A guide to investing for children

AJ Bell Youinvest

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Introduction

Teaching your child the value of saving while they are still young can lay the foundations for a wealthier, more independent life when they reach adulthood. There are several different savings vehicles for children, with two of the most tax-efficient being Junior ISAs and childrens' pensions. Both have their pros and cons, and the suitability of each depends on your specific goals. Many people set up both and use them for different purposes.

What are Junior ISAs?

If you're looking for ways to help your child financially in their early adult lives – perhaps to fund the cost of a university education, a wedding or the deposit on a first home – a Junior ISA may be the most suitable option.

Junior ISAs were introduced as a replacement for Child Trust Funds (CTFs), which were phased out in November 2011. There are two types of Junior ISA - 'stocks and shares' (also known as 'investment' ISAs) and 'cash'. The main benefit of Junior ISAs is that they provide a home in which cash and other investments can be held free of both Income Tax and Capital Gains Tax.

Who can have a Junior ISA?

Junior ISAs are available to children under the age of 18 who are resident in the UK. Children who are eligible for a CTF can only open a Junior ISA if they intend to transfer the CTF to the Junior ISA. This is relevant to anyone under 18 who was born between 1 September 2002, when CTFs were introduced, and 3 January 2011 when they came to an end.

Only the child's parent or legal guardian can actually apply for the Junior ISA, and the applicant then becomes the 'registered contact'. The capital in a Junior ISA cannot normally be accessed until the child reaches 18, at which point their Junior ISA is converted into an 'adult' ISA.

What are the rules?

There are limits on the type of Junior ISA that can be opened and the amount that can be saved during the course of each tax year (6 April to the following 5 April).

The key rules are:

- An annual subscription limit restricts the amount that can be paid into Junior ISAs each tax year. For the 2018/19 tax year the subscription limit is £4,260.
- Only one of each type of Junior ISA (one cash and one stocks and shares) can be held for a child at any time. The subscription limit can be split in any way between cash and stocks and shares Junior ISAs each tax year.
- The funds built up in a Junior ISA cannot be withdrawn until the child is 18 years old.

What are the tax advantages?

The interest payable on deposits in a Junior ISA is not subject to tax, whether it is held on instant access or on term deposit or in a cash or stocks and shares Junior ISA.

In a stocks and shares Junior ISA, dividends and interest on gilts and bonds are not subject to Income Tax or Capital Gains Tax.

How can you pay money into a child's Junior ISA?

Anybody can pay into a child's Junior ISA.However, for the 2018/19 tax year, the combined total of all payments (or subscriptions) to a Junior ISA must not exceed £4,260. This figure will increase annually, in line with inflation. Each tax year's Junior ISA subscription limit is specific to that year – once it's gone, it's gone.

One-off and regular payments

You can save monthly in a Junior ISA, usually by Direct Debit, or make one-off payments as and when you choose.

You should check with your Junior ISA manager whether there is a minimum amount they will accept if you wish to make payments to a child's Junior ISA.

Transfers-in

If your child holds a Child Trust Fund it is also possible to transfer this into a Junior ISA.

You can transfer funds between Junior ISAs of different types, but it's important to remember that your child can only hold one Junior ISA of each type at any given time. So, if you decide to transfer funds from a stocks and shares Junior ISA to a new stocks and shares Junior ISA, then you must transfer all of the assets. If you wish to transfer from a stocks and shares Junior ISA to a Junior cash ISA, then you can transfer either some or all of the assets, but you must end up in a position where only one Junior ISA of each type is held.

Children's pensions

The current State Pension Age is 65 and there is provision to increase this to 68 by the mid-2030s. Imagine what it could be by the time your child is thinking about retirement. If you want to help them avoid working into their old age, starting a pension for your child now could be the best tactic.

By starting a pension for a child at birth, their investment horizon could stretch for over 60 years. This kind of timescale can result in very significant pension pots for a relatively modest investment. For example, if you take a growth rate of 2.5% a year above inflation, contributions of £2,880 a year until the child reached 18 could result in a real-terms fund of £233,000 by the time the child reached 60 years of age – even if they never made another contribution. Of course, the value of investments can fall as well as rise, and returns are not guaranteed.

