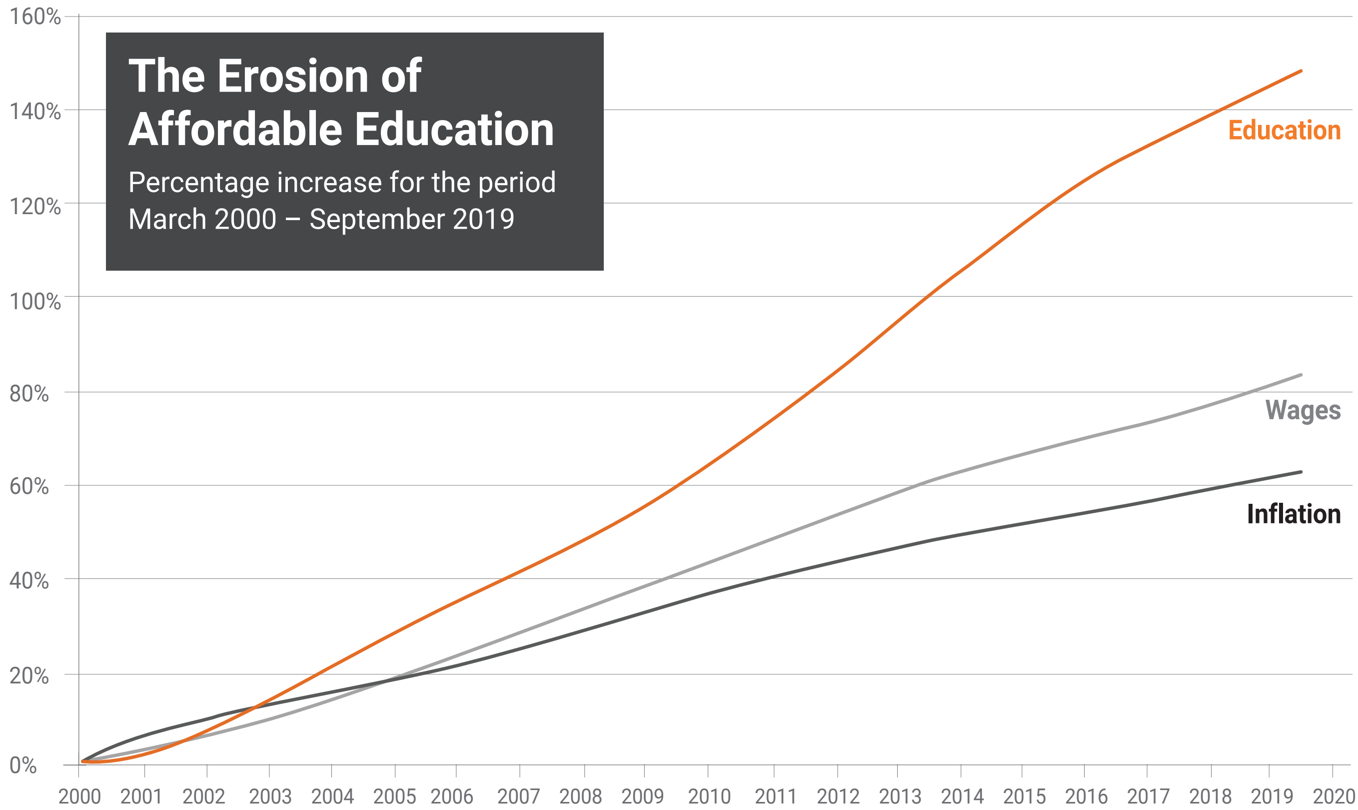
Strategy paper

180 YEARS | Australian Unity | Real Wellbeing

# Education Funding

**With education costs outpacing wage increases in Australia, parents need to be confident they are making the right choice when it comes to planning for their children's future needs.**

Year in, year out, education costs continue to outstrip the pace of inflation, and the past 10 years has been no exception. While inflation, as measured by the CPI, clocked in at 21 percent, education costs clocked in at 57 percent#. Parents also want choice, flexibility, and an assurance they won't be locked into a pre-determined future when looking at options for saving for their children's education. However, not all options offer these benefits. When it comes to education planning, it is essential to understand what funding choices are available.




Source: abs.gov.au September 2019

## Let's look at some of the most common solutions:

- The simplest and most tax effective strategy is repayment of non-deductible debt, generally the home mortgage, so that this money can be redrawn for education expenses later. However this strategy requires extreme discipline and runs the risk of the funds being withdrawn to pay for lifestyle assets such as cars, renovations and holidays.
- Direct investment in the name of the child, but this also has its limitations. In most cases, the tax free threshold for children's income is just $416* per year, and they are hit with a penalty tax of up to 66 percent* on earnings once that threshold has been breached.
- A trust structure may also be considered as a funding mechanism for education costs, with the most common type of trust being discretionary family trusts. A family trust is a vehicle to accumulate investments with the earnings or profits distributed in the most tax-effective way. However this may still fall under the confines of the minor's penalty tax of 66 percent*.
- Superannuation funds may even be considered as a solution, as long as the investor has reached preservation age and has satisfied conditions of release. This window of opportunity will really only be of benefit to a very limited number of parents or grandparents. The other concern with using a superannuation based funding strategy is the regular changes made to superannuation legislation, creating a scenario of what works this year may not the following year.

## An alternative solution

Education funds that are classified as Scholarship Plans under Australian tax law have unique tax features not available with other savings and investment products. These funds are based upon an investment bond structure and can be used for a broad range of educational related expenditure at any age or level of education.

