CHILDREN'S INVESTMENT SAVINGS STRATEGY

When considering investments on behalf of a child, it's essential to plan for their future.

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Disclaimer: The information in this document is of a general nature and does not take into account your own financial objectives, circumstances or needs. You should consider your own personal situation and requirements before making a decision.

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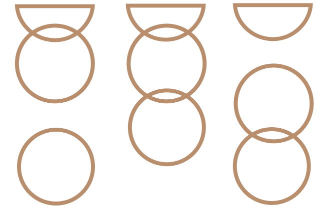


When considering investments on behalf of a child, it's essential to plan for their future. However, it's equally crucial to understand the responsibilities concerning taxation on investment income and the potential tax rates that may come into play.

Benefits

Investing for a child's future can provide the means to cover educational expenses and other life milestones, giving them a solid foundation for success. Furthermore, grasping the tax implications associated with children's investments is vital in making informed decisions and structuring an appropriate investment portfolio.

How it works

Investing for a child can be intricate due to the child's inability to hold investments in their name, which can lead to penalty taxes on investment income. Typically, when money is invested on a child's behalf in a bank account, term deposit, managed fund, or shares, a parent or guardian acts as the trustee. Taxation on the investment income largely depends on who utilises the income generated from the investment.

If the trustee (typically the parent or guardian) is the source of the funds and also utilises the investment income, they are generally considered the owner and are required to report the income on their tax return. Capital gains tax (CGT) may come into play if the trustee transfers the investment into the child's name once they reach adulthood.

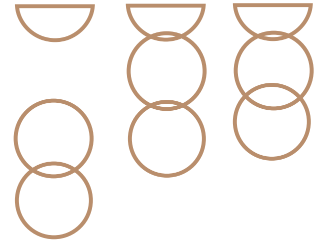
However, if the trustee reinvests the income for the child's future benefit, the child may be deemed the beneficial owner. In such a scenario, the child would be subject to penalty tax rates on the income, and CGT might not apply when the investment is eventually transferred into the child's name.

Child Penalty Tax Rates

Income earned by a child is typically subject to penalty tax rates, with a few exceptions:

- If the income falls under excepted categories, such as employment income or earnings from an inheritance or family settlement.
- If the child qualifies as an excepted person, which includes full-time working status, marriage, permanent disability, or permanent blindness.

Refer to the References section for up-to-date penalty tax rates.



Alternative Investment Choices

Certain investment bonds and education savings plans have been specifically designed for children and offer simplified taxation perspectives. These products are considered 'tax paid' investments, meaning there are generally no tax implications for the child or the trustee.

In an Investment bond, earnings are taxed within the bond at a 30% rate. After ten years, the bond is considered fully tax paid, and withdrawals can be made without tax implications for the investor. However, if a contribution exceeds 125% of the previous year's contribution, the ten-year period restarts for the entire investment bond (subject to the 125% rule).

A specific type of investment bond known as a 'Child Advancement Policy' is held in the name of an adult on behalf of a child. The child must be under 16 at the time of application, and the adult can specify when the investment transitions into the child's ownership. If no date is specified, the bond usually transfers to the child upon reaching 25 years of age.

Education savings plans or scholarship plans are also tax-paid investments, with earnings taxed within the plan at a 30% rate. This tax may be refunded if the funds are ultimately used for the child's educational expenses, such as uniforms, travel costs, fees, books, living away from home allowances, and residential boarding expenses. Withdrawals within the first ten years may be taxable to the child, but tax offsets are available to reduce this tax burden.

Key Considerations

- Seeking professional tax advice is recommended to clarify the tax treatment of investments for children.
- If you are a Centrelink recipient and invest on behalf of a child, you must notify Centrelink, as it could impact your entitlement under gifting rules.
- The decision of in whose name to invest also has implications for control over the funds.
- If investments are held in your name on behalf of a child or grandchild, legal advice may be sought to ensure that the child inherits the funds upon your passing or that another trustee is nominated to manage the funds on the child's behalf.

References

You may wish to refer to the following websites for further information child saver:

- www.moneysmart.gov.au
- www.ato.gov.au

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