INVESTING FOR CHILDREN

No parent will need reminding children cost money. Of course, there are the day-to-day expenses of food, clothes and so on, but there can also be surprises. A growing proportion of young adults are drawing on parental support to help buy their first homes, for example, while the debate about university tuition fees indicates higher education costs are increasingly likely to fall on parents.

Add in private school fees or a wedding and any thoughts of a quiet, comfortable retirement might appear to have evaporated. Unless you are earning a significant amount of money, managing these expenses out of day-to-day income is likely to prove impractical. We have therefore put together this short guide to give you some ideas – and tax-efficient examples – that might help you to plan ahead. In order to plan an investment strategy effectively, it is important first to clarify your targets. For example, are you saving for a lump sum - to pay for university at 18, for example, or a wedding at 30? Or do you need an income – perhaps to help with school fees?

Your timeline and how you need that money will be two crucial determinants of your investment strategy. After all, if you have 18 years or more over which to raise the money, you can afford to take more risk. However, if you need an income and you need it quite soon – in five or seven years, for example – the amount of risk you can take will be more limited.

"DISCIPLINED PLANNING IS THE BEST WAY TO EASE THE BURDEN OF YOUR DEAR LITTLE THINGS."

OTHER KEY QUESTIONS

Once you know what you need and when, the next thing to look at is how much money you have to invest and what investments are available to choose from. This guide will not go into detail about the actual asset classes available – this is better worked out with your financial adviser on an individual basis – but we can outline some of the questions you might need to ask yourself before you decide the approach that is most suitable for you.

How much risk can I take?

Can you tolerate short-term fluctuations in your capital value in exchange for a higher potential return? In general, if you have a longer-term horizon, you might find the potential returns generated by some volatile assets outweigh the apparent safety offered by lower-risk options. However, even if you are saving for 18 years, if short-term losses will stop you sleeping at night, then the lower-risk options are more appropriate for you.

Will I be protected against inflation?

Inflation is a hot topic at the moment and retaining the purchasing power of your investment over the long term might be difficult without taking some risk. With interest rates at such low levels, many deposit accounts are not paying enough to offset the price increases we are seeing. Over short periods, the risks of more volatile options might not be worth taking - however, over 10 or 20 years, if you want your investment to grow in real terms and not just in absolute terms, you may need to consider other options.

How might the world change as my children grow up?

If you are investing over 18 years, the world could become a very different place. China might overtake America as the world's largest economy. Countries such as Britain and France could fall behind the likes of India or Russia. If you are willing to take a few risks, perhaps you could consider a little exposure to such possibilities.

Do I need an income?

If you need an income from your investment, then at some point you will have to find a product that will pay one. Some investments are designed specifically to pay predictable levels of income so that you know where you are from month to month. Others offer the chance for a higher income, or for one that has the potential to grow, but will be less consistent and might even require the odd subsidy from your capital to meet specific needs.

TAX EFFICIENCY

ONCE YOU KNOW WHAT ASSETS YOU ARE LOOKING FOR, YOU CAN THEN DECIDE HOW TO ACCESS THEM – AND WITH CHILDREN BEING (MORE OFTEN THAN NOT) NON-EARNERS, THE LAST THING YOU WANT IS FOR THEIR HARD-EARNED GROWTH TO END UP IN THE HANDS OF THE TAXMAN. THANKFULLY, WHEN IT COMES TO CHILDREN'S MONEY, THERE ARE PLENTY OF WAYS TO PROTECT IT

1 USE YOUR CHILDREN'S PERSONAL ALLOWANCES

Children have a personal allowance, which is the same as that of an adult (£8,105 for 2012/13). You can fill in a form R85 from HM Revenue & Customs to have any income received from their savings account or investment paid free of tax. You do need to be aware that, if you give money to your child that produces gross income of more than £100 a year, the whole of the income from that gift is taxed as if it were yours. However, this limit only applies to parents and step-parents - grandparents and other adults who give money to children do not have to pay the tax if the interest exceeds £100 a year.

