



# Investing for children

# Introduction

## INVESTING FOR THE FUTURE

Most parents want to help their children financially, whether it is making sure there is enough money for their education or eventually helping them to buy a property. An early objective as they grow up may well be to help children understand the value and importance of money.

Whatever the reason, tax will be a major factor to consider, as will the risks of giving children too much money too soon. It is therefore important for parents and others to appreciate the basic tax and legal rules, and the investment products that are suitable for children, to help achieve the goals set for them.

Please note that all examples included in this guide are fictitious.

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# Setting specific investment goals

Why, when and for how long you plan to set aside money for children can have a major bearing on choosing the appropriate investments. As with any investment decisions, risk is another key issue that you need to think about carefully before taking any action.

Very broadly, the shorter the timescale, the more you should focus on cash and similar types of investment. If you are looking at five years or more, you should consider investments with a longer-term value, such as shares or property. They involve more risk, but historically provide superior returns over the longer term. The best approach to handling these matters is to consult a competent financial adviser.

## HOW CHILDREN ARE TAXED

Children – even babies – are not exempt from tax. If they have enough income or capital gains, they will be subject to a tax bill just like adults. And like adults, they are generally entitled to a certain amount of income without paying tax. This is the personal allowance, which is £12,570.

In addition, for 2022/23 each child has:

- a 0% starting rate band covering £5,000 of savings income;
- a dividend allowance of £2,000;
- (assuming they do not pay tax at the higher or additional rate) a personal savings allowance of £1,000;
- their own annual capital gains tax (CGT) exempt amount of up to £12,300 of net gains on investments.

There is a special rule that applies to children's income until the child reaches age 18 or gets married, if earlier. If the child's

income is derived from a gift from a parent it is taxed as the parent's income, unless the income does not exceed £100 a year (£200 if both parents have contributed jointly).

### EXAMPLE Parental gift

If Mary gives £20,000 to her 14-year-old son Jake, and this generates an income of £400 a year, this will be taxed as if it were Mary's income at her tax rate(s). It could not be set against Jake's personal tax allowance of £12,570, so the amount of tax Mary would have to pay would be dependent upon her tax position.

Fortunately, when a child's income is derived from non-parental sources it is taxed as the child's and can be set against their personal allowance. This might include income from investments financed by gifts from grandparents or others, or perhaps earnings from a weekend job or other work.

### EXAMPLE Non-parental gift

Mary's father, Graham, is a higher rate taxpayer. If he gives £20,000 to his grandson Jake and it generates an income of £400 a year, this will be taxed as if it were Jake's income. It would neither be taxable on Graham nor Mary. The income would be set against Jake's personal tax allowance of £12,570, so would almost certainly be tax-free for him.

Where a child's income comes from investments funded by grandparents or others, you should identify it carefully to ensure that it does not suffer tax unnecessarily. So, it is a good idea to keep investments provided by parents separate from the money the child has received from other people.

Banks, building societies and collective funds, such as unit trusts and open-ended investment companies (OEICs), which pay interest rather than dividends, do not deduct tax from interest payments, sparing non-taxpayers the potential hassle of tax reclaims.

Parents can still invest on their child's behalf without potentially giving themselves a tax liability by using special tax-efficient financial products.

### Planning point

It is important for parents and others to know basic tax and legal rules, and also some of the investment products suitable for their children.

## TAX-EFFICIENT INVESTMENTS FOR CHILDREN

Several financial products enable parents and others to invest tax efficiently for children. Of course, tax is not the only factor to consider. Aside from investment risk and reward, you need to think about the costs of investing; some investments can be significantly costlier to buy and hold than others.

### Junior individual savings account

The Junior ISA (JISA) is like the adult ISA. It is a 'wrapper' that protects the investments and savings held within it from income tax and CGT. The JISA allows up to £9,000 in 2022/23 to be invested on behalf of a child in cash and/or a wide variety of stock market-based investments. These range from individual shares in companies to UK-authorized unit trusts, OEICs and investment trusts.

Children can have one cash JISA and one stocks and shares JISA, but the combined total yearly investment must not

exceed the annual maximum. To qualify, children must be under 18, live in the UK and not hold a child trust fund (CTF) account. Children aged 16 or 17 can open their own JISA, or take over management and be the registered contact for their existing JISA, but parents or adults with parental responsibility must open and manage these accounts for younger children.

Money in a JISA belongs to the child and cannot be withdrawn before they are 18. Adults can open and manage a Junior ISA for children under 18. At 16 or 17, a child can open their own JISA or ISA, but only the cash component.

