A Whitechurch
**Understanding Investment**
Publication

# A Guide to Investing for Children

**September 2007**

Whitechurch Securities Limited
Kings Weston House
Kings Weston Lane
Bristol
BS11 0UR

Tel: 0117 373 0400
E-mail: info@whitechurch.co.uk
Website: www.whitechurch.co.uk

Whitechurch Securities Limited is authorised and regulated by
the Financial Services Authority

This document has been prepared by the Investment Team of Whitechurch Securities Ltd which is the sister Company of The Whitechurch Network Ltd. Nexus Financial Planning is an appointed representative of The Whitechurch Network Ltd which is authorised and regulated by the Financial Services Authority.

Any views and opinions expressed are those of Whitechurch Securities Ltd and the intention of this document is to provide a guide to investing for children.

# Introduction

Investing for children is an emotive subject. When asked, many parents may state that they haven't the spare money to save for themselves – but if you ask them if they want to save for their children, the story is different.

Naturally enough, parents want to do the best for their children. They want to provide them with the best possible start in life when the time comes for them to make their way in the world, whenever this may be.

As a parent, grandparent or godparent, there are a number of reasons to invest on behalf of a child. You could wish to save money in order to pay for certain stages in a child's life, for example, paying for them to go through university, a deposit for their first home or a wedding. Or you may prefer to save to enable you to give a child a cash lump sum, perhaps for a first car, or as an 18th birthday present. The Children's Mutual Friendly Society have produced some figures from independent sources to show how much some of these potential future expenses will cost in 18 years time:

| Potential future expense | Average cost today | Estimated cost in 18 years |
|---|---|---|
| 3 year university course | £38,800 | £60,500 |
| Deposit on first home | £17,600 | £27,400 |
| Wedding | £15,900 | £24,700 |
| First car | £7,500 | £11,600 |

(Source: The Children's Mutual website, assuming an inflation rate of 2.5% for 18 years)

As you can see, the potential cost facing your children in the future is frightening and saving for a child's future has now probably become a necessary consideration rather than a nicety. Therefore, for parents and relatives, the question is not only – how much can I afford to save? But also – where should I invest?

# Available investments

There are a number of ways in which to save for a child, the most common of which are detailed in this guide. The actual choice of these will be dependent on the length of time the investment will be held for, the level of investment risk you are willing to take and the specific objective of the investment.

## Building societies and banks

Many banks and building societies offer specific children's deposit accounts / bonds. A parent or guardian opens the account in their name, with the child's initials attached for tax purposes. Technically this turns the account into a bare trust, legal jargon that means that the parent is looking after the money on behalf of the child. The money saved belongs to the child but they are unable to access it until that attain the age of 18.

When opening an account for a child, as long as the child is not paying income tax already you can elect to have the interest paid gross. In order for interest to be paid gross an Inland Revenue R85 form needs to be completed by an adult unless the child is over 16 years old. In addition, the form must still be signed by the child's parent or guardian if the child's account is opened by a grandparent or someone else. R85 forms can be requested from the bank or building society providing the account.

## Child Trust Funds

The Child Trust Fund (CTF) is available to every child born after 1 September 2002. The Government will make an initial voucher payment to each child's CTF account at outset and have agreed to make a further, as yet undisclosed, payment when the child reaches age 7. Family, friend, and even the child can contribute to the CTF account up to a specified total annual limit – currently £1,200 per annum. The CTF account offers tax advantages, along similar lines to ISAs. CTFs are the investment responsibility of the parent or guardian but the fund reverts to the child as soon as they attain the age of 18.

There are 2 types of CTFs available, stakeholder and non-stakeholder. The Government backed stakeholder models will cap charges at 1.5% per annum and the minimum additional contribution amount must be £10. CTF providers can offer non-stakeholder share or bonds based investments, which are not subject to the cap in charge or the low investment amount, as long as they also offer a stakeholder option or provide information on one.

## National Saving & Investments (NS&I)

Government backed and secure, NS&I offer a couple of choices for children's investment, specifically the **Children's Bonus Bonds**. These are designed for children up to the age of 16 and have a term of 5 years. They can be bought in units of £25 up to a maximum of £3,000. Currently, the interest rate payable on the bonds is 5.1% per annum (source NS&I website, as at 01.08.07).

Effectively the child is the owner but the bond must remain under a parent's or guardian's control until that child reaches 16 years of age. All interest and bonuses on the bonds are free of income tax for parents and children. The tax position is not affected even if the child begins working and becomes a taxpayer before cashing in the bonds. Children from 16 years old have the option to reinvest the bond for another 5 years until their 21st birthday and children under 16 may use their own money to buy these bonds provided their parent or guardian signs the application forms.

