FACTSHEET

INVESTING FOR CHILDREN

Introduction

Investing on behalf of a child can be a complex area. This is in part due to the fact that many investments cannot generally be held in a child's name (due to legal requirements) and in part due to the fact that children (ie. generally aged under 18 and not earning an income) are subject to tax rates on income earned above just $416.

The complexity can be further heightened when we also consider the potential impact on the adult's Centrelink benefits and the protection of assets for the intended beneficiary in the event of the adult's death.

Finally, selecting the right investment should take into account the time frame over which you are looking to invest.

In summary, finding the right investment for your child should involve a consideration of all of the following factors:

- investment time-frame
- taxation
- Centrelink
- estate planning.

Each of these considerations is explored in further detail below:

Investment time-frame considerations

For most parents, investing for their children is part of a long-term plan. The two most common scenarios include funding for their high school education or helping to set their children up for the future.

In both of these scenarios, new parents would typically be looking at investing for at least a 10-year period. When selecting investments for the long term it can be important to consider growth assets like shares to ensure the value of your savings continue to outpace inflation. Furthermore, typically over the longer term, the risks and volatility of investing in growth type assets are reduced.

Taxation considerations

Whether the income from an investment held on behalf of a child is taxed as the adult's or the child's will depend on the source of income and how the investment earnings are used.

When considering the source of income you need to consider whether the investment is the result of gifts for the child or whether it is from the parent's own funds. The source of income then needs to be considered in light of how the income from the investment is being used.

If reinvested or used to cover expenses like school fees, then the adult should not be personally liable for tax on the investment. However if the income is being spent and used by the adult as if it is their own, they will be liable for the tax on the investment.

Where the income received from the investment is less than the child tax-free threshold (see table below) it may be preferable to have the income attributable to the child.

Furthermore, where the investment income has always been attributable to the child, there will be no capital gains tax triggered when the child turns 18 and legal ownership is transferred to them. However, for larger investment amounts, particularly where the adult is not on the top marginal tax rate of 45%, it may be preferable to have the income attributable to that adult.

Tip: In the scenario where, irrespective of whether the adult or the child is attributed with earning the income, it will be taxed at the top marginal tax rate (45%), it may be preferable to explore investing via an investment bond (where the tax rate on earnings within the bond are levied at 30%).

Alternatively, for large amounts it may be worthwhile exploring the use of a discretionary trust structure (where income can be distributed to take advantage of each beneficiary's tax-free threshold.)

Tax rates for a minor

OTHER INCOME	TAX RATES 2013/14
$0 – $416	Nil
$417 – $1,307	Nil + 66% of the excess over $416
Over $1,307	45% of entire amount

It should be noted that these taxation rates do not apply to income earned by minors as a result of personal exertion, for example a part-time job while still at school.

Specialist education savings funds

There is a broad range of specialised education savings vehicles available in the market place today. One of the main benefits of choosing such a plan is that, provided the funds are used for genuine educational expenses, the investment earnings are concessionally taxed. As most of them are based around a regular savings-plan type structure, they are also good at enforcing some discipline in your saving strategy. On the other hand, they may lack the flexibility of other investment vehicles, and some have penalties should you decide to withdraw funds earlier than you initially committed to. Also, the tax effectiveness of such plans will depend on the tax situation of the parents. Considerations when comparing these plans should include:

- What stage of your child's education are you saving for? Some plans allow you to compartmentalise amounts for specific schooling stages (eg primary, tertiary).
- Can you make single contributions or regular contributions only?
- What are the entry fees, ongoing fees and exit penalties (some can be quite substantial)?
- Does the plan allow you to pay for uniforms, books, etc?
- What are the investment choices?
- How secure are the funds and how reputable is the provider?

Centrelink considerations

It is important that people realise that, when investing on behalf of a child (particularly where an adult's funds are used to fund the investment), the relevant adult will usually still be regarded as owning the asset for Centrelink purposes under the asset and income test. For example, if a grandparent invested $20,000 in a managed fund on behalf of their grandson, subject to the rules on gifting (explained below), irrespective of who is paying tax on the income, the grandparent will still be assessed as being the owner of the asset for Centrelink purposes, the $20,000 will be included as their assessable asset and subject to the deeming rates.

While the Centrelink consideration is likely to be less important for those who are well under the relevant thresholds or those who don't qualify for Centrelink, for asset and income test sensitive investors it is important they check that by making the investment on behalf of the child, they're not jeopardising their age pension entitlements.

Tip: Grandparents may wish to consider gifting funds to their grandchildren (within the allowable gifting rules, currently $10,000 in a financial year and up to $30,000 over a 5 year period) by gifting the amount to a trust established for their grandchildren and with their adult children acting as executors of the relevant trust.

Estate planning considerations

Another concern, particularly for grandparents, is that when they die, any investments held in trust for their grandchildren may end up with unintended beneficiaries. For instance, upon death, generally, these investments would form part of the grandparent's estate (as they are still the legal owner of the investment) and then be distributed according to the will. Even though the will can direct the executor to pay the nominated benefits to the grandchild, other family members may be able to contest the will.

Tip: Investing in an investment bond with a child advancement option may be an effective strategy as it is possible to have the investment 'vest' in the child at any point after their 10th birthday. This essentially means the investment becomes the absolute property of the child on the death of the grandparent. Generally (depending on the age of the child) the only requirement is the appointment of another adult to act in trust for the child.

The grandparent may also wish to consider the use of a trust with the grandchildren as the beneficiaries. However, it is important to weigh up the protection of benefits against the potential loss of Centrelink benefits and establishment costs.

For more help

More information can be found by visiting centrelink.gov.au and ato.gov.au, or by calling to speak with a ClearView Financial Planner on 132 976.