

# INVESTING FOR CHILDREN

by Arthur Childs, Chartered Financial Planner

## Introduction




Most parents would probably agree with the idea of building up a nest egg for each of their children, and no doubt wished their own parents had done so for them. However, **it is surprising how few actually invest for their children in any methodical way.**

Consider the difficulty that most children will find in purchasing their first house when the 10% deposit is probably going to be **equivalent to their total take home pay for two years** in their first proper job; or consider the total cost of getting through university or college.

How many young people would love to start their own business if only they could find the 'stake' money to do so?

## Tax Implications

Where you invest money in the name of your child, **the resulting income may be taxed as if belonging to you.** This treatment applies where:

-  your child is a minor, and
-  your child is unmarried, and
-  the income exceeds £100 per tax year for each child.

This means that **whilst it is fine for other family members to give money to your children,** you have to be more careful with the money that you put aside for them.

A way which remains open for achieving a tax saving is for you to give capital to your child, with the money being **invested in a roll-up fund or some other investment which does not produce taxable income.**

If the roll-up fund is cashed after your child's 18th birthday, **the income will count as your child's income and not yours.** Please note that if a growth investment grows by more than the capital gains tax allowance of £9,200 (2007/2008) it will be liable to capital gains tax.

Any other income is taxed as your child's whether it is gifts from other members of the family or earnings from part-time work etc. However, **no tax is payable providing the child's income does not exceed the personal allowance of £5,225 (2007/2008).**

If there is any likelihood of tax being payable it may make sense to invest your gifts to your children separately from other gifts and to keep a record of gifts made.

Giving lump sums to your children during your lifetime is also **a good way of saving inheritance tax** rather than passing everything to them in your will.

Where relatively large gifts are to be made for the benefit of a child you should **consider putting them under trust.** See the heading below 'Setting up a Trust'.

## Types of Investment Available

There are a number of investments that can be used for children. Most parents look for **a savings vehicle that is capable of receiving regular amounts from themselves and lump sums from time to time from relations** of the child such as uncles, aunts and grandparents.

Which investment is right for you will depend on **the contribution flexibility that you require** but more particularly on **the level of risk that you are happy to take** with your child's investment fund. You may find it appropriate to use more than one type of investment.

## National Savings

National Savings accounts effectively present you with **no risk to your child's money** as they are fully backed by the government. It could be argued, however, that there is a risk to the capital over the longer term because of **the detrimental effects of inflation.**

You could use **Children's Bonus Bonds.** These provide a **guaranteed tax-free return** (even if the children become tax payers) **over five years.** As this is tax-free there is, of course, no tax liability for you to worry about however much interest is received.

New fixed rates (which include the fifth year bonus) are notified **every 5th anniversary to age 21.** You can invest a minimum of £25 and then units of £25 up to a maximum of £3,000 per child for each issue.

Assuming your child is a non-taxpayer, it could also make sense to consider other National Savings investments which pay a return before tax. For example, **National Savings Capital Bonds** might provide **a higher gross guaranteed rate than Children's Bonus Bonds over five years.**

## Bank or Building Society Deposit Accounts

You could simply save money in a deposit account in your child's name, **making sure that you fill in form R85,** available from the bank or building society. This means that interest will be paid gross until your child is 16. This will be **particularly appropriate where you will only be saving over two or three years.**

Postal, telephone and internet accounts provide better returns than accounts available from the High Street branches. The returns available are similar to those from National Savings but **tend to be from variable interest rates** whereas many National Savings products use fixed rates. Which will provide a better return over the next five years will depend on the general direction of interest rates over that period.

## Unit Trusts/OEICs

The major disadvantage of National Savings and deposit accounts is that there is **no possibility of capital growth** on your child's money apart from the accumulation of the interest.

That is why many parents with very young children **prefer to invest the money where it has a chance to grow above the rate of inflation** and for this we need to use an equity based (ie stocks and shares) investment.

The **most straightforward way of investing into equities is through a unit trust** or OEIC (Open Ended investment Company) where the risk is spread over a wide range of different stocks and is actively managed by a professional fund manager.

An investment into a unit trust can be set up for monthly or one-off amounts. If money can be left undisturbed until your children are adults, such an investment could enable them to benefit from **much higher returns than are normally available from less risky savings mediums**.

There are unit trusts that are specifically marketed for children. The problem with using these products, however, is that if the particular fund you are using performs badly against its peers there is nowhere else to go without encashing the product.

**Where a monthly investment of at least £50, or a lump sum of at least £1,000 is available**, we recommend that you invest in unit trusts/OEICs through the Cofunds Fund Supermarket. In this way you obtain the ability to switch funds easily and at a very low cost if the current fund choice starts under performing.

**Where a lump sum of at least £20,000 is available**, we recommend that you invest in unit trusts/OEICs through the Nucleus Wrap.

Such investments will have to be **applied for in your name but can be identified with your child's initials** and can be placed under trust (see below).

## Multi Manager Funds

A multi manager fund is particularly suitable as an investment for children over the long term because of the **additional layer of active fund management** involved.

The benefits of using multi manager funds include the added security of **an additional layer of professional fund management**; the concentration on **good asset allocation**; the ability to **choose an overall level of risk** for the portfolio as a whole; **reduced administration**; more **straightforward income tax and capital gains tax (CGT) calculations**.

For further information see our Guide: *Multi Manager Funds*.

## Stocks and Shares ISAs

Although you have to be 18 before you can take out a Stocks and Shares ISA (16 for a Cash ISA), there is nothing to stop you **taking one out in your own name and then passing the money over to your children when they reach 18**.

