

Centuria Life

Investment bond strategies to create, protect and transfer wealth



June 2017

www.centuria.com.au

Agenda

- Centuria Life
- The impact of superannuation reform
- Investment Bonds – what are they and how do they work
- Why use Investment Bonds
- Structuring options family trusts, companies and Investment Bonds
- Goals based strategies, growing, protecting and transferring wealth
- Investment Options

Introduction to Centuria Life

- Centuria Life has been managing investment bonds for over 35 years
- We have a range of investment options ranging from cash through to high growth
- Investment bonds may be suitable for:
 1. Creating wealth – Education funding and savings goals
 2. Protecting wealth – Asset protection
 3. Transferring wealth – Estate planning
- Centuria Life was a finalist in the AFA Life Company of the Year Awards 2015



Utilising investment bonds creating, protecting and transferring wealth



Age 10 to 16

- Shelter from Minors Tax Rates



Age 16 to Retirement

- Tax Minimisation
- Supplement superannuation savings
- Education Funding for Children
 - Goals Funding
 - Asset Protection
 - Estate Planning



Retirement onwards

- Tax Simplification
- Income Streams
- Centrelink Planning
- Aged Care Planning
- Estate Planning
- Education Funding for Grandchildren

Creating and protecting wealth

Superannuation changes
1 July 2017

The limitations of superannuation from 1 July 2017

From 1 July 2017 individuals may be forced to seek alternatives to Superannuation

	Current rules	New rules (1 July 2017)
Concessional contributions cap	<ul style="list-style-type: none"> • \$30,000 per financial year if under age 50 • \$35,000 per financial year if age 49 or over 	<ul style="list-style-type: none"> • \$25,000 for everyone from 1 July 2017 • 5 year carry forward rule for individuals with a balance of \$500,000 or less.
Non-concessional contributions cap	<ul style="list-style-type: none"> • \$180,000 per financial year • If under age 65 on 1 July can contribute \$540,000 over three years 	<ul style="list-style-type: none"> • \$100,000 per financial year with a 3 year bring forward • Maximum balance of \$1.6m.

Significant growth in non super structures expected from 1 July 2017



DEXX&R Research predicts between July 2017 and July 2018 an extra \$18 Billion will flow into funds outside of Superannuation, including those that manage Investment Bonds in light of Super Reform.

Source: December 2015 DEXX&R market projections media release

June 2017

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Post 1 July 2017 – Who may be affected

- Will you have **large capital proceeds** from property, business, family trust or private companies
- Are you a **high earning individual with significant excess cash flow**
- Are you likely to receive a **large inheritance**
- **If you're single high net worth** who can't utilize excess caps of spouse
- If you're retiring from a **self employed business**

