SAVING FOR CHILDREN AND GRANDCHILDREN

Introduction

One area that remains at the forefront of people's minds is providing their children and grandchildren with a good start in life. Due to changes in legislation, increasing costs of further education, higher house prices, planning for the future of young adults has never been more important. This guide provides further information on this important area.

The Child Trust Fund

The Child Trust Fund (CTF) gives the savings of every child born on or after 1st September 2002 a financial boost to the tune of at least £250. This figure can rise to £500 if your family is awarded the full Child Tax Credit. The initial £250 payment will take the form of a voucher, automatically sent to qualifying families during the first few months of 2005. And after that new parents should receive their vouchers once they start receiving Child Benefit.

When you receive your voucher, you can then invest it in a special Child Trust Fund account. There are different types of account available and you may decide to choose one that meets all the government's stakeholder criteria, which sets out a range of terms and conditions that must be met.

The good news is that anyone can make extra payments to the account, whether regular or one-offs up to a total of £1,200 each year. And the fund still remains free of personal income tax and capital gains tax.

The Government will make a further contribution when your child is seven of £250 into their CTF account, with children in lower-income families receiving an additional £250. These payments will be paid around the child's 7th birthday direct into their account.

There are three main types of CTF account.

- **Savings accounts.** If you don't want to invest in shares, you could choose a savings account for your child's CTF account. With a savings account any money you invest is secure. For example if you invest £500, your child will get that sum of money back as well as earning some interest. But you should consider that although your money earns interest, it might not grow as much as it would if it was invested in shares. Savings accounts do not usually perform as well as money invested in shares over the long term, especially when inflation is taken into account. The effect of inflation means that money in the account could lose value over the long term. This is because prices usually rise each year and so £20 won't buy you as much today as it did ten years ago. As with all accounts your provider will charge you for the cost of running it. You might not notice this cost as it will not appear on your statement, but providers cover these costs when deciding how much interest to pay on savings. This is something you should check before deciding to open an account.
- **Accounts that invest in other investments.** These accounts invest your child's money in other types of investments such as shares. Often the use of Unit Trusts and Investment Trusts is wise as this can spread the investment across a wide number of individual companies. When those companies do well and the shares go up in value – they make money. This type of account has the potential to do well when money is invested for a long time. Investing in shares is more risky than putting money in a savings account as shares can lose value if companies are not performing well. You must remember that shares can go down as well as up and past performance is not a guarantee of how shares will perform in the future. The charge on this type of account is usually a percentage of its value. You should check how much this would be with your chosen CTF provider.

- **Stakeholder CTF account.** Stakeholder accounts invest your child's money in shares in companies when the account is opened. The Government has made certain rules for these accounts to reduce the risk of investing in shares. Your child's money is not put into just one company, as they could lose out if that company does badly. Instead, it is invested in a number of companies in order to reduce the risk. Once your child is 13, money in the account starts to be moved to lower risk investments or assets. CTF providers will consider how well shares are performing to decide how much to move over into safer assets and how quickly. This means that although your child's money may not benefit if the stock market is performing well, it is protected from stock market losses as they approach their 18th birthday. Once the account is open, all providers must accept a minimum contribution of £10 into a stakeholder account – but they can accept less if they wish. The charge on the stakeholder account is limited to no more than 1.5 per cent a year – which means the charge can be no more than £1.50 for every £100 in the account. The charges on all other types of CTF account are not limited in this way. The stakeholder account is the one the Inland Revenue will open if you don't use the CTF voucher before it expires.

Ethical accounts

Some people don't like to invest money in businesses they don't agree with, such as companies involved in arms, tobacco or alcohol. And some prefer to invest in companies that sell goods according to the rules of fair trade or that work to protect the environment. All CTF providers are required to publicise their policy about social, ethical and environmental investments, if they have one. So you may wish to ask providers about this when you are considering which account and provider to choose.