The other option for parents and relatives is to buy **Premium Bonds**. Although not really an investment strategy as returns are based on pot luck, Premium Bonds can be held in the name of the child and if they are really lucky – it could make them millionaires!

The minimum purchase for Premium Bonds is £100 and they are sold in multiples of £10. The maximum that can be held per person is £30,000. Premium Bonds can be cashed in at anytime with a full return of your amount invested. Bonds can be bought by anyone aged over 16 but parents, guardians and grandparents can buy them for children under 16. Any prizes won on Premium Bonds are free of income tax and capital gains tax. Prizes range from £50 to that elusive £1 million jackpot.

## Friendly Societies

Friendly societies typically offer either unit linked or with profit endowment plans marketed as children's bonds. As these are qualifying endowment policies they need to be taken out for a minimum term of 10 years in order to gain the relevant tax advantages.

Children's bonds, as endowment policies written under friendly society legislation, have favourable tax positions provided the premiums are paid for the full savings term. Parents or relatives can pay the premiums on the child's behalf subject to a maximum of £25 per month or £270 per annum for each child to qualify for the tax benefits, which are a tax free build up of savings and a tax free payout at maturity.

Investors, though, should not be tempted simply by the tax advantages of these friendly society products. What matters ultimately is performance and some of them have produced poor track records because of high charges and poor fund performance – particularly the With Profits funds.

## Unit trusts, OEICs and Investment Trusts

These funds are typically invested directly into equities, corporate bonds and / or property and so investments need to be viewed for a 5-year period at least. Unit trusts, OEICs and investment trusts are much riskier investments than National Savings or deposit accounts, as the fund values will rise and fall as per the stockmarkets. However, higher risk can mean the potential for higher returns and these investments can provide the potential to outperform over the medium to long term.

Many of these types of investments allow children to hold units or shares in a designated account. The unit trust, OEIC or investment trust is effectively registered in the name of the parent or guardian but has the child's initials designated in a box on the application form. This is because the child cannot hold, sell or deal in shares until the age of 18. When the child reaches 18 years of age the fund then belongs to them.

Unit trusts, OEICs and investment trusts also offer flexibility as they allow investors to invest on a regular monthly basis. Regular monthly saving carries its own benefit in the shape of 'pound cost averaging'. Basically, this means that a steady monthly investment will capture units at a cheaper price if the market falls and when the market rises, there is comfort in knowing that there is greater profit to be had from those cheaper units. This process reduces risk and can mean that in volatile market conditions, returns are better than could be obtained by investing a single lump sum at an inappropriate time.

Regular monthly saving into unit trusts, OEICs and investment trusts are not as expensive as you might think. For example, Invesco Perpetual, who manage a number of quality equity funds, allow investors to make regular monthly savings for as little as £20 per month.

## ISAs

At present, cash ISAs are only available to those aged 16 or over and stocks and shares ISAs for those aged 18 or over. In order to utilise an ISA for this purpose, parents would have to take out the ISA in their own name, using their personal allowance for that tax year, with a view to giving the proceeds to the child at some stage in the future.

This option will be tax efficient in the hands of the parent, as they will not need to worry about any income tax or capital gains tax implications and also the parent will have the flexibility to use the money for different purposes other than for their child if circumstances dictate. Discipline may be required though, as the 'child's' savings could end up being spent long before they reach the child.

## Stakeholder Pensions

There are no age limits on stakeholder pension plans, which means that a newborn baby can have a stakeholder pension taken out in their name. The stakeholder pension will be subject to a maximum annual investment amount of £3,600 gross (£2,808 net). This means that if £2,808 is invested, the amount grossed up with tax relief is £3,600 – so, in effect, the Government is giving you a free gift of £792!

A grandparent may contribute into a Stakeholder Pension for a grandchild and can make the cheque payable to the pension company. However, it is still the parent or guardian who must sign the application form if the grandchild is less than 18. The tax relief is the major plus point of setting up a stakeholder pension for a child, though this relief must be weighed up against a certain lack of flexibility. Under current legislation the child will not be able to gain any benefit from their stakeholder pension until they are 55 years old (based upon the increase in minimum retirement age from 50 to 55 years of age as of 2010).

