



Budget



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# Booster

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## ARE YOUR YOUNGER INVESTORS ABOUT TO GET AN UNEXPECTED TAX BILL?

Recent tax changes for most children means anybody investing for their children or grandchildren may need to consider new strategies.

Until recently, a minor (child aged less than 18 years) could earn investment income of \$3,333 a year tax-free which was equivalent to about \$55,500 invested earning 6%pa. But from 1 July 2011, this tax free threshold has reduced to \$416 as minors will no longer be eligible to claim the Low Income Tax Offset (LITO) which had helped reduce tax by up to \$1,500 per annum. This represents a large reduction in funds that can be invested in the name of children from \$55,500 to around \$7,000 at an annual earning rate of 6%.

Generally, all investment income is taxable – such as dividends, bank interest, managed fund and discretionary trust distributions. Exceeding the tax free threshold may result in a high tax rate being applied. Tax rates for a resident minor are:

Taxable Income	Tax Rates
Up to \$416	Nil
\$417 - \$1,307	66% on the excess over \$416
Over \$1,307	Flat rate of 45% on the total amount

Children who were previously receiving \$3,333 tax free, will now pay tax of \$1,500 on this same amount – a substantial cost and therefore a real reduction in net after tax income.

Some exceptions to these tax rules do apply:

- Employment income
- Investment income of minors who are orphans or disabled
- Investment income received as a result of an inheritance

Many parents and grandparents may consider investing in their own name, rather than the child's. Although the LITO changes for minors do not impact on the parents or grandparents, they may be unaware of the impact additional taxable income could have on their own position – such as higher personal tax, reduced Family Tax Benefits or the loss of a Commonwealth Seniors Health Card.

Action may need to be taken quickly before the \$416 tax free threshold of a child is reached.

One investment solution is to consider an investment bond. Ongoing investment earnings from an investment bond are not counted as taxable income of the investor. Instead, they are counted as taxable income of the investment bond provider. This means that the investor does not need to worry about declaring ongoing investment earnings in their annual tax return.

Investment earnings within a bond are based on its underlying asset allocation – an extensive portfolio choice is available. The returns vary considerably and are usually quoted after considering the impact of all bond costs and tax.

Bonds that are held for 10 years or longer do not attract any personal tax on withdrawal – if withdrawn prior to this period, concessional tax rules generally apply:

Year of Investment	Amount Declared for Tax
Years 1 – 8	All investment earnings taxed at marginal rates less 30% tax offset
Year 9	2/3 rd of investment earnings taxed at marginal rates less 30% tax offset
Year 10	1/3 rd of investment earnings taxed at marginal rates less 30% tax offset
Year 11 onwards	Nil to be declared

Investment bonds are ideally suited for investors who wish to invest for a child or grandchild's future. Child advancement policies provide for an investment bond to be transferred to a child when they reach a specified age chosen by the investor. There are no personal tax consequences to either the investor or the child when this transfer occurs.

A great and simple solution – no taxable income or tax reporting for parents and grandparents, or for the child.

For more information on how this type of investment could suit your personal circumstances please contact your PIS financial adviser.

Source | LifePlan

Your local adviser office is located at:

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