### Individual savings account (ISA)

Children aged 16 or 17 can invest in a full ISA, but only in the cash component. The contribution ceiling is £20,000 for full ISAs in 2022/23 and is in addition to the JISA allowance.

Investments in a Lifetime ISA (LISA) cannot be made before age 18 and are limited to a maximum of £4,000 in each tax year (plus up to a £1,000 bonus added by the government each year). LISAs are intended to support investors with buying a first home or saving for later life. If you incur a government withdrawal charge, however, you may get back less than the value you paid into a LISA. Investing in a LISA instead of a pension can affect the benefits you could get from an employer contributed pension and affect entitlements to means-tested benefits.

Investors do not pay any personal tax on income or gains, but ISAs do pay unrecoverable tax on income from stocks and shares received by the ISA managers.

Stocks and Shares ISAs invest in corporate bonds; stocks and shares and other assets that fluctuate in value.

### Child trust funds (CTFs)

CTFs were the original long-term tax-free savings account for children, but the scheme is now closed. Very similar to JISAs, they were available for children born between 1 September 2002 and 2 January 2011, meaning that the first CTFs reached maturity in September 2020. Regulations issued in January 2020 ensure that funds in CTF accounts retain their tax-free



status after maturity, even if no action is taken by their owner. Nearly 30% of CTF funds were set up as default arrangements by HMRC, which is one reason why it has set up an online tool at [www.gov.uk/child-trust-funds/find-a-child-trust-fund](http://www.gov.uk/child-trust-funds/find-a-child-trust-fund) to help CTF owners and their parents trace their funds. HMRC reported that in the first year of CTF maturities, 'Hundreds of thousands of accounts have been claimed so far, but many have not'.

If a child has a CTF, they cannot have a JISA (and the reverse is also true). Originally, CTFs were set up to hold funds that the government granted to these children, so every child born between those dates has a CTF to which parents and others can contribute up to £9,000 in total. It is worth checking to see if a child's CTF has been invested in suitable funds; they can usually be switched if necessary.

The tax advantages and rules governing CTFs and JISAs are very similar. The funds are essentially free of UK tax and so are the proceeds on encashment. It is possible for CTFs to be transferred into JISAs, but once the transfer is completed, future contributions can only be made to the JISA.

### Collective funds

If your child's JISA allowance has been used up for the tax year and you still want to invest more in stocks and shares on their behalf, you could consider collective funds – i.e. unit trusts, investment trusts or OEICs. Investments in funds for children are usually held in a designated account, which is administered by the parents and belongs to the child, but which they cannot normally access until they are 18. Any income from funds paid for by a parent is treated for tax purposes as the parent's income under parental settlement rules.

### Offshore funds

Non-reporting offshore funds allow for income and gains to be held free of UK tax until the investor disposes of them. At that point, they become subject to income tax in the investor's hands. Among other uses, this facility can allow parents to invest for a child without the income being subject to tax at parental rates. Then, when the child reaches age 18, the investment can be sold and set against the child's personal allowance, which would allow them to receive up to £12,570 free of income tax. If the child has no other income, the £5,000 0% savings rate band and £1,000 savings allowance would then apply before the basic rate at 20% (19% from 2024/25) is chargeable. This would mean that, in 2022/23, £18,570 is free of tax with the next £31,700 taxable at 20%.

### Life assurance investment bonds

These investments can be used to postpone the potential tax liability until a convenient time for them to be cashed in. Parents or others can invest in these bonds for the child – usually within a trust for the child. The investment bond produces no income for the trust itself and the funds within the bond are subject to tax at the life insurance company's rates. When the child reaches age 18 or over, the trustees can pass over the bond to the child who can encash it at the rates that apply to them that year.

There is little or no UK tax within offshore investment bonds, but the proceeds are potentially subject to starting rate (0%), basic rate (20%, reducing to 19% from 2024/25), higher rate (40%) and additional rate (45%) tax. (Scottish income tax rates and thresholds however do not apply to savings or dividend income). Gains will also count towards the personal savings allowance. UK investment bonds suffer some tax on the income and gains of the underlying funds, but they benefit

## JISA/ISA/CTF 2022/23 summary

Product	Age range	Maximum investment	Notes
<b>Cash ISA</b>	16 upwards	£20,000	16- and 17-year-olds may start a cash ISA in addition to holding a JISA but can only use the cash component.
<b>Junior ISA</b>	Under age 18	£9,000	A child cannot also have a child trust fund (CTF).
<b>Child Trust Fund</b>	Born after 31 August 2002, but before 3 January 2011 Child Trust Fund Born after 31 August 2002, but before 3 January 2011 and under age 18	£9,000	A child cannot also have a JISA.
<b>Help to Buy ISA (started before 1/12/19)</b>	16 upwards	£200 a month	Counts towards ISA investment limit. New plans are no longer available, but existing plans can continue to receive contributions.

from a tax credit for any basic rate tax that would be payable on the bond gains.