Planning considerations checklist pre and post 1 July 2017



Comparison checklist

Investment objectives and timeframe

Your risk profile

Risks in the strategy and how you might feel about each risk

Flexibility to deal with unforeseen circumstances

Simplicity and ease of management

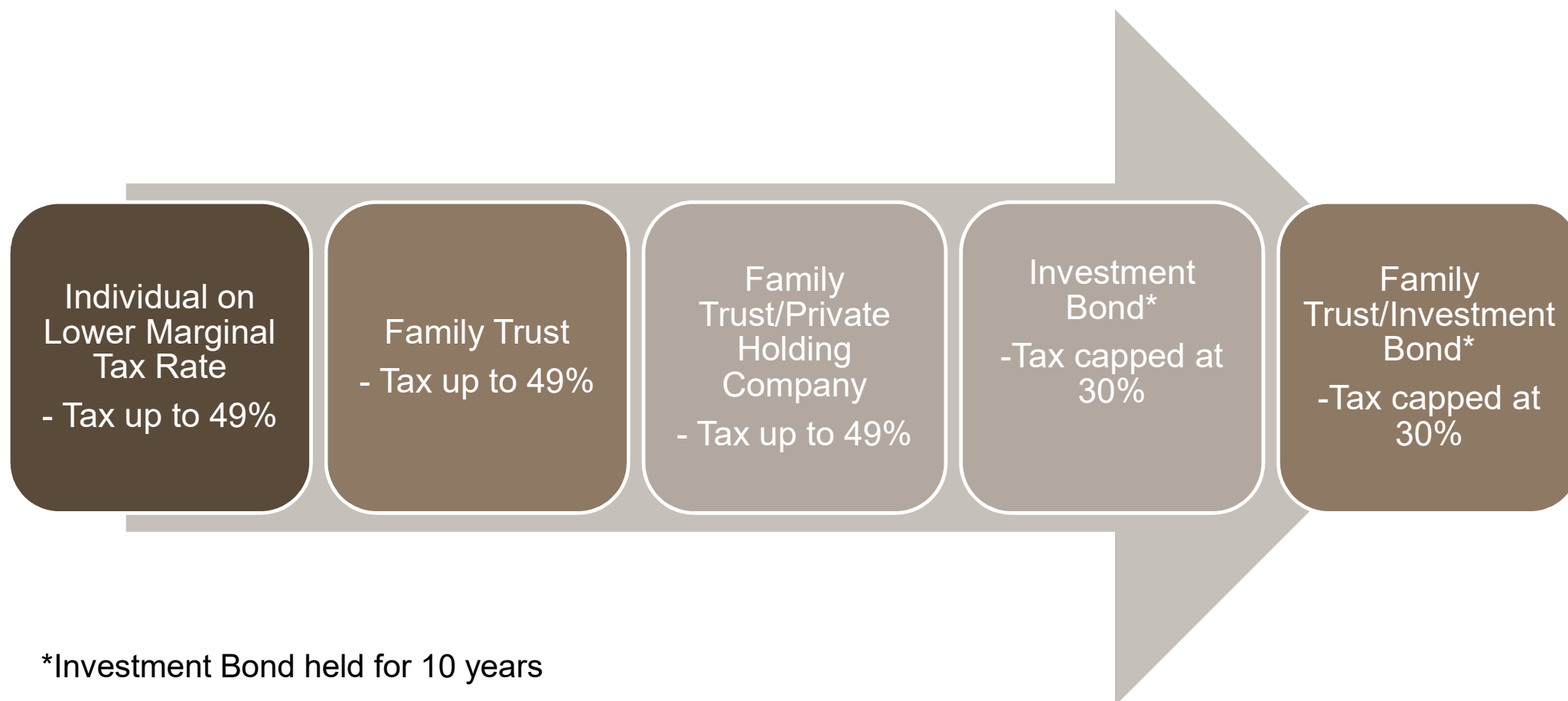
Cashflow implications

Taxation outcomes

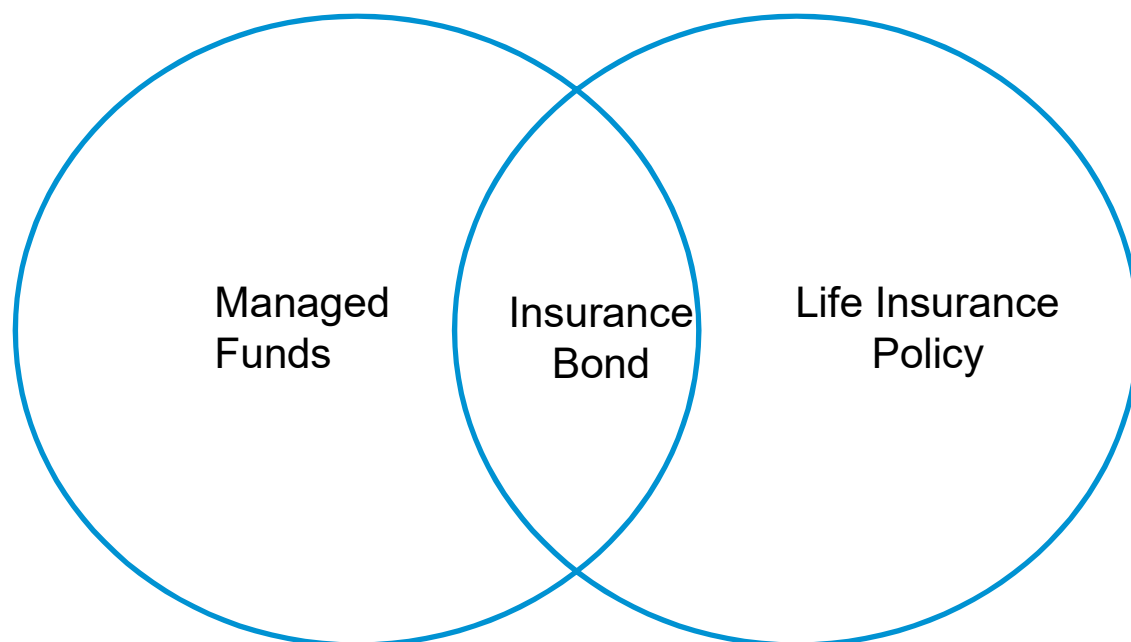
Impact on Centrelink/Veterans' affairs payments

Options and strategies for estate planning

Tax structuring options



An alternative tax structure



- ✓ Accessibility
- ✓ Estate Planning
- ✓ Tax Paid Investing
- ✓ Unlimited Contributions in year 1
- ✓ Investing for children and grandchildren

Investment bonds

Investment bonds (aka “insurance bonds”) are a tax paid self insurance and investment vehicle regulated under the Insurance Act. Investment Bonds work much like ordinary investment structures, you can select an investment option and withdraw from it at any time. Investment Bonds provide investors with flexibility, the potential for tax minimization, asset protection, Centrelink and estate planning benefits.

