Investing for Children (Minors)

Entrust

Parents and grandparents commonly wish to invest for their children or grandchildren while they are still minors. However, minor children usually cannot buy shares in their own name. Structuring such investments can have access and tax consequences so determining the ownership and investment setup is considered important to the long-term success of the strategy.

Initial Considerations

Cash-based accounts (such as bank accounts or term deposits) can be viewed as the simplest way of creating a secure and low-cost investment for children. The main disadvantage of cash accounts is they provide very little capital growth or hedge against inflation.

For those wishing to implement a cash-based account, or focus on gaining share or managed fund exposure, there are a number of factors to consider when deciding on an appropriate way to invest. This includes:

- The purpose of the investment
- The level of risk
- The desired level of control or protection
- The taxation of ongoing income and any future capital gains issues

Tax Rates for Minors

Minors who receive 'unearned' income, which is generally passively derived investment income, are subject to penalty tax rates. This is summarised below.

Unearned Income (per annum)	Tax Payable (excl. Medicare Levy)
$0 - $416	Nil*
$417 - $1,307	66% on the income exceeding $416
Over $1,307	45% on the entire unearned income

*A tax return should be lodged for a minor once income (excluding salary) exceeds $416 for the financial year.

There are a variety of exceptions for minors where these penalty tax rates will not apply. Examples include; minors who suffer from certain disabilities, those that receive income via employment or business income from their own exertion or investment income as part of a deceased estate.

Who's responsible for the tax?

Where an investment portfolio is established outside of the above exceptions, the tax applicable will depend on who is seen as having control of the asset. The ATO will generally apply the following principles:

1. Where the money is received as a gift or earned by the child and subsequently invested, the income and capital gains will be assessable to the child.
2. Where the money is provided by another person who retains control over the operation of the investment (e.g. the grandparent), then the other person should declare the income and capital gains in their tax return.
3. If an investment is held by an adult for a child under an informal trust arrangement, the child is required to declare any income and capital gains from the investment.

Informal Trust Arrangement

Where the investment portfolio is being held as an informal trust, the account operator will allow for a designation to be added to the account name to indicate that the investment is being held by the adult in trust for the minor. The trustee is the legal owner but is merely holding the asset 'on trust'. Either the child or trustee can quote their Tax File Number (TFN) against the investment/s.

Generally, a capital gains tax event occurs where there is a change in beneficial ownership. Although the income and capital gains of the investment is taxable to the child at higher (penalty) rates, where the investment is truly held under an informal trust, the benefit is that the asset can be received by the child in the future (e.g. age 18) without triggering a capital gain.

Alternative Investments

Insurance Bonds

An insurance bond is a long-term investment offered by insurance companies and friendly societies where investors' money is pooled and invested according to the investment option chosen. Investment earnings are taxed in the bond up to a maximum of 30% (i.e. avoiding the minor penalty tax rates). There are tax advantages for higher income earners if the investment is held for at least 10 years and certain conditions are met.

Superannuation

Super is a popular long-term savings vehicle. Although it's never too early to think about super, it may not always be an appropriate investment vehicle in which to save for certain purposes (e.g. funding education costs). Capital cannot be accessed until a condition of release is met under super rules.