Investment bonds in trusts are very useful for larger investments for children, but their tax position can be complicated in some circumstances and it is especially wise to seek advice before either making or encashing such investments.

### Planning point

While it may seem early, setting up a pension for your child could offer tax-efficient investments and provide security for their later life.

## PERSONAL PENSIONS

The generous tax breaks and long investment term make pensions an effective way to invest for children.

- Anyone can contribute up to £3,600 gross in a tax year into a personal pension for a child.
- Contributions automatically benefit from basic rate tax relief (currently equivalent to an uplift of 25%), so only £2,880 needs to be paid into the scheme, with the government making up the balance.
- Returns roll up broadly UK tax-free within the fund, and ultimately up to 25% of the pension fund can be taken as a tax-free lump sum with the rest of the fund drawn as taxable payments.

Contributions made to a child's pension do not count against the contributor's own pension contribution annual allowance and they may also help with the contributor's inheritance tax (IHT) planning. However, the child will not be able to draw the pension until they are within ten years of state pension age, which is now under review and is currently planned to rise to 68 by 2039.

### Friendly society bonds

Some friendly societies offer tax-free savings schemes for children which can be designed specifically to mature for a significant event, like an 18th or 21st birthday, starting university or graduation. The maximum investment is £25 a month or £270 a year and bonds must last for at least 10 years for the proceeds to be free of income tax and CGT. Although the premiums on these schemes are low, the charges can be high.

## SHOULD YOU USE A TRUST?

If you are planning to set aside money for the long-term future benefit of a child, you may want to use a trust.

A trust is basically a way for one group of people (the trustees – who could include you) to hold investments or other assets for the benefit of some other people – called beneficiaries. Using a trust can also help IHT planning by allowing you to



### Planning point

Trusts let you, or a group of people, look after investments for children, and can help with estate planning and reducing your inheritance tax bill. The way that they are taxed can be complicated so it is worth taking advice before setting one up.

transfer the assets outside your taxable estate. A trust can also control when the children will have access to the funds.

There are several types of trust with different tax and other legal characteristics. They all have different advantages and drawbacks, but there are two main kinds of trust in this context.

### Bare trusts

These are sometimes called simple or absolute trusts, and are the most commonly used trusts for gifts to children. The beneficiary – in this case the child – is absolutely and immediately entitled to the income and capital held in the trust. The assets are held in the name of the trustees, who manage and make decisions about the trust until the beneficiary reaches the age of 18 (16 in Scotland). At this point, beneficiaries can demand that trustees transfer the trust fund to them.

### Discretionary trusts

The trustees can decide how much income and/or capital each beneficiary should receive and when. Discretionary trusts are sometimes used to provide for future needs that might not yet have developed, or for beneficiaries who are not capable or responsible enough to deal with money themselves.

Bare trusts are generally more tax-efficient than discretionary trusts, but are rather rigid and inflexible. By contrast, discretionary trusts often involve additional tax costs, but provide greater flexibility. An important advantage of discretionary trusts is that you do not have to pass over assets to children when they reach the relatively young age of 18 (16 in Scotland).

## TAX POSITION OF TRUSTS

Trusts can help to ensure that your money is used as you intend for the benefit of children or grandchildren. But they do not necessarily reduce overall tax liabilities, and in some cases a trust might increase the amount of tax to be paid. For example, you could incur IHT on a large lifetime gift into a discretionary trust.

### Income tax and trusts

The beneficiary of a bare trust is liable for tax on income that the trust receives unless the parental settlement rules apply, although the trustees can pay this tax on their behalf. Beneficiaries should notify their tax office of the income and fill in the appropriate self-assessment tax return form.

The rate of tax on the income from investments held in a discretionary trust depends on the type of income and whether it falls within the 'standard rate band' – up to the first £1,000 of income.

The tax band's size varies according to whether the settlor – the person who has set up the trust – has established any other trusts. Where the settlor has set up other trusts, the £1,000 band will be split equally between them, subject to a minimum band of £200. So, if the settlor has set up five or

## EXAMPLE

### Discretionary trust taxation

The Little Harry Discretionary Trust receives £1,500 of interest and £2,000 of dividends. It is one of four separate trusts that Philip set up for his grandchildren, so the trust's standard rate band is £250 (£1,000/4). The trust's tax bill will be:

Income	Amount £	2022/23	
		Tax Rate %	Tax £
Interest	250	20	50.00
Interest	1,250	45	562.50
Dividend	2,000	39.35	787.00
<b>Total</b>	<b>3,500</b>		<b>1,399.50</b>

If Philip had made his gift via a bare trust for Harry's benefit, there would probably have been no tax to pay thanks to Harry's personal allowance.



more trusts, each trust will benefit from £200 of income taxed at the standard rate.