- The maximum tax paid on earnings and capital gains within an investment bond is 30%
- Investors can contribute up to 125% of the previous years gross contributions
- If the investment is withdrawn after 10 years, no further tax is paid by the investor

However, if the investment is withdrawn within the first 10 years, then the investor will pay tax shown below:

Withdrawal occurs	Taxable portion (of growth withdrawn)
Within first 8 years	100%
In year 9	Two-thirds
In year 10	One-third
After 10 years	Nil

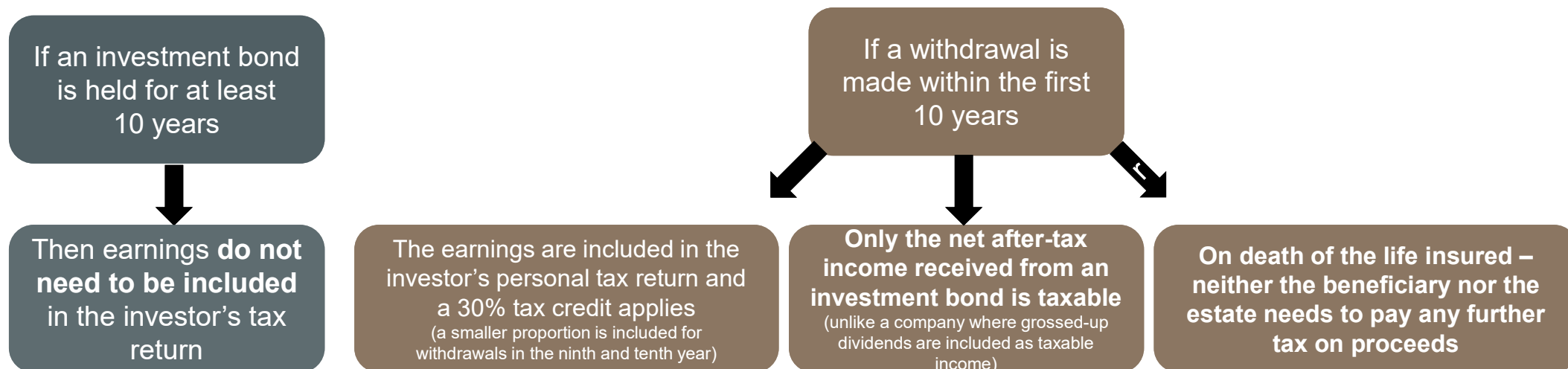
- The investor receives a 30% tax offset on any taxable amount

Tax advantages of investment bonds

Investment bonds are taxed under company tax rules

Tax on earnings is payable at the company tax rate, currently 30%

This is far lower than the top personal tax marginal rate on individuals



Investment bond – benefits

1. **No limit on the initial investment** – there is no limit on the initial investment into the bond and Investors can contribute 125% of the total of the previous years investment. This is based on gross investment amount so does not take into account withdrawals
2. **Tax effective** – earnings are automatically reinvested in the bond, reinvestment dates do not need to be tracked for capital gains purposes and earnings do not need to be declared within an individual's tax return
3. **Estate planning** – On death of the life insured the proceeds of the investment bond are passed tax free to the beneficiaries
4. **Bankruptcy protection** – protection from creditors in the case of bankruptcy, which may not be provided via a company structure
5. **Investment options** – Access to asset classes across the risk/return curve. Switch between investments without triggering a capital gain

Creating wealth

Investing as an
individual v's in an
Investment Bond

Creating wealth – Investing as an individual with low marginal tax rate

- Where taxable earnings may be different between spouses, investment assets may be moved to the spouse who is assessed at the lower marginal tax rate to reduce tax
- This may reduce tax on earnings significantly where there is potentially a significant tax differential between client and their spouse

Considerations

- **No Tax Differential** – client and spouse have the same marginal tax rate
- **Bracket creep** – assets invested in an individual's name may lead to bracket creep in the future. It is worth considering the future earnings potential of the individual
- **Tax structuring for the long-term** – once established, income splitting structures may be difficult to unwind and restructure because of large unrealized capital gains
- **Asset Protection** – Investment in the spouses name may also provide limited asset protection for the client
- **Estate Planning** – Investment in the spouses name provides limited Estate Planning certainty

Individuals and Investment Bonds compared

Depending on the income/growth component of investment returns, individuals with taxable income over \$87K may save up to 14.5% pa in tax by investing in an Investment Bond

