

Smart Money

Saving for kids isn't child's play

The generous tax breaks of yesteryear have been cut back, so parents with plans for the children have to think outside the box.

Debra Cleveland

Parents wanting to put away sizeable amounts for their children are going to need good hiding places – not under the mattress but in the mortgage, for example, or even in the grandparents' superannuation accounts.

Previously pretty large sums could be amassed in children's names – as much as \$66,000 each, thanks to a tax break which meant they could get investment earnings or savings income of up to \$3333 tax-free each year. The \$66,000 was based on earnings of 5 per cent, or \$3300.

But on July 1 last year, the rules changed. Now the low-income tax offset on "unearned income" – passive income from savings or investments rather than wages earned via part-time jobs – can no longer be used by minors.

That means kids can get only \$416 a year tax-free, which equates to a comparatively meagre \$8000 being held in their name.

Other than putting kids'

investments in the name of a lower-earning spouse, there are numerous alternatives, say advisers, but you'll have to think outside the box.

Rather than having dedicated accounts for each child, Multiforte Financial Services director Kate McCallum suggests getting back to basics by remembering that based on a 6.5 per cent home loan rate, putting money into the mortgage is equivalent to getting a 12 per cent pretax return for top-rate taxpayers or 10.5 per cent for those paying 38.5 per cent tax.

This is because you're not only saving yourself from paying that rate in interest but the equivalent return you'd have to get elsewhere would have to be higher to take into account tax paid on that investment.

The calculation to get the "grossed-up" amount is your mortgage interest rate divided by (100 minus your tax rate), multiplied by 100.

"What you could consider if you want to save for your child is instead of setting up a bank account and tax eating away some of the earnings, keep a paper trail of what's gone into the mortgage on behalf of the child and track the interest it earns," says Louise Biti, director of industry adviser Strategy Steps.

When access to the money is needed, it could simply be redrawn



Get back to basics by putting money into the mortgage.

Kate McCallum, Multiforte

from the home loan, with interest savings helping the family as a whole along the way.

Another suggestion from Biti involves the grandparents. If they're over 60 and still able to make super contributions, one idea would be to hand over children's savings to be put into their super accounts and left there to accumulate at 15 per cent tax on earnings. When you – or your offspring – are ready to take the money back, it can be done tax-free.

But while this may sound simple, dealing with family and money can be fraught. There could also be estate planning issues if grandparents die while the money is still in their super funds, although Biti says this could be overcome with a binding death benefit nomination. You'd also need to be mindful of the impact of this sort of arrangement on Centrelink benefits.

Being aware of the new rules around kids' unearned income is really important as, like any other tax breaches, the penalties are not paltry. Anything above \$416 and up to \$1308 in a year will be taxed at 66 per cent, with the rest being taxed at 45 per cent (not including the 1.5 per cent Medicare levy).

As Biti explains, the 66 per cent tax is arrived at because as soon as earnings go over \$416, tax of 45 per cent is applied on the whole amount,

not just the excess. The bottom line is how much you've already invested – or want to amass – for your offspring. Use the \$8000 figure as a ballpark estimate but remember you'll need to adjust it depending on likely earnings.

As an example, if you've got \$8000 sitting in a UBank USaver account in your child's name earning 6.11 per cent, that's \$488.80 in interest and you'll lose about \$48 in tax.

If you have a similar amount invested in an equities-based managed fund, the earnings may be lower due to current market conditions, although fine-tuning this year might be irritating and costly.

If you're saving for the longer term and you've got 10 years, both McCallum and Biti point to insurance bonds because tax at 30 per cent is paid internally. Biti refers to a suggestion contained in the budget a few years ago to make half the interest or income earned on the first \$1000 tax free.

"If it does get through it won't start until 2013 but that might help investing in kids' names," she says.

According to industry group Taxpayers Australia, income earned by minors that can still make use of the low-income tax offset includes income from deceased estates as well as income from testamentary trusts.