

# Is there a tax effective option for saving for my child's education?

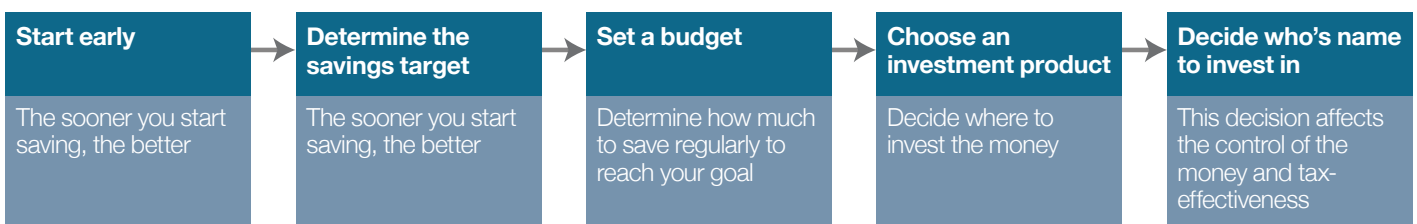


*The rising cost of education means that educating your children is increasingly becoming a major expense. The sooner you start saving for your children's future, the better.*

*In 2012 it was estimated to cost a typical middle income family \$812,000 to raise two children from birth until they leave home (AMP/NATSEM report on the cost of kids ). This was up from \$537,000 only five years earlier.*

Education costs are a large contributor to this increase. Over the five-year period preschool and primary education costs have almost doubled while secondary education costs have more than doubled. Higher income families are spending as much as a quarter of their family budget on schooling. So preparing and saving ahead for this expense has become a priority.

A five-step guide to start a savings plan for a child's education is illustrated below:



The challenge, however, is to find an investment that is both tax-effective and yet flexible enough to meet your children's future education needs.

For investors seeking the most tax effective long-term investment vehicles there are a few choices. Some may turn to managed funds - which can be a good asset for long-term investing but does have some drawbacks. The tax incurred on managed funds will be at the investor's marginal rate. This can be a problem especially if the parents are on high marginal tax rates, as higher tax will result in lower investment earnings.

What if there was an alternative investment vehicle with less of these limitations? What if that investment structure provided the additional investment flexibility with the potential to also reduce the tax liability of the investor over the long-term (10 years or more)?



## Introducing Investment Bonds.

For high-income earners, investment bonds are a tax effective alternative investment vehicle to save for their children's education. If funds can remain invested for at least 10 years, then personal tax obligations are permanently removed after year 10. Bonds can thus provide a significant tax saving, especially if the investor is paying personal tax at the highest marginal rate.

### How are investment bonds taxed?

The investment bond is an ideal tax-effective way to save for future education needs. The bond can be held in the name of a parent, grandparent or child, without impacting that person's personal tax, provided the money remains invested in the bond for at least 10 years. Earlier withdrawals may see all or some of the growth withdrawn taxed at marginal tax rates.

Tax is paid within the bond to create a simple option that caps the maximum tax rate at 30%. After allowing for dividend imputation credits and other tax deductions, the effective rate may be much lower. In contrast, the top marginal rate on personal taxes, inclusive of the Medicare levy, is 47%.

The differences between managed funds and investment bonds are outlined in the example below. Consider the following:

#### Example

Anthony and Kate have become parents for the first time and would like to start a savings plan for their daughter so that they can afford to choose the best high school for her. They would like to have \$80,000 saved in 10 years' time. Both parents are on the highest marginal tax rate.

They start a savings plan and determine that they can afford to invest \$450 a month into the savings plan. They compare investing in an Investment Bond and a managed fund (where they pay tax on earnings at their marginal tax rate). They expect to earn 8% after fees on both investments. The graph below compares the expected results.



**Note:** The temporary budget repair levy impact has been ignored and may reduce the estimated balance of the managed fund.

Investing in a managed fund, which is taxed at their marginal tax rate, falls short of their investment target due to the higher tax paid compared to the investment bond (assuming the same returns).

If they chose to save using the managed fund they would need to make higher monthly contributions to address the expected shortfall in their savings target.

### Advantages of investing in an investment bond structure

While the investment bond offers a tax advantage alternative to managed funds, it also offers many more key benefits that make it a viable option to fund for children's education. Here are our top 7.

**Affordable** – it is easy to make small regular contributions. Bonds can start with \$500 and a regular savings plan can add as little as \$100 per month.

**Investment choice** - offers a choice of diversified investment options as well as an Australian shares option to provide the potential for capital growth over the long term.

**Flexibility** – if the money is not used for education it can be used for any other purpose with no loss of earnings accrued.

**Transfer** – a Bond can be transferred to a child at their “vesting age” without triggering capital gains tax.

**Tax-effective** – tax is paid within the Bond, so tax is capped at a maximum of 30% and does not affect the owner's taxable income.