Tax structuring options – individual vs investment bonds

Income Tax Compared – Investment Bond, 39% MTR, 49% MTR

Assumptions: \$500,000, 4.5% Income (80% franked), 4% Capital Growth, **100% annual turnover of the portfolio**, 50% CGT discount applies to individual

	Investment Bond at 30%*	Individual at 39% MTR (> \$87K)	Individual at 49% MTR (> \$180K)
Income	\$22,500	\$22,500	\$22,500
Grossed Up Income	\$30,214	\$30,214	\$30,214
Income Tax	\$9,065	\$11,783	\$14,805
Less Franking	(\$7,714)	(\$7,714)	(\$7,714)
Net Tax	\$1,350	\$4,069	\$7,091
Net Income	\$21,150	\$18,431	\$15,409
Net Benefit of the Investment Bond	-	\$2,719	\$5,741

* If held for 10 years

- Doesn't take into account the fees of any structure. Fees may impact materially on the final outcome.
- The composition of income vs growth in a return will also have an impact on the outcome. Generally, the higher the growth component the greater the benefit of CGT tax discounting for an investment through the managed fund structure. This will change the outcome.
- Advisers are encouraged to undertake their own research based on the risk tolerances and investments to be selected by their clients.

Tax structuring options – individual vs investment bonds

Capital Gains Tax Compared – Investment Bond, 39% MTR, 49% MTR

Assumptions: \$500,000, 4.5% Income (80% franked), 4% Capital Growth, **100% annual turnover of the portfolio**, 50% CGT discount applies to individual

	Investment Bond at 30%*	Individual at 39% MTR (> \$87K)	Individual at 49% MTR (> \$180K)
Capital Gains	\$20,000	\$20,000	\$20,000
Capital Gains Tax	\$6,000	\$3,900	\$4,900
Net Gains	\$14,000	\$16,100	\$15,100
Net Benefit of the Investment Bond	-	(\$2,100)	(\$1,100)

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Tax structuring options – individual vs investment bonds

Total Tax Compared – Investment Bond, 39% MTR, 49% MTR

Assumptions: \$500,000, 4.5% Income (80% franked), 4% Capital Growth, **100% annual turnover of the portfolio**, 50% CGT discount applies to individual

	Investment Bond at 30%*	Individual at 39% MTR (> \$87K)	Individual at 49% MTR (> \$180K)
Income Tax	\$1,350	\$4,069	\$7,091
Capital Gains Tax	\$6,000	\$3,900	\$4,900
Total Tax	\$7,350	\$7,969	\$11,991
Net Benefit of the Investment Bond	-	\$619	\$4,641

* If held for 10 years

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Tax structuring options – individual vs investment bonds

10 Year Projections – Investment Bond, 39% MTR, 49% MTR

Assumptions: \$500,000, 4.5% Income (80% franked), 4% Capital Growth, **100% annual turnover of the portfolio**, 50% CGT discount applies to individual

	Investment Bond at 30%*	Individual at 39% MTR (>87k)	Individual at 49% MTR (>180k)
Net Balance after 10 years	\$986,336	\$974,982	\$904,065
Effective Tax rate	17.29%	18.75%	28.21%
Benefit over 49% taxed Individual	\$82,271 9.10%		
Benefit over 39% taxed Individual	\$11,355 1.16%		

* If held for 10 years

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Tax-effective investment structures for wealth creation



Superannuation



**Family Trust/
Company**



Investment Bonds

The company structure vs an investment bond - example:

Harry set up a **private company** and transferred \$120,000 into the company – invested in a range of investments

After **six years**, Harry withdraws the full investment and declared a fully franked dividend of \$36,000.

Harry is on the top marginal tax rate (49%).

His tax position after receiving the dividend payment is shown below.

Harry decides to invest \$120,000 into an **investment bond** instead of using a company.

After **six years** he withdraws the full balance of \$156,000 (includes \$36,000 earnings). His tax position is shown below.

Case example outcome

Harry's tax position after receiving the company dividend:

Fully franked dividend	\$36,000
Franking credit (\$36,000 x 30/70)	\$15,429
Total included in taxable income (\$36,000 + \$15,429)	\$51,429
Tax at 49%*	\$25,200
Less: franking credit	\$15,429
Net tax payable (\$25,200 - \$15,429)	\$9,771
Net earnings (\$36,000 - \$9,771)	\$26,229

Harry's tax position after receiving the investment bond proceeds:

Investment	\$120,000
Amount withdrawn	\$156,000
Growth portion (included in taxable income)	\$36,000
Tax at 49%* (\$36,000 x 49%)	\$17,640
Less tax offset (\$36,000 x 30%)	\$10,800
Net tax (\$17,640 - \$10,800)	\$6,840
Net earnings (\$36,000 - \$6,840)	\$29,160

Even though Harry made the withdrawal before 10 years – he still comes out ahead

* Medicare Levy is included (2% from 1 July 2014). Additional 2% 'budget deficit levy' applies on taxable income above \$180,000, derived between 1 July 2014 and 30 June 2017.

