The pros and cons of investment bonds

Also called insurance or growth bonds, investment bonds can be a tax-effective way to save for something big.

If you're saving for a particular goal, looking for an alternative to super, or want to ensure those who matter most are taken care of after you're gone, investment bonds (also known as insurance or growth bonds) may have benefits while potentially reducing what you pay in tax.

What are investment bonds?

Investment bonds are a type of investment-savings plan, and because earnings are taxed within the bond at 30%, they're considered 'tax-paid' investments.

This means you don't have to worry about including the earnings you've made at tax time, and if you pay a higher rate of tax on your income, they could be a tax-effective way to invest and save.

Investment bonds often suit long-term investors because they're typically designed to be held for at least 10 years, and while you could access your money before that, there could be tax implications.

What are they used for?

Investment bonds can be used for many things, such as saving for something big. This could include your retirement if you can't contribute to super—you may have exceeded your contribution cap.

You might even use it to save for a child's future or education, with the ability to transfer the policy to the child, at a certain age, often possible.

Another feature of an investment bond is the ability to nominate beneficiaries, who'll receive the proceeds of the investment bond, tax free, should you pass away.

This is why some people see investment bonds as a type of life insurance policy and why some people may refer to them as insurance bonds.

How are they taxed?

If you hold onto an investment bond for at least 10 years, you won't have to pay additional tax at tax time on any profit that you've made.

That's because investment bonds are 'tax-paid' investments, where earnings are taxed within the bond along the way at 30%.

If you're paying substantially more than 30% in income tax, an investment bond may be a tax-effective structure, but if you're paying 30%, or less, an investment bond mightn't be tax effective at all.

Tax implications

If you decide to make a withdrawal within the first 10 years, some or all of the profit you make upon withdrawal will be taxed at your income tax rate, on top of the tax paid within the bond.

Because your earnings have already been taxed at the 30% tax rate within the bond, you will however receive a 30% tax offset to reduce the amount of tax you are required to pay.

As such, the tax effectiveness of an early withdrawal will depend on your income tax rate at the time of the withdrawal.

Another thing to note is if the amount you contribute in a particular year exceeds 125% of what you put in the year prior, the start date of the 10-year period will be reset.

How is money invested?

With an investment bond, your money is pooled with money from other investors and a portion is then invested in the investment options each investor chooses.

Investment options will vary in terms of risk, and may include things like cash, fixed interest, shares, property, infrastructure, or a range of diversified investment options.

Choosing suitable investment options will often come down to your goals and risk appetite, keeping in mind the value of the investment bond can rise or fall depending on investment performance.

More information

It's important to think about your goals and circumstances before deciding whether an investment bond is right for you. We can help you to understand the risks, costs and anything else that might be worth weighing up.

The potential advantages

- If you’re a high-income earner, it may be a tax-effective way to save over the long term
- Money can be withdrawn from the investment bond at any time
- Any growth or income earned will not need to be included in your annual tax return, as investment bonds aren’t subject to personal tax assessment until you make a withdrawal
- If no withdrawals are made in the first 10 years, any profit on a withdrawal made generally won’t incur tax, as earnings are taxed within the bond along the way
- They often offer a range of investment options to cater for different goals and risk appetites
- They may be useful for people who are unable to contribute to super
- They can be an effective way to save for a child's future, including education
- You can name who you want the proceeds to go to after you’re gone, tax free.

The potential disadvantages

- Any income or capital gains that are derived are taxed within the bond at up to 30%
- While money can be withdrawn at any time, if it’s within 10 years, some or all of the profit on your withdrawal will be taxed at your income tax rate (albeit with a 30% tax offset)
- If you contribute more than 125% of your previous year’s contribution, the 10-year investment period will begin again
- Some investment bonds have minimum balances that must be maintained, so check out individual product documents for details
- Investment bonds charge fees which can vary depending on the provider and options
- If you want to access money in the investment bond, this may take more time than if you’re extracting money from a different type of investment
- An investment manager will be making the day-to-day investment decisions, meaning you won’t have direct control over the decisions made.

By AMP Life Limited
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