GRAYISSUE

Your minor children and the taxman

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Investing on behalf of under 18s
Investing on behalf of your children is a generous act of foresight and, if you can afford to do it, opens up future opportunities for them. Unit trusts are a common choice for many parents due to their flexibility and the easy access to the invested money. But what does the fine print say about tax and ownership rights?

If you donate money to your children or transfer an investment to them, the income is taxed in your hands while your child is a minor. This also applies to income received by minor stepchildren and adopted children. It is not the donated amount itself that must be included in your income (e.g. the value of the unit trusts), but the income resulting from the donation (e.g. dividends and interest generated). If you later sell the unit trusts at a capital gain, this amount must also be included in your capital gains tax calculation.

In addition, you will be liable for donations tax at a rate of 20% of the donated amount which must be paid within three months of making the donation. There is an annual donations tax exemption of R100 000. This exemption is per person per year and not per donation.

To summarise – if you invest some of your own money in your minor children's names you must include the income and capital gains from their investments in your own tax return.

Donation from a person other than a parent
The tax situation is different for minors when it comes to donations from people other than their parents. Minors are liable for tax on the income generated from money they inherit or receive as a gift from anyone other than their parents (for example, a grandparent). This means that the minor (and not the donor) will be liable for any tax on interest, dividends and capital gains.

If your minor children's taxable income is sufficient to make them liable for tax, you must register them for income tax and submit a return on their behalf. In the 2015 year of assessment, a return is not required if the minor does not have any tax deductions to claim and their gross income consists solely of South African sourced interest income not exceeding R23 800.

Who is liable for the withholding tax on interest and dividends?
Interest withholding tax and dividend withholding tax are paid to the South African Revenue Service by the company paying the interest/dividends or by a regulated intermediary, and not by the person liable for the tax, i.e. the investor. Even if a minor is not registered as a taxpayer and does not have an income tax number, they may still be liable for withholding tax on interest and dividends, and this will be deducted from the interest and dividends before it is paid out to the child (where applicable).

Things change when your child turns 18
When a minor turns 18, they become an adult in the eyes of South African law and the legal owner of their investments. Many parents are not aware that this means that they will lose transactional rights to their child's investment. This is an important aspect to take into account in your planning.

If you want to retain your rights to an investment you have made in your child's name, you need to act before their 18th birthday. Depending on the type of investment you have made, you can usually choose to either transfer the investment into an investment account in your name, or make a full withdrawal. These transactions may result in a capital gains tax event.

If you do not withdraw the investment before your child turns 18, and your child would like you to continue to manage their investment, he or she will have to give written authorisation to the investment manager, giving you permission to access their investment and act on their behalf. If the child is happy to manage the investments, they need not do anything (other than provide the investment manager with any required documents).

When your child turns 18, you will no longer be liable for the income and capital gains earned from investments you have made on their behalf. The child will be required to complete their own tax return.

Tax on other investment products
Investors cannot, except in exceptional circumstances, make a withdrawal from a retirement annuity (RA) before retirement. Minors invested in an RA will only be able to access their investment when they eventually retire, at which point they will be allowed to withdraw one-third in cash, a portion of which is tax free. The rest of their investment must be transferred into a living annuity and income withdrawals will be taxed according to the tax tables at the time. No tax is payable on the investment returns realised in a living annuity, regardless of whether they consist of interest or dividends.

Minors who inherit a living annuity have the option of taking the full value as cash or as an annuity. They will be taxed according to the tax tables. Endowments are taxed within the product, with no special allowance for minor children.

The newly launched tax-free investment products allow individuals to earn tax-free returns on investments of R30 000 per year (R500 000 over a lifetime). You can invest in this product in your children's names and they will not be liable for capital gains tax when they eventually withdraw. The amount you invest on behalf of your children will however reduce their own life-time contribution limit.

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