Case study example outcome

Though Harry includes the earnings in his tax return, the fact that only the net earnings received are taxable results in Harry paying **\$2,545 less tax** with an investment bond under the company example

If Harry had retained his investment bond for at least 10 years:

- He would not pay any additional personal tax
- This would have resulted in a **tax saving of \$8,485** compared to a company structure
- This saving would be less if the 2% budget repair levy does not continue post 30 June 2017

Creating wealth

Individuals capped or locked out of superannuation or with a desire for liquidity (younger accumulators) may consider an Investment Bond to invest outside of superannuation

Discretionary Family Trusts, Companies and Investment Bonds

Tax structuring options – Investing via a Family Trust/Company

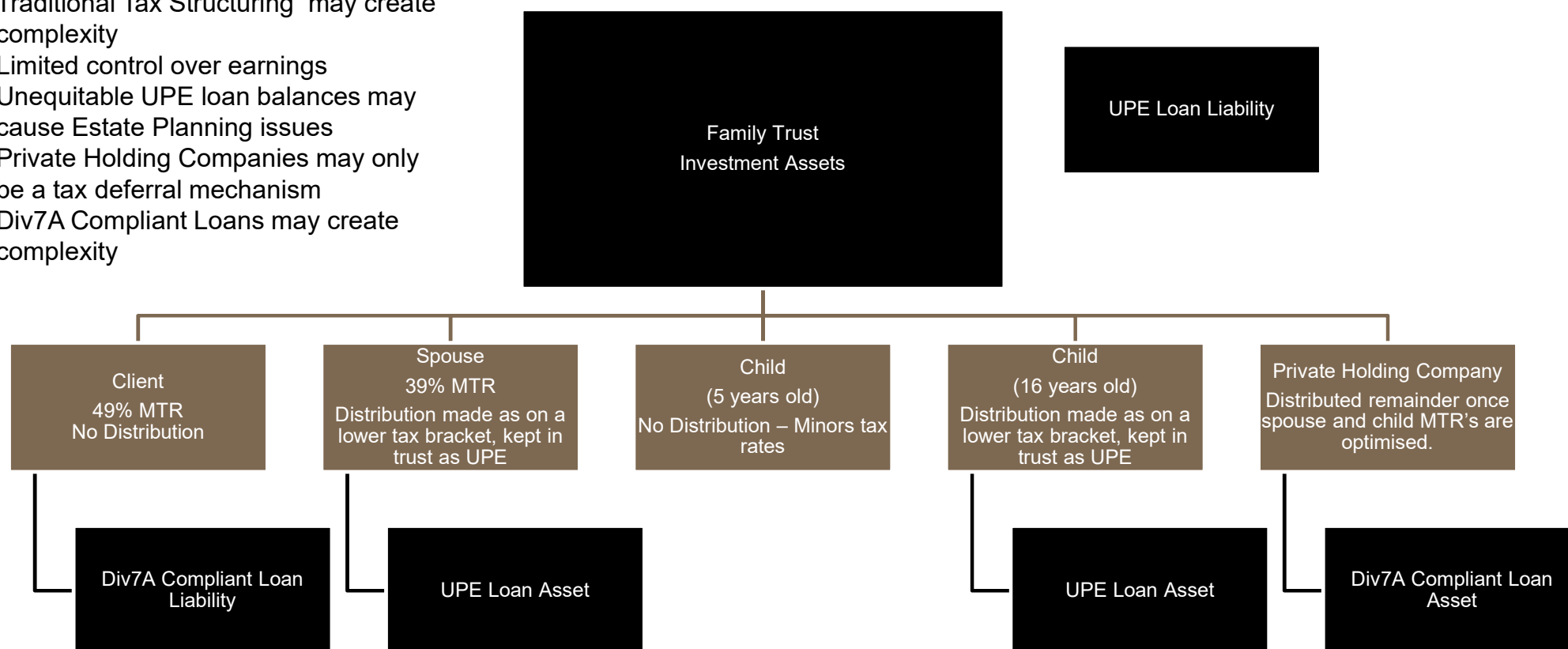
- Where there is a taxable earnings differential between spouses and other family members assets may be moved to different tax structures to provide income splitting flexibility to a household
- Where income splitting between individual beneficiaries has been maximized, a private holding company beneficiary may be used to defer tax
- Unpaid Present Entitlement and Div 7A compliant loans may be used ensure continued tax effectiveness as the clients assets grow