Friendly Society Bonds

A Friendly Society bond is a very simple and highly effective savings plan, which takes advantage of a tax concession only available to friendly societies. This means the child's investment should grow faster than in similar, fully taxable funds. Another advantage of investing in a friendly society is that they use all their profits for the benefit of their members, as they don't have shareholders.

When the plan matures the child can use the proceeds as they wish. This nest egg could help fund a university course, or take care of a deposit on a first home, or enable a year out to go travelling. It is available for anyone under age 18 at outset, so it's never too late for a child to take advantage of all the benefits and privileges a friendly society can offer.

The maximum you can save for each child is £25 a month in all friendly society tax-free savings plans. You can often save more than this, with the excess above £25 invested in taxable funds.

Saving For Much Later - Stakeholder Pensions

Stakeholder pensions are a low cost personal pension. Unlike other pension vehicles you can pay into a stakeholder for your partner or your children or grandchildren even if they are not earning - their pension fund will benefit from the available tax relief. This makes them an ideal means to squirrel away money for retirement. This is especially important at a time when there are warnings that we may not be able to rely on a state pension in the future.

Stakeholders are extremely flexible: you can increase and decrease your contributions as desired and start and stop contributions without penalty. It is also possible to transfer funds from one stakeholder pension to another. Minimum contributions are as little as £20 and can be made at irregular intervals but you can pay up to £3,600 gross each year. (If you do wish to pay the maximum amount, it will only actually cost you £2,808 as the available tax relief will increase your contribution to £3,600). There is a limit of 1% annual charges for all stakeholder pension schemes. You can buy a stakeholder pension from banks, building societies or insurance companies.

Stakeholder pensions offer a secure, tax-efficient way to save money for your child's retirement but they will not be able to touch the money until they are at least 50 so they're not really suitable for school or university fees!

Tax Rules and Regulations

Saving and investing for your child may have important tax implications.

Income Tax

Income from savings or investments given to the child by a parent is taxed as the parent's income, apart from the first £100. In real terms, if you invest more than around £2000 for a child at today's interest rates you may be lumbering yourself with an added tax burden. It is useful to note that each parent can give their child investments so a child could earn a maximum of £200 interest a year from the two investments. Income from savings or investments given to the child by adults other than their parents is taxed as the child's. Everyone, including children, can claim their personal income tax allowance, which is £5,035 for the 2006/07 tax year. Because of the rules concerning parents investing for their child, it makes sense to invest gifts from people other than parents separately and to keep a note of these gifts. Investment funds pay interest net of 20% income tax. You can reclaim the income tax by completing form R40 that you can get from any Inland Revenue Enquiry Centre or Tax Office. However, if an investment fund is paying a dividend, it will be paid net of 10% tax credit. Unfortunately, this cannot be reclaimed.

Capital Gains Tax

When an investment matures or is sold, there will hopefully be a capital gain (you'll have more money than you started with). Few children will face a capital gains tax liability because they are entitled to the annual capital gains tax exemption which is £8,800 for the 2006/07 tax year. This is the case whether funds are held in a bare trust or a designated account.

General

In addition to the above, it is possible to also give money to children and grandchildren but retain full control through a suitable trust wrapper. This is a more detailed area with a range of solutions to meet your individual needs. We are pleased to provide advice on this and any of the plans mentioned above to give a specific plan that meets with your concerns and the needs of the family. Such planning can also provide tax savings and can feature in Inheritance Tax planning, particularly for grandparents. The financial assistance needed by the present young generation has probably never been greater and forward planning is the key to success. It is a crime to let financial considerations hold back our children’s future unless absolutely necessary.

Important Information

Information is based on Braunton IFA Ltd’s interpretation and cannot be held liable for any errors or omissions. Any information is by no means implied as specific recommendations and you are strongly advised to take independent advice before proceeding with an investment or other policy and legal advice before commencing any form of trust. Past performance is no guarantee of future returns. The returns from stock market investments can rise as well as fall particularly in the short term and if you surrender early you may not get back your original investment. Your home may be repossessed if you do not keep up repayments on your mortgage.

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