You should be aware, however, that you are only allowed to have one Stocks and Shares ISA in your name in each tax year, so if you and your spouse or partner have both taken out an ISA in this tax year then you will have to wait until next year to start the investment. If only one of you has an ISA, you can take out another one now.

For further information see our Guide: *Individual Savings Accounts*.

## Friendly Society Savings Plans

If you like the idea of using some form of equity investment but are put off by the minimum levels of investment required you could use one of the Children's Bonds available from friendly societies such as **The Children's Mutual, Family Assurance and Homeowners Friendly Society**.

These tend to be 10 year plans with minimum premiums of just £10 per month. As well as investing in a typical equity fund you can also choose a lower risk With Profits Fund.

## Setting up a Trust

Especially for larger sums you should consider putting your investment for your child in a trust. Using a trust enables you to invest money for your children now, without their being able to get their hands on it for the time being.

**The simplest form of trust is a Bare Trust**. This is fine where you want to give money for a named child or children. The child becomes entitled to the money at age 18 but any tax on the investment from the moment you put it into trust is based on their tax circumstances not yours.

You would be the trustee (together with your spouse) of the trust and would control it until the child reached age 18. From the moment the trust is set up, however, the money belongs to the child and no longer to you.

Where you require the flexibility to change the beneficiaries if necessary then you would need to set up a Discretionary Trust. Whereas bare trust forms are readily available **a discretionary trust should be set up via a solicitor**.

Properly set up, **a trust can reduce your estate for inheritance tax purposes** without you losing control of the capital held in the trust.

There follows a comparison between simply designating a unit trust or OEIC as being for a child, or putting the investment under a bare trust.

	Designated Account	Bare Trust
<b>Ownership</b>	The money is controlled by you, but is designated for the child. Allows you to retain ownership of the investment and decide when to hand it over to the child. You have <b>the option to transfer the investment to the child</b> on reaching the age of 18.	The money is held in trust for the child. <b>You have no rights to the investment</b> , but as trustee retain legal control until the child reaches 18 - at which point the <b>investment is automatically transferred into the child's name</b> .
<b>Withdrawals</b>	Yes	Yes (as long as for the child's benefit).
<b>Capital Gains Tax</b>	Gains are <b>treated as yours</b> and will be liable to tax if they exceed the annual CGT allowance.	Gains are <b>treated as the child's</b> and will be liable to tax if they exceed the child's annual CGT allowance.
<b>Income Tax</b>	The investment and any income generated will be <b>counted as part of your income</b> .	Investments held are <b>taxed in the child's name</b> . It is unlikely that the income will exceed the child's tax allowance.
<b>Inheritance Tax</b>	Money held in a designated account is not treated as a gift and <b>remains within your estate for IHT purposes</b> .	If the gift into the trust is not covered by one of the exemptions (eg £3,000 per annum) <b>the gift is a potentially exempt transfer (PET)</b> . If you die within 7 years of making the gift it is added back to your estate to determine whether any IHT is due.

## Very Long Term Planning

If you want to really set up some security for your child's long term future then you might want to investigate setting up a stakeholder pension for them.

You can contribute up to £2,808 a year per child to a **stakeholder pension plan** which, because the pension fund can claim back tax from the Revenue, would mean a total investment of £3,600 a year per child.

The money **cannot be touched by the child until age 55 at the earliest**, but the potential for growth on such an investment will look quite impressive over such a long period. Under current legislation (which will almost certainly change by the time your child is 55!) 25% of the fund may be taken as a tax free lump sum, and the balance used to provide an income in retirement, for life.

## Child Trust Funds

Child Trust Funds (CTFs) were introduced by the Government with effect from 6 April 2005 **to help parents save for their children**.

Parents who qualify will receive a **voucher for £250** (or in some cases £500) **issued in the child's name** which is to be invested in a Government approved **tax-free savings fund**. The fund can be invested in **cash** (ie deposit accounts), **bonds** (ie fixed interest investments) and **equities** (ie stockmarket linked investments) over an 18 year period.

Once the child reaches his or her 18th birthday **the money can be used by them for any purpose**.

Around two million parents with **children born on or after 1 September 2002** qualified to receive a voucher at the outset, provided that child benefit had been awarded to them and they lived in the UK. A further 700,000 children now benefit every year.

For further information see our Fact Sheet: *Child Trust Fund*.

## Risk Factors

- An investment into a Stocks and Shares ISA, or other collective investment scheme such as a unit trust, is intended as a long-term investment.
- Because this investment may go down in value as well as up, you may not get back the full amount invested. Where past performance is mentioned please note that the past is not necessarily a guide to future performance.
- An investment into a Stakeholder Pension or other Personal Pension Plan is intended as a long-term investment. Where past performance is mentioned please note that the past is not necessarily a guide to future performance. For example, the treatment of pension funds has changed with the removal of tax credit on UK equity investment.
- The value of units may go down as well as up and your pension fund may be less than the amount you have invested. Tax relief depends on individual circumstances and tax rates and laws may change in the future.

Please note that **this information does not constitute personal advice** and should not be treated as a substitute for specific advice based on your circumstances. If you are in any doubt as to whether an investment for a child is suitable, then **you should discuss the matter with a suitably qualified independent financial adviser** such as ourselves.

## For Further Info

If you would like to discuss how best to invest for a child, please ask your usual Arch adviser or contact us via one of the following:

Tel: **0845 3700 661**  
Email: **enquiries@arch-fp.co.uk**  
Online: **www.arch-fp.co.uk**

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