Planning Considerations

- **No Tax Differential** – If there is no difference between the taxable incomes of the client and family members, there may not be a benefit in investing in a family trust
- **Single** – Single clients with no family members to distribute to will require a company beneficiary
- **Non adult beneficiaries** – Clients whose children are minors will only be able to distribute \$416 of earnings tax effectively to their children. Earnings received by minors between \$417 and \$1,307 are taxed at 68%. Earnings above this are taxed at 49% from 1 July 2017
- **Bracket Creep** – As a beneficiaries' circumstances change, there may not be no advantage in distributing to those beneficiaries
- **Too much taxable income** – Once beneficiaries have capped out their MTR's, the family trust's only option is to either retain or distribute and pay tax at the highest marginal tax rate, or distribute to a company beneficiary which may only act as a deferral mechanism
- **Complexity** – Unpaid present entitlement and Div 7A compliant loans may lead to complexity in the future
- **Estate Planning** – Unequitable unpaid present entitlement balances may lead to future estate planning challenges

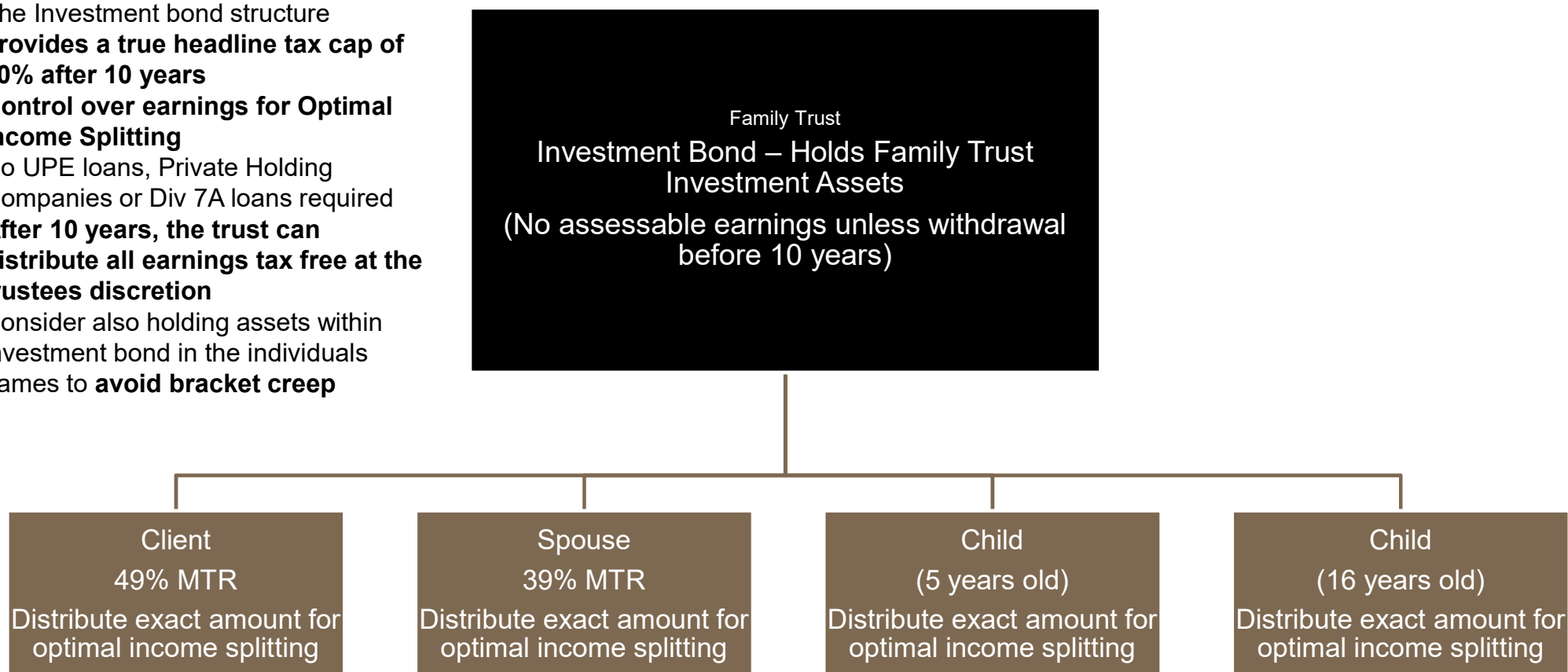
Tax structuring options – traditional Family Trust /Company structures

- Traditional Tax Structuring may create complexity
- Limited control over earnings
- Unequitable UPE loan balances may cause Estate Planning issues
- Private Holding Companies may only be a tax deferral mechanism
- Div7A Compliant Loans may create complexity



