Investing on behalf of your kids

Investing on behalf of your children can help give them a financial leg up and introduce them to good financial practice at an early age. Here are some considerations to help you find an appropriate kind of investment vehicle to set them on their way.

Whether it's birthday cash from proud grandparents, a slice of an inheritance, or you just want to set them up with something in their own name, many parents want to invest on behalf of their children.

Picking an appropriate investment for your child

Just as you wouldn't set off across the Nullarbor on a hovercraft, it's important to pick an appropriate vehicle. Tax, social security and the appropriate structure will all affect your decision.

The first thing to consider is why you want to invest. There's a plethora of products you could select, so think about which goals you're aiming to achieve. Setting something up to fund year-on year educational expenses might be quite different from a fund to establish a deposit on a first home, where the aim is a lump sum.

Alternatively, you may simply to want to open a bank account to give them the feeling of ownership, the equivalent of the old over-the-counter passbook. This might be a first step towards financial literacy in adulthood.

Once you're clear about your aims, it pays to bear in mind the effects of taxation.

Minors and tax

In Australia, children under 18 on the last day of the financial year (30 June) are considered minors as far as tax is concerned. Minors are generally taxed at penalty rates on unearned income such as interest, rent and dividends.

There are exceptions for certain children working full-time, with disabilities or who are entitled to a double orphan pension.

Further, the above minor penalty tax rates don't apply to amounts of excepted income received by children – these amounts will be taxed at adult rates. Excepted income includes income from employment, their own business, or from a deceased person's estate.

Mario is 15 years old and is not an excepted person. His income consists of a $500 family trust distribution and $8,000 wages from casual work. Mario also has $180 in deductions relating to earning his wages.

In whose name?

The most common approaches are to hold the investment in the child's name, or in the parent or grandparent's name, with them as a trustee. Whichever you choose, it helps to think upfront who will be liable for any tax and what the social security impacts might be.

For tax purposes, the ATO determines who has control of the assets, and therefore who pays tax on the income earned.

If the money to set up the investment is given without any conditions, such as pocket money, or earned and used by the child and no-one else, then income, and any capital gain or loss, is assessable to the child. It's the same if the investment is held under an informal trust agreement and the ATO is satisfied that the money belongs to the child. This applies in most cases where the money is a genuine gift.

However, if the money for the investment is provided by the parent and the parent uses the money as if it were their own, then they should declare the income on their return.

Note that children are not exempt from quoting a tax file number (TFN) and can apply for one at any age. Whichever investment vehicle you choose, make sure you supply the right TFN, if one is required.

Investment vehicles

These are some of the popular options parents turn to.

Bank accounts

Opening a bank account is usually the most straightforward. This doesn't require the child to sign a legal document and so can be registered with your child's name. However, if they are under 16, the bank will often require parental permission.

Managed funds

Managed funds and share investments generally require legal capacity, which doesn't apply to under-18s. Therefore, these are usually registered in an adult's name. The fund manager or share registry may allow for a name that reflects the intention, ie. John Smith in trust for the late Jane Smith.

Insurance bonds

An insurance bond is a type of life insurance policy, with a range of investment options. It may be withdrawn in part or full at any time, although there may be tax implications. It can be established in the child's name for those aged 10 to 16 with parental consent. Anyone over 16 can invest without consent.

For children under 16, insurance bonds generally also offer a 'child advancement option', where a parent or grandparent invests on behalf of the child, with ownership passing at a nominated 'vesting' age. This might tie in with making funds available for education, home deposit or travel and so on.

Superannuation

Although it may seem odd for an under 18 more into skateboards, it's never too early to think about super.

Children can become members of a super fund, if the rules of the fund allow this. Generally, a parent or guardian needs to sign the application form and there are additional considerations if the child will be a member of a self-managed super fund (SMSF).

Because of its concessional tax treatment, super is a popular savings vehicle. However, depending on your purpose for setting up the investment, it may not be right for your child as they may not be able to access their funds until their own grandchildren have skateboards.

Social security

Where a parent or other adult holds investments on behalf of a child, Centrelink typically treats these as protective trusts. As a result, assets will most likely be attributed to the adults, up until they transfer to the child.

It's important to evaluate the pros and cons to get a suitable approach for your family. These can be complex, so you may wish to speak to your adviser.

Source: AMP

To find out more about investing and how we can help, please contact Shaun or Vicky a call at Evans Edwards Financial Advisors | Wealth Creators on **4927 4588**.

We will guide you with a tailored approach that works for your circumstances. Give us a call on 4927 4588 (Rockhampton) or 4939 1766 (Yeppoon) to see how we can help.

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