# Taxation considerations

## Income Tax

There is a potential income tax pitfall for parents when they invest money for children. If any interest or income derived from the saving or investment exceeds more than £100 per tax year, the parents will then be taxed on the total income received. The income tax situation is far more favourable on gifts made from grandparents, friends or other relations as it is treated as the child's, which means that the child's personal tax allowance, £5,225 for the 2007/2008 tax year, should be available to set against the income.

## Capital Gains Tax

It is essential that capital gains tax (CGT) implications are considered when gifting to children. Once investments are in the child's name it does need to be recognised that they will have a CGT exemption allowance, which is £9,200 for the current tax year. This means that when taking proceeds the child would have to make realised gains in excess of this amount from all of their investments, before CGT becomes a consideration and, in addition, taper relief can also be utilised.

**Shares** – parents can only give shares to their children via a trust or a nomination arrangement. In doing this it is not exempt from CGT as this is regarded as triggering a disposal for CGT purposes. However, taper relief may apply.

## Inheritance Tax (IHT)

Inheritance tax (IHT) is an important matter when planning to gift money to children. When parents or relatives want to donate money to a child in many instances this will not be subject to inheritance tax. The estates of parents or relatives are generally exempt from paying inheritance tax on the amount gifted if the donor lives for seven years or more after making the gift.

Also inheritance tax can be avoided on unlimited gifts of up to £250 to different people every year based on the small exemption rule. In addition, the donor can give up to £3,000 to a specific individual in a tax year and this will immediately fall outside of their estate for IHT purposes, although the £250 and £3,000 exemption cannot be mixed.

Lastly, the normal expenditure out of income exemption could be used. This means that the donor can make a regular gift to an individual as long as the donor is left with sufficient income to maintain his usual standard of living and that the regular gift is made out of income and not capital. This practice, however, must be proved to the Inland Revenue.

# Do you need advice?

We hope that you find this guide useful and that it has gone some way in providing ideas and areas for investing for children. Our guide gives a brief summary of the options available to parents and relatives but is not exhaustive.

Ultimately, after reading this guide, if you feel that you need to seek expert, independent financial advice regarding investing for children then we recommend that you contact us and ask to speak to one of our financial advisers.

To speak to one of our qualified financial advisers please call Nexus Financial Planning on 01278 439 494 or e-mail us at **office@nexusifa.co.uk**

# Important notes – please read

***This guide was prepared by Whitechurch Securities Ltd using sources believed to be reliable and accurate. The opinions are our judgement at the time of writing.***

***Do you need advice?***

*This publication contains product specific details only and unless we have complete up to date written details of your financial circumstances and requirements we cannot and will not offer any opinion as to the suitability of any investment for any client. Any response to this publication will therefore be on the basis that client specific advice has not been given. These investments are not suitable for everyone. If you have any doubt whether they are suitable, you should obtain expert advice.*

***Ensure you obtain and read the literature***

*It is essential before you consider purchasing any of the products mentioned that you obtain, read, and fully understand the Terms of Business and Key Features relating to the specific products(s) in which you are interested, as each have different risk levels and some are more volatile than others dependent on where and how they are invested. They also set out the risks, charges, cancellation rights and terms of the investment. Do not invest unless you have read this information.*

***Important notes***

*It is important to always bear in mind that any stock market and equity linked investment carries risk and are subject to market and economic forces and can go down in value as well as up. Past performance is not a guide to future returns and may not be repeated. Investment into the stock market, whether directly or indirectly should not be considered as suitable for short term investment. Where a fund has holdings in fixed interest securities, these are likely to be impacted by changes in interest rates and/or inflationary expectations. Where the main objective of the fund is to provide an income, the level of income is not guaranteed and can fluctuate up or down.*

***Overseas investments***

*You should also bear in mind exchange rate fluctuations may cause the value of overseas investments to fall as well as rise.*

***Taxation***

*Levels and bases of, and relief's from, taxation are subject to change. Please read the product prospectus carefully to ensure you understand how the investment product is taxed and how this may affect your personal tax position.*

**Whitechurch Securities Limited is authorised and regulated by the Financial Services Authority**
**Registered office: Arclight House, 3 Unity Street, Bristol, BS1 5HH**

**Tel: 0117 373 0400**
**E-mail: info@whitechurch.co.uk**
**Website: www.whitechurch.co.uk**

**This document has been prepared by the Investment Team of Whitechurch Securities Ltd which is the sister Company of The Whitechurch Network Ltd. Nexus Financial Planning is an appointed representative of The Whitechurch Network Ltd which is authorised and regulated by the Financial Services Authority.**

**Any views and opinions expressed are those of Whitechurch Securities Ltd and the intention of this document is to provide a guide to investing for children.**