2 JUNIOR ISAS

Individual savings accounts (ISAs) are now available to children, and are known as Junior ISAs. Just like a standard ISA, Junior ISAs are long-term, tax-free savings accounts - however, Junior ISAs are only available for children up to the age of 18, and the money cannot be withdrawn until the child's 18th birthday. Anyone can contribute to the account, although the total amount that can be invested during a single tax year is capped at £3,600. However, a child cannot have a

Junior ISA if they already have a Child Trust Fund account (see below).

3 CHILD SAVINGS BONDS

These are offered by friendly societies and allow parents, grandparents, other relatives and friends to all save up to £25 a month on behalf of each child with the benefits then being earned free of further tax. The bond must have a minimum term of 10 years, up to a maximum of 25 years. The contributions must be maintained to earn the tax benefits. However, they do offer a valuable alternative, particularly if you are not the child's actual parent.

4 PENSIONS

These are a niche choice for investing for children, but can provide a solution in certain circumstances. Investments into a pension attract tax relief on the way in, but tax is payable on any income received. From the age of 55, investors can take out 25% of the value of their fund as a tax-free lump sum that can be useful in paying for a wedding or helping your children find a deposit for their first home. You can also put up to £3,600 gross every year in a pension on behalf of your child. That will cost a basic-rate taxpayer just £2,880 as the government adds tax relief, but the child will not be able to access the money until they are 55.

5 TRUSTS

Legislation over the past few years has eroded many of the tax-planning advantages of trusts. In general, these are now used to control access to the funds rather than for tax planning. A "bare" trust is the most common. Income and capital gains are treated as those of the children, which means that they can use all their allowances each year. It also gets round the problem that children cannot hold shares in their own name.

6 CHILD TRUST FUNDS (CTFS)

Although CTFs were stopped in the 2010 Emergency Budget, millions of parents still have active CTF accounts for their children. Parents, family and friends can add a total of up to £3,600 to the account each year. There is no tax to pay on any income or any gains from the fund. However, as with savings accounts, it remains in the child's name and they will ultimately have control over how it is spent.

7 LIFE COMPANY REGULAR SAVING PLANS

These tend to be used by relatively sophisticated investors, particularly expats and international executives. Investors can use them to build up a tax-free lump sum and then assign segments of it to their children. These segments are usually paid out tax-free as long as they fall within a child's tax-free allowance but, in the meantime, the policyholder retains control of the investment policy. However, minimum investment levels may be higher than some other options.

INVESTMENT TYPES

INVESTMENT TRUSTS

Investment trusts are a popular investment for children. They are a type of collective fund that is listed on the London Stock Exchange, and are invested across a range of assets in order to diversify risk. There are many different underlying investment strategies available – from emerging markets to solid UK or global blue-chip stocks – so you can pick and choose the type of fund you require. Investment trusts have some inherent advantages in that they tend to be cheaper than other forms of collective equity investment. In addition, they are accessible for smaller savers. Using specific savings products, you can invest at a low minimum investment level – perhaps as low as £25 per quarter.

UNIT TRUSTS/OEICS

These are also collective funds. Again, they are available from a broad range of fund managers offering a wide variety of different investment strategies, including bonds, equities and alternatives. These tend to have slightly higher minimum investment levels than investment trusts. Savings plans usually start around £50 per month, although some providers offer lower minimum investments to encourage smaller savers.

INDIVIDUAL SHARES

This is a higher-risk option. Put simply, if one company goes bust in a collective fund, an investor may lose perhaps 1% or 2% of their money. However, if that company is the only share that investor owns and it goes bust, the investor loses all their money. Nevertheless, the returns can be significant for those in a position to take on that level of risk.

For more individual or specific investment information, please do contact your professional adviser.

SUMMARY

Investing for children is not so different from investing for any other purpose. You need to decide on your time horizon and attitude to risk and this will inform your investment strategy. You then ensure that saving is undertaken in the most tax-efficient way possible. There are a few short cuts, but disciplined planning is the best way to ease the burden of your dear little things.

contact

We hope you found the information in this guide useful and informative. If any of the points are of interest, or you would like to discuss your own situation in more detail, please get in touch.

Produced by adviser-hub.co.uk on behalf of your professional adviser.

April 2012

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