**Estate planning** – if the Child Advancement Option is selected the money is always held for the child and will not form part of the owner's estate.

**Simplicity** – it is easy to set up a Bond and a regular savings plan without worrying about taxation each year.

**Note:** There are some ownership issues that need to be taken into account when using an investment bond to fund education needs:

- A child age 10 or older can be the owner of a bond but they will gain full control to decide how to spend the money once they reach age 16.
- The preferred option may be to hold the investment bond in the name of a parent or grandparent. This avoids penalty tax rates for children under age 18 (if they make withdrawals in the first 10 years) and the adult stays in control. This also allows a Bond to start for a child younger than age 10.
- There is generally a Child Advancement Option, and if selected, ownership can transfer to the child without triggering capital gains tax, at a nominated “vesting age” between 10 and 25. If the money is not fully used for education, the child can use the balance to help pay expenses such as a wedding, home deposit or holiday - or even to start saving for their own children.

<sup>1</sup> Assuming the 125% rule on deposits is not broken and withdrawals are not made within the first 10 years.

<sup>2</sup> Retirees need to consider the impact on age pension entitlements.

## Conclusion

If your clients are looking for tax effective investment alternatives to fund their children's education, then investment bonds provide a range of advantages to investors seeking more flexibility and diversification.

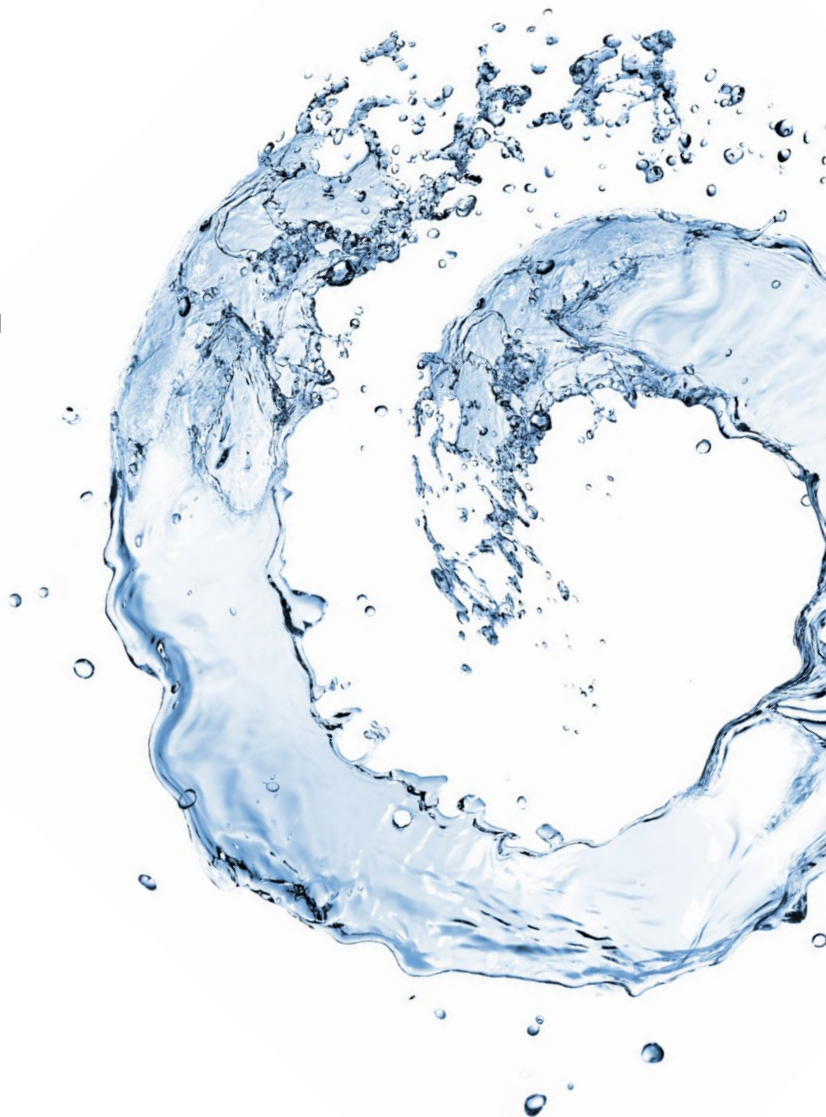
When compared to managed funds, investment bonds are a highly attractive savings vehicle for long-term education purposes, particularly for those on a higher marginal tax rate.

A Centuria Investment Bond provides flexibility, certainty and tax effectiveness which can be particularly useful for long-term investment such as for children's education costs.

Centuria Capital is an ASX-listed diversified funds manager with \$2 billion in funds under management. Our businesses offer something refreshingly different to our direct clients, and to financial advisers and their clients: we manage investments personally. That means your investment is constantly under the control of an expert with in-depth market knowledge, commercial acumen and an unerring sense of what matters to you.

For more information about achieving flexibility with investment bonds, contact Centuria on 1300 50 50 50

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