Tax structuring options – Family Trust and Investment Bond structuring

- The Investment bond structure provides a true headline tax cap of 30% after 10 years
- Control over earnings for Optimal Income Splitting
- No UPE loans, Private Holding Companies or Div 7A loans required
- After 10 years, the trust can distribute all earnings tax free at the trustees discretion
- Consider also holding assets within investment bond in the individuals names to avoid bracket creep



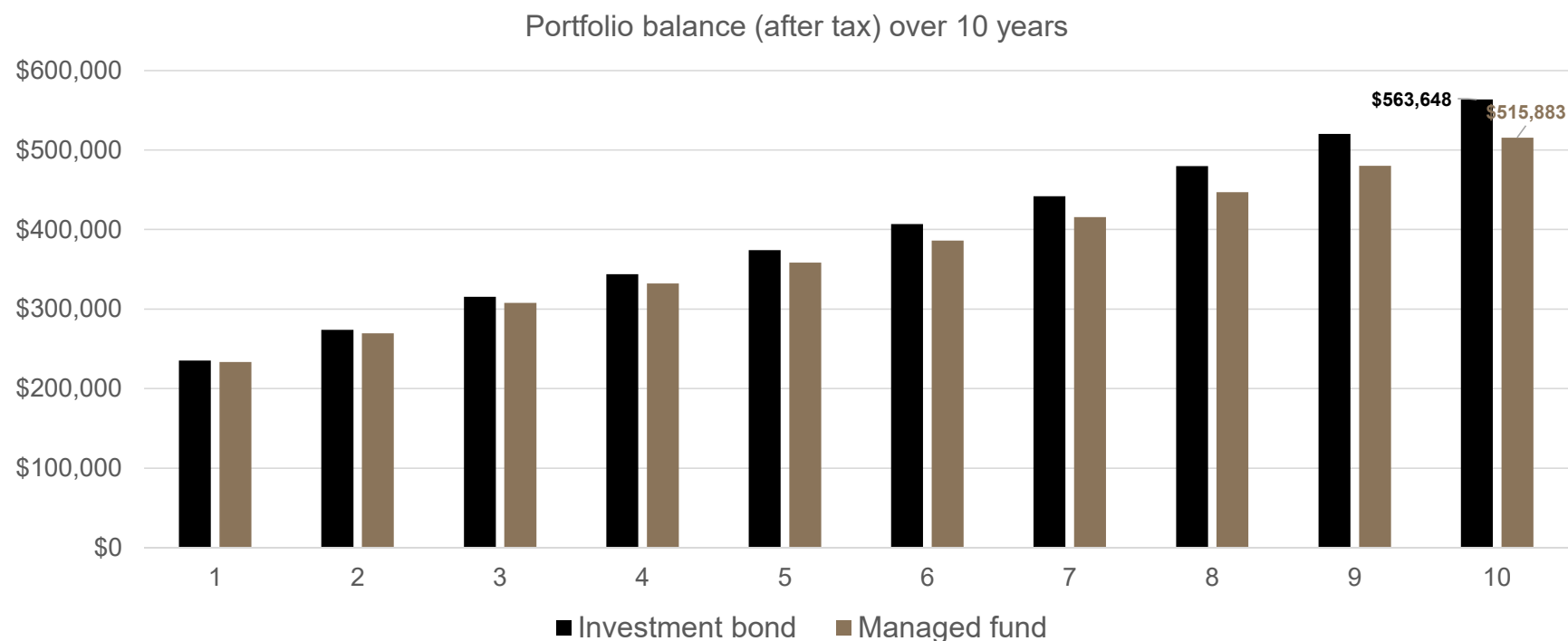
Case Study: Anthony – tax structure considerations

- Anthony – is 45 years old and has invested wisely in the property market. He has sold his inner-city investment property and realised a healthy capital gain and does not wish to re-invest in property.
- Anthony has paid off his mortgage and maximised his concessional and non-concessional contributions
- Anthony is looking at options to invest his surplus proceeds of \$200,000 in a tax effective manner. Anthony earns a good income and does not need access to his funds and can adopt a long-term investment time horizon of 10 years plus
- Anthony could consider investing in Australian shares via a managed fund, directly in the share market or via his family
- Franking credits are important to Anthony as they can help him reduce the tax paid, given he is on the highest marginal tax rate

