceeds will pass tax paid to the grandchildren.
3. Set up a family trust, which will own the insurance bond and nominate the five grandchildren as the lives insured. The beneficiaries of the trust will include Usman, Sabrina, their children and grandchildren. After 10 years, the bond proceeds can be directed to the grandchildren, without any personal income tax liability. If amounts are withdrawn from the bond within the 10-year period, the family trust as the owner of the bond will be entitled to 30 per cent tax offset on the assessable earnings.
4. Set up a child advancement policy for each grandchild owned by either Usman or Sabrina, with an appropriate vesting age upon which ownership will transfer to the grandchildren. Usman and Sabrina can stipulate in their wills that if they die the policies are to be held on trust for the relevant child until they reach the vesting age. If the bond owner should die.

Note: clients need to be aware of the gifting rules of giving $10,000 per financial year or $30,000 over five years, when setting up or transferring an AIA IGB for a grandchild.

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

NSW/ACT/SA/WA/NT
Simon Felice
0416 037 066
simon.felice@aia.com

QLD/VIC/TAS
Vijay Mathew
0475 955 323
vijay.mathew@aia.com