

Introduction

A Children’s Education bond is a tax advantageous way to fund a child’s education. The bond is segregated to a capital and earnings component, where the earnings are taxed at 30%. Any withdrawals related to a child’s education related expenses is offset tax payable from the funds earnings. It also has advantages for estate planning and asset protection purposes.

Financial Snapshot

Gerrard (60) is a semi-retired Director of a Mining Consultancy. His daughter Tilly has recently married Tom and they are expecting their first child. Gerrard wishes to help provide his grandchildren the best possible start in life by funding their education. He is also conscious of protecting his assets and any monies from the risk of being maritalised if Tom and Tilly were to separate.

Income	Expenses	Assets
Gerrard: \$350,000	Income Tax: \$191,738	Cash Savings: \$250,000
Investment Property Rental Income: \$50,000	General Living Expenses: \$120,000	Share Portfolio: \$2,500,000
Dividends: \$80,000		Investment Property: \$1,500,000
	Surplus Cashflow: \$168,000	SMSF: \$1,900,000

Understanding Gerrard’s Needs

The need for an education bond pertained to a small aspect of Gerrard’s overall investment needs. The premise of establishing this bond was a consideration to help his grandchildren get the best possible education while potentially alleviating any stress on Tom and Tilly’s cash flow. Should more grandchildren enter into the equation they can be added to the existing bond.

Strategy Consideration: The Details Behind Investment Bonds

Earnings are taxed at a rate of 30% and can be invested according to an agreed asset allocation.

- ◆ You cannot exceed 125% of the previous year's contribution, otherwise the start date of the bond will ‘re-set’, i.e.
- ◆ Year 1 contributions = \$10,000 while Year 2 contributions = \$12,500.
- ◆ The bond can be held for up to 99 years.
- ◆ There are penalties for early withdrawals and the earnings will be subject to your personal tax return.
- ◆ After a 10-year period the investor is able to withdraw the funds tax free and not be subject to any Capital Gains Tax.

Education Tax Benefit

The education bond is designed to be a ‘scholarship plan’ as described in the income tax assesment act 1997. A Scholarship plan means a life insurance policy that:

- (a) is issued by a friendly society for the sole purpose of providing benefits to help in the education of nominated beneficiaries ...

Financial Objectives

- ◆ To fund Tom and Tilly’s children’s education, where the cost of a private high school is \$25,000/a. The cost for school fees are also indexed at a rate of 9%.
- ◆ In the event of Gerrards passing, for the bond to continue to be administered by Tilly and she would take control of the asset to fund her children’s education.

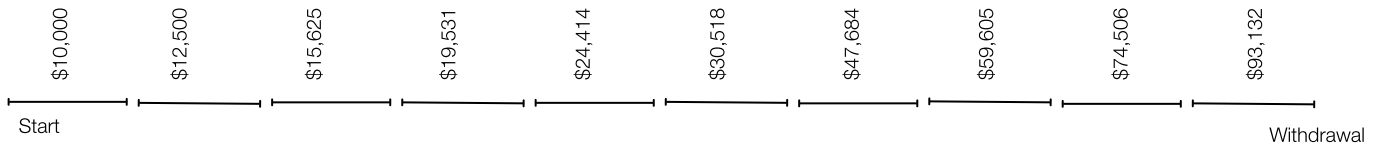
Considerations with Education Bonds

Upon reviewing their financial needs Gerrard through the following steps with their advisor and implemented the strategy recommendations in the form of a Statement of Advice. The reason why an investment bond was selected as it was an ancillary product to establishing other entities such as a Company and/or Family Trust.



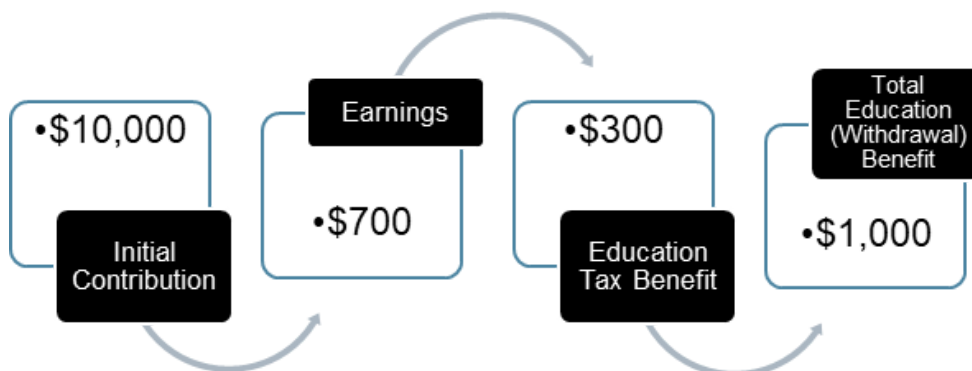
The 125% Rule Explained

The time line below displays how a bond holder can make contributions equal to 125% of the previous years contribution.



Understanding The Tax Benefit Upon Withdrawing an Education Related Expense

The capital component of the bond can be redeemed at any point in time. The earnings component is taxed at 30%, for any educational related expenses the tax on earnings is apportioned and rebated to the expense claimed as portrayed in the diagram below.



Children’s Education Bond E-Book

We also have an e-book with more details and an expanded version of how children’s education bonds work. This e-book goes into depth about the cost of a child’s education and how the rate of tuition fees are contributing to the added stress of a household. You can access this here -

Outcomes:

- Assuming that Gerrard started with an initial contribution of \$10,000 and followed the 125% rule; at an after tax return of 6% he would be able to make a withdrawal of the bond for \$512,803.
- This sum would have been received tax free and not be reportable on his tax return.
- The funds available can be withdrawn from the capital component at any point in time for education related expenses.
- Should Gerrard pass away - these funds could be passed on to a grandchild, or Tilly could have a Powers of Attorney or Guardian function over the bond.
- As it is a separate entity and insurance product, assets held inside the bond are precluded from maritimization should Tilly and Tom part ways.
- Should Gerrard also pass away, the bond would receive testamentary status, and any withdrawals from the taxable component would be taxed to a minor at adult tax rates (up to \$18,200 of income received tax free).

Further Considerations

As part of the advice provide to Gerrard, he also considered the other areas of financial advice which were:

- Children's Education Bonds e-book
- Insurance Bonds

Learning More

Want to talk about your personal situation with one of our advisors?

Call, email or visit our website using the details below for a **free no-obligation 30-min catch-up** with one of our experts.

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