Case Study: Anthony tax structure considerations

- Anthony's adviser suggests investing in an investment bond, he is able to benefit from franking credits from Australian Shares within the investment bond. The investment bond pays tax at a maximum rate of 30% per annum
 - Anthony can also afford to invest additional amounts of \$20,000 per annum into the investment bond for the first 3 years as he is unable to direct any surplus funds into superannuation without exceeding his contribution caps
 - In 3 years time, he plans on reducing the contribution amount he invests to \$5,000 per year
 - His adviser confirms he can redeem his investment bond and pay no additional tax after 10 years
 - When Anthony reaches age 55, the investment bond has accumulated to approximately \$563,648 (tax paid). This is estimated to be \$47,765 higher than the alternative of investing at his personal marginal tax rate
 - The net sum available in the investment bond in 10 years' time by comparison to the same return achieved within a managed fund tax structure that is taxed at Anthony's marginal tax rate is shown in the graph on the following page. It is important to note that this is illustrative example based on specific assumptions noted. Advisers are encouraged to consider the assumptions and run their own calculations.
-
- Doesn't take into account the fees of any structure. Fees may impact materially on the final outcome.
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Portfolio balance (after tax) over 10 years (\$53.4K higher than investing at his personal marginal tax rate)



Provided for illustrative example only based on the basic income and growth assumptions described above. This illustrative example does not purport to represent the actual return possible in any of Centuria Investment Bonds. An investment is subject to risk, the degree of which depends on the assets in which the bond invests. Assumptions: total returns of 8.5% pa (4.5% pa income (80% franked), 4% pa capital growth, 100% annual turnover of the portfolio, 50% CGT discount applies for managed funds).

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Other choices - Anthony case study

- Anthony could have chosen to invest the \$200,000 into a discretionary family trust or invest the funds in managed fund in his own name – the result would be potentially be the same as investing in his own name
- This is because the discretionary trust does not pay tax, the earning's are passed onto the beneficiaries and they pay tax at their marginal rate
- A discretionary family trust can provide the ability to choose who to make the distributions to if there are multiple beneficiaries on different marginal tax rates
- An investment bond may be an option worth considering, given Anthony is the only beneficiary
- If Anthony were to set up a discretionary trust, he would need to consider the initial and ongoing costs of establishing and running the trust

Tax Structuring Options – Family Trusts and Investment Bond structuring



Investment Bonds can provide optimal income splitting when used within a family trust.
When held in an individuals name an investment bond may minimize bracket creep

Protecting wealth

Asset Protection

Protecting wealth

The Bankruptcy Act 1966 specifically excludes Life Insurance proceeds from division amongst creditors

- Occupations with high risk of litigation – Medical practitioners, lawyers, accountants, real estate agents, small business owners

An insurance bond can ensure assets are protected in the event of bankruptcy

Planning and structuring assets using an investment bond may ensure your clients assets are protected from adverse events such as bankruptcy

Transferring wealth – Estate Planning

Estate Planning Case Study

Poor estate planning can have a significant impact on the value of the estate and the beneficiaries:

- The estate could be distributed to unintended beneficiaries
- High legal fees could be incurred to collect all the assets
- Any disputes can result in lengthy delays in accessing estate proceeds
- Erosion of wealth due to tax implications (eg Superannuation taxable component to non dependant beneficiaries), reducing the value of the estate

There are strategies that can be used to help avoid, or minimise, these consequences and **get the right assets in the right hands at the right time**

Finding an effective wealth building vehicle that also provides estate protection and estate planning opportunities is key

The right vehicle

Investment bonds (aka “Investment bonds”) have features that make them an ideal estate planning tool as they **allow the owner/insured to appoint a beneficiary to receive the bond proceeds upon their death.**

Investment bonds:

- **Fall outside of the estate** so are not distributed according to the will nor are they affected if the owner dies intestate
- Are **paid tax-free** to the nominated beneficiary/ies
- **10 years or death**

Transferring wealth using investment bonds

Investment bonds can be structured to enable seamless wealth transfer

- **One or more Life Insured/Owner** – Adding an additional owner and life ensured can ensure that a surviving spouse retains control and access to the investment bond in case one member of a couple passes away
- **Joint names with child** – Owning an investment bond in joint names with a child will ensure that in the event of death of a parent that the child or guardian can maintain the investment bond until they wish to access the funds.
- **Held in trust for a child** – An investment bond held in trust for a child provides an indication of intent for the investment bond proceeds and can be reassigned to the child at the owners discretion
- **Owned by Family Trust** – Can ensure that investment bond proceeds are released to the family trust rather than to individuals upon the death of the life ensured to protect against adverse Centrelink or tax impacts to beneficiaries

Estate planning case study blended families

- Joan (68) and Brian (73) are married, it is both their second marriage
- Joan has 4 children from her first marriage and Brian has 2 Children from his first marriage
- Joan's main estate planning issue is leaving her non superannuation assets accumulated during her first marriage to her 4 children
- Joan can consider investing her non super assets into a Centuria Investment Bond, with her 4 children as beneficiaries
- Joan remains the owner and life insured and if she needs the funds during her lifetime she has access to them
- On Joan's death the funds are paid to her beneficiaries

Service and support

For more information:

www.centuria.com.au

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