BREWIN DOLPHIN

Investing for children

The difference you can make

Contents

In need of a helping hand

Younger people today have many things in their favour as they grow up in a world full of new opportunities. However, they also face a future filled with uncertainty and financial challenges.

Many young people starting their working lives do so with debts from university, putting a serious strain on their finances. Rocketing house prices and rising rental costs means the hope of owning a home – a hope that previous generations took for granted – can seem like an impossible dream.

Fortunately, though, with a little help from parents and grandparents that doesn't have to be the case. Starting to save early for a child or grandchild's future can give them a welcome and much-needed financial leg up. Gifting wealth now could also cut a future inheritance tax bill. All it takes is a little foresight and financial planning.

In this guide we provide information on the three main options available, and examples of how they could be used:

- A Junior ISA allows you to save up to £4,260 (£4,368 in the 2019-20 tax year) for a child in a tax-efficient way.
- A bare trust is particularly useful for grandparents who want to keep tax on savings to a minimum – and retain some control.
- A junior pension can give a child a substantial head start in saving for retirement – one less thing to worry about when they become an adult.

Each option serves a purpose. The final decision over which is right for you should be based on what you want the child to do with the money once they are of adult age.

Make the most of Junior ISAs

Junior ISAs (JISAs) are a great way to put money aside for a child's future. They offer the same tax advantages as adult ISAs. You don't have to pay tax on returns that come from the growth of investments and there is no income tax on interest or dividend income.

Money in a JISA is locked away until the child reaches 18, at which point they will get a lump sum that they can convert into an adult ISA or put to good use for university, a deposit on a first home or to start a business.

Only parents or guardians with parental responsibility can open JISAs on behalf of their child, but anyone can contribute, be they grandparents, godparents or generous aunts or uncles. As with adult ISAs there is a limit on how much you can pay into a JISA during a single tax year. In the 2018-19 tax year it is £4,260. The annual JISA allowance will rise to £4,368 in the 2019-20 tax year, which begins on 6 April 2019.

Cash or stocks and shares?

The annual allowance can be invested in cash, stocks and shares or split between the two. Traditionally in Britain we have shown ourselves to be cautious and roughly seven out of ten JISA accounts are invested solely in cash.[1] However, a stocks and shares JISA offers the potential for higher returns, although it does increase the amount of risk as well.

A stocks and shares JISA should be particularly attractive if you are investing when the child is a baby or a toddler, because the money has the potential to keep growing until they turn 18. The younger the child, the greater the chance a stocks and shares JISA will outperform a cash JISA by the time they reach adulthood.

[1] Office for National Statistics: Individual Savings Account (ISA) statistics, August 2018.

Illustration – Finishing university debt-free

This example shows how your child could emerge from university debt-free and with a head start to their adult working life, if you start saving early into a Junior ISA.

Lucy, 34, and Robert, 37, are celebrating the birth of their first child Aaron. Even before he was born the couple had been thinking about the best ways to support him. Having heard that many students leave university with huge debts, Lucy and Robert have decided to set up a savings plan earmarked for Aaron's university education.

Three years of tuition fees and living costs, starting in 18 years' time, could amount to £95,444. This assumes that both tuition fees and student living costs rise in line with general consumer inflation from now.[2]

A JISA to cover costs

Investing £355 a month into Junior ISA (corresponding to the current annual JISA allowance of £4,260 a year) from now until Aaron's 18th birthday could easily cover the estimated total cost of £95,444.

At 18, Aaron's university savings pot would be worth £123,000, based on growth of 5% per annum net of charges. Even at more modest growth of 3% per annum net of charges the savings pot could be worth £101,000 – again sufficient to cover three years of university. Please bear in mind that this is an illustration only and the value of an investment can fall as well as rise and you may get back less than you invested.

Long-term benefits

Thanks to Lucy and Robert's foresight and generosity, at the end of his third year Aaron graduates and unlike most of his student friends he is completely debt-free. He is also freed from having to make student loan repayments for the next 30 years. This means he can save for a house deposit instead of paying off his loan, potentially giving him a head start over many of his graduate friends.

[2] Source: Brewin Dolphin. Cost assumes 2.1% inflation of current university tuition fees (£9,250) and living costs (£12,160).

The benefits of a bare trust

Bare trusts are a convenient and tax-efficient way for individuals to invest money for a child's future that are often overlooked. They can be created by anyone for a child - unlike JISAs which have to be opened by a parent or guardian. Bare trusts are often useful for grandparents who wish to retain some control over the trust funds until their grandchild reaches 18.

Under a bare trust, money or investments are held by a trustee – such as a parent or grandparent – for the benefit of a beneficiary – for example, a child or grandchild. By placing the assets within a bare trust, the trustee relinquishes ownership of them, but they control access to the money or investments until the beneficiary reaches 18 (16 in Scotland), after which the beneficiary has a right to the assets.

