How Children's Bank Accounts Are Taxed

Many parents (including business owners) open saving accounts with banks soon after their child is born so they can deposit money and teach their child about money and saving.

This has been a popular strategy in recent years as the interest is usually tax free to the child due to the low income tax offset.

This article examines the tax implications of this strategy in light of the recent budget announcement and the ATO views on whether the child or the parent should be declaring the interest as well as PAYG withholding implications.

BUDGET ANNOUNCEMENT

As announced in the May Federal Budget, minors (i.e. children under the age of 18 on 30 June) will no longer be able to access the low income tax offset ($1,500 for the 2010/11 year) to reduce tax payable on their "unearned income", such as dividends, interest, rent and royalties. This change applies from 1 July 2011 and is intended to discourage income splitting between adults and children.

It is likely that the previous tax free threshold of $416 for unearned income of minors will be reinstated thereby significantly reducing this form of income splitting.

WHO DECLARES THE INTEREST?

According to the ATO, the person who declares the interest depends on who owns or uses the funds of the account (no matter what type of account it is or the name of the account holder).

The parent is considered to own 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:

In general, if...	**then...**
The parent: has provided the funds for the child's account, and spends or uses the funds in the account as if they belonged to that person	The parent needs to declare the interest from that account in their own tax return.

Example 1

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

Steven makes regular deposits and withdrawals to pay for Joshua's pre-school expenses. Interest earned from the account is considered to be Steven's.

In general, if...	**then...**

the funds in the account are made up of money received from 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.

If the amount deposited to the account is considered excessive, further examination is needed to decide where the money came from and who the money really belongs to.

Example 2

Eugene is aged 8 and has a savings account in his name. Eugene's mother Jill is signatory to the account.

The funds in the account totalling $500 are birthday and Christmas presents from Eugene's relatives. Interest earned from the account is considered to be Eugene's.

However if Jill uses the funds to pay for Eugene's school fees and living costs, interest on the account is considered to be Jill's.

PAYG WITHHOLDING

A child can obtain a tax file number (TFN) at any age (there is no minimum age). Children are not exempt from quoting a TFN.

When a child's account is opened, the bank usually requests the birth certificate of the child. In this regard, the child is entitled to a threshold of $420 per income year on interest before any pay as you go (PAYG) withholding is deducted.

Where the **total interest** earned during an income year is **$420 or more** and the child:

quotes a TFN, the investment body **will not** withhold PAYG tax

does not quote a TFN, the investment body **will** withhold PAYG tax at the rate of 46.5%.

This applies to the total interest earned (not just the amount above $420, or the payment period threshold equivalent).

If the child has had PAYG tax deducted from the account, a tax return will need to be lodged for the child to claim these amounts back from the ATO. A TFN will therefore need to be obtained for the child first.