With a contemporary education fund it is possible to claim on a range of expenses such as uniforms, books, materials, private tuition, student fees, residential boarding costs, excursions and accommodation expenses.

The investment income of an education fund is taxed up to a maximum rate of 30 percent*. While the earnings accrue within the fund there is no assessable income to declare for either the investor or student. Only when funds are withdrawn will it affect assessable income and may be taxed – and even then the tax may be minimised or even not incurred at all. When a claim is made for education expenses from investment earnings, the education fund can obtain a refund of tax on the education expenses being claimed. This produces an education tax benefit which is passed on to the nominated student as part of the education claim and can be worth an additional $30 for every $70 of earnings withdrawn.

### Case Study:

**Objectives**

- Fund future education costs for their child
- Lessen the financial burden in future years
- Tax efficient & flexible
- Capital access if required

**Background**

- Age: newborn first child

**Investment**

- $3,000 initial investment
- + $1,200 per year x 10 years
- + $15,000 per year x 10 years

**Primary Education costs**

- $2,000p.a. indexed @ 10% from age 5 to 11

**Secondary Education costs**

- $7,000 p.a. indexed @ 10% from age 12 to 17

**University Education costs**

- $15,000 p.a. from age 18 to 20

**Total Education costs**

- $117,983 projected

**Balanced Investor**

- 5% net of fees & taxes

| | Age | Initial & additional contributions | Education | Education Tax Benefit | Tax-Paid Earnings (Education) | Capital | Unfunded | Closing Balance |
|---|---|---|---|---|---|---|---|---|
| Policy commences | 0 | 3,000.00 | | | | | | 3,153.49 |
| | 1 | 1,200.00 | | | | | | 4,576.22 |
| | 2 | 1,200.00 | | | | | | 6,071.74 |
| | 3 | 1,200.00 | | | | | | 7,643.78 |
| | 4 | 1,200.00 | | | | | | 9,296.24 |
| Primary school commences | 5 | 1,200.00 | 2,000.00 | 124.8 | 291.2 | 1,584.00 | | 9,158.05 |
| | 6 | 1,200.00 | 2,200.00 | 124.8 | 291.2 | 1,784.00 | | 8,812.79 |
| | 7 | 1,200.00 | 2,420.00 | 124.8 | 291.2 | 2,004.00 | | 8,229.86 |
| | 8 | 1,200.00 | 2,662.00 | 124.8 | 291.2 | 2,246.00 | | 7,375.11 |
| | 9 | 1,200.00 | 2,928.00 | 124.8 | 291.2 | 2,512.00 | | 6,210.63 |
| | 10 | 1,200.00 | 3,221.00 | 124.8 | 291.2 | 2,805.00 | | 4,693.57 |
| | 11 | 15,000.00 | 3,543.00 | 124.8 | 291.2 | 3,127.00 | | 17,282.93 |
| Secondary school commences | 12 | 15,000.00 | 7,000.00 | 124.8 | 291.2 | 6,584.00 | | 27,059.39 |
| | 13 | 15,000.00 | 7,700.00 | 124.8 | 291.2 | 7,284.00 | | 36,636.02 |
| | 14 | 15,000.00 | 8,470.00 | 124.8 | 291.2 | 8,054.00 | | 45,932.62 |
| | 15 | 15,000.00 | 9,317.00 | 124.8 | 291.2 | 8,901.00 | | 54,857.85 |
| | 16 | 15,000.00 | 10,248.00 | 124.8 | 291.2 | 9,832.00 | | 63,308.71 |
| | 17 | 15,000.00 | 11,274.00 | 124.8 | 291.2 | 10,858.00 | | 71,165.93 |
| Tertiary study commences | 18 | 15,000.00 | 15,000.00 | 4,500.00 | 10,500.00 | | | 80,074.34 |
| | 19 | 15,000.00 | 15,000.00 | 4,500.00 | 10,500.00 | | | 89,438.53 |
| | 20 | 15,000.00 | 15,000.00 | 4,500.00 | 10,500.00 | | | 99,281.80* |

Source: LIfeplan Education Bond calculator, advisers.lifeplan.com.au
*ato.gov.au

## Case study: Outcome

The closing balance of $99,291.80 can be used for any purpose such as repaying a mortgage or a first home deposit.

| | |
|---|---|
| Total Education Cost | 117, 983.00 |
| **Funded** | 117, 983.00 |
| Education Tax Benefit | 15,122.40 |
| Tax-Paid Earnings (Education) | 35,285.60 |
| Capital | 67,575.00 |
| Investment Bond Withdrawal | |
| **Unfunded** | |
| Closing Balance | 99, 291.80* |

## How does the tax work?

**Investor**
contributions Access any time for any purpose with no tax consequences

**Investor earnings**
Taxed at the capped life insurance tax rate (up to 30%) and paid by Australian Unity

If funds are not used for education or are withdrawn by investor

Investment Bond rules apply–30% tax offset applies

**If funds in this account are used for education expenses**
Australian Unity claims back the 30% tax paid from the ATO and this becomes part of available funds to spend on education

The tax liability is passed to the student

**If Student <18 (2019-2020)**
- Student can receive $416 per financial year tax free
- Portion of withdrawals >$416 are declared accessable income

**If Student >18 (2019-2020)**
- Normal adult tax free threshold and LITO applies

Australian Unity's EasyClaim facility makes this allocation easy

Source: ato.gov.au

* Withdrawals made for other or unspecified purposes do not qualify for the Education Tax Benefit and the proceeds are assessed as investment income in your hands in accordance with normal investment bond rules. Refer to our Product Disclosure Document for further information.

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