Grandparents' gifts

The tax treatment of bare trusts depends on whether money is put into the trust by parents or someone else. If money or investments are put into a bare trust by anyone other than the parents the contents are taxed as if they belong to the child. This includes gifts from grandparents and usually means that there is little or no tax to pay on any income or gains.

If money or investments are put into a bare trust by a parent the situation is different. If the income from a parental gift exceeds £100 per year the parent will have to pay tax on all the trust's income until the child reaches 18.

Illustration: Giving your grandchildren a leg-up

This example shows how a grandparent can use a bare trust to pass on wealth to a grandchild in a tax-efficient manner – while maintaining some control over how it is used.

Margaret, 72, has a granddaughter Beatrice, aged eight. She is keen to help Beatrice but doesn't want her to have access to the money until she can really benefit from it.

Margaret has £50,000 to invest. She decides to establish a bare trust for Beatrice's benefit, perhaps to help her with the cost of a university education at 18 or a deposit for a first home. She appoints herself as trustee. Assets held in a bare trust are treated as potentially exempt transfers. This means that they will be outside Margaret's estate if she lives a further seven years.

The income produced from the investments held in the trust, of around £1,500 a year, is treated as Beatrice's for tax purposes. As this is well within Beatrice's personal allowance (£11,850 in the 2018-19 tax year; £12,500 in the 2019-20 tax year) it is tax-free. Beatrice's capital gains tax (CGT) annual allowance (£11,700 in the 2018-19 tax year; £12,000 in 2019-20) is also available to mop up any realised capital gains. With careful management that means Beatrice pays no CGT.

Tax-free exemptions

Assuming net growth after charges of 5% a year, Margaret's granddaughter's trust will be worth £81,000 when Beatrice is 18. At that point Beatrice becomes entitled to the assets in the trust. Although the value of investments can fall as well as rise, Beatrice decides to leave the assets in the trust so that she can continue to benefit from investment growth.

Pensions - start them young

The idea of starting a pension for a child might sound faintly ridiculous, given how long it will be before they retire. Money in pensions can't be accessed until age 55, or 57 from 2028. If the government continues to push up the 'private pension age', by the time your child or grandchild is ready to retire they may have to wait even longer to access their pension savings.

However, putting money into a pension on a child's behalf can be a sensible idea, as it can give a huge boost to their retirement savings. Saving into a pension also removes any danger of younger family members using the money you have saved on their behalf, for frivolous purchases.

The maximum amount you can put into a junior SIPP (a type of pension for a child) is £2,880 per year. Contributions benefit from 20% tax relief boosting that £2,880 to £3,600 after tax relief. It is possible to invest in a wide range of shares and investment funds within a junior SIPP.

If you put the maximum each year into a pension fund from birth until the child turned 18 it could create a pot of £1,003,000 by age 65. The figure assumes a total net contribution of £51,840, a growth rate of 5% per annum, and is net of product charges.

Keep an eye on the lifetime allowance

The biggest concern for your child or grandchild may be that their pension pot is growing too big: a nice problem to have. It may not be an immediate problem, but if you set up a child with a pension they will need to keep an eye on the lifetime allowance.

The lifetime allowance is the maximum amount that can be saved into a pension over a lifetime without facing a tax charge. The limit is £1,030,000 in the 2018-19 tax year. In the 2019-20 tax year it will rise to £1,055,000. It should continue to increase in the future, though the government is also able to reduce the lifetime allowance, and your child's pension could breach the limit in the future if they don't take care.

Illustration: A long-term nest egg

This example shows how you can give your grandchildren a financial head start by contributing to a pension on their behalf.

There is an increasing amount of debate about the prospects of younger people ever being able to retire. Given the uncertainty around future pension provision, Ananya and Rohit, both in their late 60s, decide it would be sensible to set up a a child pension (junior SIPP) on behalf of their newly born grandchild Samar.

The couple decide to contribute the maximum amount to a junior SIPP of £2,880 a year. With £720 annual tax relief on top that results in an annual contribution of £3,600 a year.

If Ananya and Rohit pay £3,600 a year (including tax relief) into a junior SIPP, from birth until Samar's 18th birthday the pension pot would be worth £101,000, assuming 5% net of charges growth per year.

Even if Ananya and Rohit's contributions stop when Samar is 18, by the time Samar is 57, and can withdraw the money, it would have grown to £679,000, assuming 5% net of charges annual growth. If Samar leaves it untouched until 65 it would have grown to £1,003,000. However, it is important to remember that there are no guarantees with investments and they can fall as well as rise.

How we can help

Junior ISAs, bare trusts and pensions can all be great tax-efficient ways to save for children or grandchildren.

If you are comfortable investing without advice, you can set up a JISA or a bare trust through our online investment portal, the Brewin Portfolio Service. Go to www.brewin.co.uk/BPS to find out more.

If you would like financial advice before deciding which route to take, you can speak to a Brewin Dolphin financial planner to understand more. Go to www.brewin.co.uk to find out how we can help.

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