Financial Planning designed *by* women *for* women

Investing for Children

No parent will need reminding that children are expensive. Of course, there are the day-to-day running costs of clothes, shoes ñ not to mention large mobile phone bills ñ but there are also some potential surprises.

An increasing proportion of first-time buyers are drawing on parental support to buy their home. Meanwhile, rising university costs are encouraging many parents to put money aside to help their children to fund their higher education. Add in private school fees or a wedding and any thoughts of a quiet, comfortable retirement might start to look a little remote. Unless you are earning a significant amount of money, managing these expenses out of day-to-day income is likely to be almost impossible. We have therefore put together this short guide to give you some ideas – and tax-efficient examples – that might help you to plan ahead.

DECISION TIME

In order to plan an investment strategy effectively, it is first worth clarifying your targets. For example, are you saving for a lump sum, perhaps to assist with the deposit for a first home at 25 or for a wedding at 30? Or do you need an income, perhaps to help with school fees?

When and how you will need that money are the two most important determining factors of your investment strategy. After all, if you have eighteen 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 may be limited.

“IF YOU ARE INVESTING OVER 18 YEARS, THE WORLD COULD BECOME A VERY DIFFERENT PLACE.”

TYPES OF INVESTMENT

Once you know what you need and when, the next thing to consider 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 – your financial adviser is better placed to help there – but we can outline some of the questions you might need to ask yourself before you decide on 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, if short-term losses will stop you sleeping at night – even if you are saving over 18 years – then the lower-risk options are more appropriate for you.

Will I be protected against inflation?

Inflation erodes the real value of your cash over time; therefore, retaining the purchasing power of your investment might be difficult in the long term without taking some risk. When interest rates are low, many deposit accounts will not pay enough interest to offset price increases. Over short periods, the risks of more volatile options might not be worth taking; over ten or 20 years, however, if you want your investment to grow in real terms and not just in absolute terms, you may need to look at other options.

These investments do not include the same security of capital which is afforded with a deposit account. The value of your investment can go down as well as up and you may get back less than the amount invested.

How is the world likely to change as my children grow up?

If you are investing over 18 years, the world could become a very different place . China could overtake the USA as the world’s largest economy. Countries such as UK and Germany could fall behind the likes of Mexico. If you are willing to take a few risks, perhaps you could consider a little exposure to such opportunities, just in case.

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 you know where you are from month to month. Others offer the chance for a higher income, or for an income that offers potential for growth; however, this could 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, THERE ARE PLENTY OF WAYS TO PROTECT IT:

1 USE YOUR CHILDREN’S PERSONAL ALLOWANCES

Children have a personal allowance for income tax purposes, which is the same as that of an adult (£12,570 for 2021/22). 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 available to children, and are known as Junior ISAs (JISAs). Just like a standard ISA, JISAs are long-term, tax-free savings accounts; however, JISAs are only available for children up to the age of 18, and the money cannot be withdrawn until the child’s 18th birthday. Only a parent or guardian with parental

responsibility can open a JISA. Anyone can contribute to the account, although the total amount that can be invested during a single tax year is capped at £9,000 for 2021/22. Although a child cannot have a JISA as well as a Child Trust Fund account (see below), you can ask their CTF provider to transfer the trust fund into a JISA.

3 PENSIONS

These are still a niche, long-term 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. You can also put up to £3,600 gross every year in a pension on behalf of your child: this will cost a basic-rate taxpayer just £2,880, plus the government adds tax relief. Once your child reaches the age of 18, they will assume ownership of the pension, and they can begin to make contributions of their own.

4 TRUSTS

Legislation over the past few years has eroded many of the tax-planning advantages of trusts. In general, they are used primarily to control access to the funds rather than for tax-planning purposes. A "bare" trust is the most common. Income and capital gains are regarded as belonging to the children, and this means they can use all their allowances each year.

5 CHILD TRUST FUNDS (CTFS)

Although CTFs were stopped in 2010, millions of parents still have active CTF accounts for their children. Parents, family and friends can add a total of up to £9,000 to the account in the current tax 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 control how it is spent.

6 FRIENDLY SOCIETY TAX-EXEMPT PLANS

These savings plans are only available through Friendly Societies, which are mutual societies owned by their members for the benefit of their members. You can save up to £270 per year (or £300 per year in monthly payments of £25) into the plan for your child between ten and 25 years, and the money will be invested into an investment fund. If you pay into the plan for at least ten years, it will not incur any capital gains tax or income tax. On the plan's maturity date, you must have paid into the plan for at least ten years, and the child must be at least 16 years old.

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

Levels, bases of and reliefs from taxation may be subject to change and their value depends on the individual circumstances of the investor.

How to Invest

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, global blue-chip stocks and even corporate bonds – so you can pick and choose the type of fund you require. They 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 or £50 per quarter.

The value of your investment can go down as well as up and you may get back less than the amount invested.

UNIT TRUSTS/OPEN ENDED INVESTMENT COMPANIES (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 1-2% of their money. However, if that company is the only share that the investor owns and it goes bust, the investor loses all their money. Nevertheless, the rewards can be impressive for those in a position to take the risk.

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 us

To arrange a no obligation meeting call us now on **0115 9819 529 or email: enquiries@cockburnlucas.co.uk**

The information provided must not be considered as financial advice. We always recommend that you seek independent financial advice before making any financial decisions.

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The investment and retirement specialists for women

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