You apply the standard rate band first to non-dividend income and then to dividend income. The dividend allowance is not available to trusts, but dividends falling within the standard rate band are taxable at 8.75% in 2022/23.

Income paid by a discretionary trust to a beneficiary is treated as having already been taxed at 45% – the current rate for trusts. If the beneficiaries themselves pay tax at a lower rate, they should be able to reclaim some of this. A beneficiary who does not pay tax, or who pays tax at below the additional rate may be able to claim some or all of the tax back. If they pay tax at the additional rate, there will be no more tax to pay on the trust income outside Scotland, where there will be an extra 1% tax to pay because the Scottish additional rate is 46%.

### Capital gains tax and trusts

If you set up a trust you may have to pay CGT when you set it up. This could be because you either sell some investments to put cash into the trust – potentially realising a profit – or because you simply transfer some of your own existing assets into it. However, if you use a discretionary trust you could postpone the CGT liability by claiming hold-over relief; the trustees would then pay tax on the held-over gain when in turn they sell or transfer the asset, although on transfer they too have the option of claiming hold-over relief.

Trustees are potentially subject to CGT on investments if they realise profits by selling them or transferring them to the beneficiaries. The position varies, mainly depending on the type of trust involved.

- In the case of a **bare trust**, the investments are taxed as if the beneficiary owns them. If the trustees realise gains on any investments, these are taxed on the beneficiary and set against their annual exempt amount. If the gains are large enough to be taxable, the tax rate(s) will generally be 10% and/or 20%, depending on the beneficiary's own level of income and gains. Residential property gains attract an 8% surcharge.
- Gains within **discretionary trusts** are not taxed by reference to the beneficiaries. The trustees have an annual exempt amount of up to £6,150 in 2022/23, although it will be less if the settlor has set up any other trusts. The minimum is £1,230 in 2022/23. Any net gains that exceed the available allowance are taxed at a flat rate of 20% (or 28% for residential property).

A CGT liability may also arise when assets are distributed from the trust. In a discretionary trust, the trustees would normally be liable to pay the tax (unless hold-over relief is claimed). This is not the case in a bare trust, when the beneficiary is 'absolutely entitled' to the trust assets, usually because they have reached age 18, or the trust has come to an end. A CGT liability would also arise for the trustees if the trust became non-resident.

#### Planning point

If you use a discretionary trust you could postpone the CGT tax liability by claiming hold-over relief; the person who receives the asset would then pay tax on the held-over gain when in turn they sell or transfer the asset.

#### Inheritance tax and trusts

There is a possibility of incurring an IHT charge on transfers into a trust. If you make an outright gift to an individual, or place it into a bare trust, there could be an IHT charge of up to 40%, but only if you were to die within seven years of making the transfer.

If you make a transfer into a discretionary trust of more than the amount of your unused nil rate band (until at least April 2026 the full band is £325,000), you will have to pay an IHT charge of up to 20% on the excess. If you die within five years of making the gift, there could be a further tax charge to bring the total up to a maximum of 40%. This is less than the usual seven-year period, because the taper relief will eliminate any additional tax after just five years. There could also be further relatively small IHT charges for the trust every ten years that the trust continues and then when assets leave the trust.

Trusts and trust investments are not an area for do-it-yourself tax and financial planning. The position is complicated, and the law and HMRC practice change frequently.

Stocks and Shares ISAs invest in corporate bonds; stocks and shares and other assets that fluctuate in value.

Tax treatment varies according to individual circumstances and is subject to change.

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

Past performance is not a guide to future performance.

The value of investments and income from them can go down as well as up, and you may not get back the original amount invested.

The Financial Conduct Authority does not regulate tax and trust advice, will writing, National Savings and Investments, inheritance tax and some forms of estate planning.



#### HOW WE CAN HELP

Planning for your child's future is one of the most important things you will ever do, and we are here to advise you about the best way to achieve your aims and to help ensure that your investments produce the outcomes you want for your children.

We can help in a range of ways. We are very willing and prepared to work with your other professional advisers. The scope of our work can include:

- Comprehensive financial planning for your family's finances and estate planning.
- Investment planning for yourself, your family and any trusts, from asset allocation to investment selection.
- IHT mitigation.
- Advice on the choice of appropriate trusts.
- School fees and other educational costs planning.





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