`How to avoid paying 66% tax on your Child's bank interest!

Any parent or grandparent would be horrified to find that the interest earned by their under 18 year old child or grandchild, could be taxed at 66%.

It doesn't stop at interest, but also includes dividends and trust distributions. With the December 2011 quarter trust distributions and the typical 6 monthly dividend due to be paid very soon, it's time to review your child's income for this financial year now.

So what are the income limits, what is the level of income that is tax free, what tax is payable, is it really income that belongs to my child and should it be declared in their name?

And finally, understand what you need to do to avoid 66% tax.

Income limits

In the last financial year, ending 30th June 2011, children could earn up to $3,333 in unearned income before they were liable to pay tax, after taking into account the low income tax offset

Unearned income includes distributions from trusts, dividends, interest, rent, royalties and other income from property.

But in this current financial year 2011/12 which ends 30th June 2012, minors (children under 18 years of age) can no longer access the low income tax offset to reduce tax payable on their unearned income.

Which means that the income limit on unearned income before tax is imposed is only $416.

If you start doing the maths and work out that a Term Deposit at 5% only needs a balance of $8,400 before this occurs, and applies to any child under 18, then the tax at 66% is a reality.

The tax rates applicable to minors

Unearned income	Tax rates
$0 - $416	Nil
$417 - $1,307	Nil + 66% of the excess over $416
Over $1,307	45% of the total amount of income that is not excepted income

Income Exceptions

There are some, income earned by minors from the investment of any property transferred to them as a result of compensation payments, inheritances or marriage breakdown will also not be affected by this change in tax legislation. These types of incomes are known as ‘excepted income’ and also include

- employment income
- taxable pensions or payments from Centrelink or the Department of Veterans' Affairs
- compensation, superannuation or pension fund benefits
- breakdown, or income in the form of damages for an injury they suffer
- income from their own business
- income from a partnership in which they were an active partner
- net capital gains from the disposal of any property or investments listed above, and
- income from the investment of any of the amounts listed above.

Plus minors will still be able to use the low income tax offset to reduce tax payable on their earned income such as salary and wages.

So who should be declaring the income, the parent or the child?

It depends on who owns or uses the funds of that account (no matter what type of account it is or the name of the account holder).

The parent owns the money if they provided the money and they spend it as they like, regardless that the parent spends the money upon resources for the child. The parent includes the interest in their income tax return.

When an account is held in trust for the child by the parent and the parent controls the income and expenditure in the account, interest earned in that account is included in the parent's income tax return.

Common situations

Note: In all situations other than those outlined below, who owns the money depends on the facts of each case.

In general, if...	then...
a person, other than the account holder (child): has provided the funds for the child's account, <u>and</u> spends or uses the funds in the account as if they belonged to that person	that person needs to declare the interest from that account in their own tax return.

Example 1

Wayne opens an account for his son by depositing $5,000. Wayne is signatory to the account because Jack is two years old.

Wayne makes regular deposits and withdrawals to pay for Jack's pre-school expenses.

Interest earned from that account is considered to be Wayne's.

In general, if...	then...
the funds in the account are made up of money received as birthday or Christmas presents, pocket-money, or savings from part-time earnings such as newspaper rounds, and these funds are not used by any person other than the child	the interest earned is the child's income.

Example 2

Shauna is aged 8 and has a savings account in her name.

Shauna's mother Jill is signatory to the account.

The funds (totalling $90) are birthday and Christmas presents from Shauna's relatives.

Interest earned from the account is considered to be Shauna's.

Who declares the dividends?

Whoever rightfully owns and controls the shares declares the dividends or the net capital loss from the sale of shares.

See Common situations

Situation 1

If...	**and…**	**then...**
the money to buy the shares was provided by a person other than the child	that person makes all decisions about those shares, and that person spends or uses the dividend from those shares as if it was their own	that person is the owner of the shares and declares the dividend income and all capital gains and losses from the sale of those shares.

Example 1

Peter withdraws $3,000 from his own bank account to buy shares in the name of his daughter Georgia.
He deposits the dividend of $200 into his own bank account and uses it for his own personal expenses.
Peter must declare the $200 on his tax return. When he sells the shares, he will also need to declare any capital gain or loss.

Situation 2

If...	**and…**	**then...**
the money to buy the shares was provided by a person other than the child	that person makes all decisions about those shares on behalf of the child, and all the dividends and the shares are held for the child	the child is the owner of the shares and declares the dividend income and all capital gains and losses from the sale of those shares.

Example 2

Simon withdraws $5,000 from his bank account to buy shares in the name of his son Jordan.
Simon makes all the decisions about those shares as Jordan is only three years old.
All dividend income and any profit from the sale of those shares are deposited into a bank account in Jordan's name with Simon as trustee.
The dividends and capital gains must be declared on Jordan's tax return.

Situation 3

If...	and…	then...
the money to buy the shares was given to the child (for example, on birthdays or at Christmas) or earned by the child	the investment decisions are made by another person on behalf of the child, and the dividends or funds are held for the child	the child is the owner of the shares and declares the dividend income and all capital gains and losses from the sale of those shares.

Example 3

Jenny buys shares on behalf of her daughter, Talia, with money saved from Talia's part-time job, plus money received for Talia's birthday.
Dividends of $300 are deposited in Talia's bank account.
Talia must declare the $300. When those shares are sold, any capital gain or loss from the sale will belong to Talia.

So what do you need to do?

I'm certainly not going to suggest you definitely need to close the child's bank account, and sell those shares or units in the managed trust that maybe held in trust for them.

Just simply, you need to consult with your tax advisor to run through your particular circumstances and take action to minimse or avoid the excess tax completely mindful of the other implicationsTax liabilities can be considered, as well as capital gains tax liability if shares or units will be sold.

The above information requires serious consideration, so that you can avoid tax at 66% being imposed on your child's income. Please don't wait until after the 30th June 2012, as it could be too late.

The team at Marsdens are happy to assist you with your enquiries concerning the above, please call us on 9382 3244.

David Lennon – Marsdens