Who can have a children's pension?

Any child who is resident in the UK can have a pension.

What are the rules?

An annual contribution limit restricts the amount that can be paid into a child's pension each tax year. For the 2018/19 tax year the contribution limit is £3,600.

What are the tax advantages?

Any contributions made into a child's pension benefit from the same tax relief that basic-rate taxpayers get. So, in order to make full use of the £3,600 annual limit, you only need to contribute £2,880 a year into their pension. The Government then tops this up with the 20% tax relief of £720.

Your child won't have to pay Capital Gains Tax on any investment growth, and there is no Income Tax to pay on any dividends or other income paid into their pension from their investments. When your child eventually makes the decision to take money from their pension, current rules allow for up to 25% of the fund to be paid as a tax-free lump sum.

How can you pay money into your child's pension?

Anybody can contribute to a child's pension. However, for the 2018/19 tax year, the combined total of all contributions paid in must not exceed £2,880 (net).

One-off and regular payments

People can contribute monthly, usually by Direct Debit, or make one-off payments as and when they choose.

It is important to check with the child's pension manager whether there are any minimum amounts which they will accept if you wish to make payments to a child's pension.

Transfers-in

If you've set up a pension for your child in the past but are looking to change pension provider, perhaps because you've made the decision to switch provider yourself and wish to keep the family assets in one easily manageable place, it is easy to transfer between pensions.

Making a transfer is usually a simple process. Typically, you complete a transfer form, send it to your new pension provider and they take care of the rest – it really is that simple.

Junior ISAs versus children's pensions

The decision to save in a Junior ISA or a children's pension will depend on what you are saving for. If you are looking to support a child through university or perhaps to help them with a deposit for a home, then a Junior ISA might be suitable. However, if you are looking much longer term and considering the type of retirement a child will have, then you may want to start a children's pension like a Self-Invested Personal Pension (Junior SIPP) now.

Payments made to a Junior ISA aren't topped up by the Government with tax relief in the same way as payments to a child's pension would be. However, your child won't have to wait until they're 55 to take money out, there is no tax to pay when they do withdraw funds, and there are no limits on the amount that can be withdrawn once they reach 18.

The table below summarises the key differences between a Junior ISA and a child's pension.

	Junior ISA	Child's pension
Is there Income Tax relief on payments-in?	No	Yes
What are the maximum payments each year?	£4,260	£2,880 (net)
Is Income Tax due on withdrawals?	No	Yes (on retirement) None on tax-free lump sum
Is there an age restriction on withdrawals?	No withdrawals before age 18	No withdrawals before age 55
Is Capital Gains Tax payable?	No	No

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Are you more comfortable being in control?

Some children's personal and stakeholder pensions, along with some types of stocks and shares Junior ISAs, don't offer you complete control over your child's investments. Instead the pension or fund manager may offer only a limited range of investments, or might even decide where the money in the pension or ISA funds held with them are invested. This might be a good option for people who lack the knowledge or confidence needed to make their own investment decisions. However, investors in these types of children's pensions and Junior ISAs may have to pay higher fund charges and don't benefit from the discounts available from many modern investments platforms.

If you would prefer to take direct control of how your child's savings are invested you can choose to open a 'self-select' stocks and shares Junior ISA, or a Junior Self-Invested Personal Pension (SIPP) instead. Self-select Junior ISAs and Junior SIPPs offer the freedom to invest in a huge range of investments. It is also quick and easy to switch investments if you're not happy with the ones your child is holding. Dealing charges will apply when you buy and sell some investments and you may pay an annual fee which can be either a fixed amount, or a percentage of the value of your child's investments.

What can you invest in?

Junior SIPPs and stocks and shares Junior ISAs allow your child to hold many types of investment.

A few examples include:

- shares and corporate bonds listed on any recognised stock exchange
- UK Government gilts or similar securities
- units or shares in funds, e.g. unit trusts and OEICs (Open-Ended Investment Companies)
- shares and securities in investment trusts

Why consider us?

Low charges

Our charging structure is simple. There are no set up costs, and you don't pay charges for paying money into, or making a transfer to, your child's Junior SIPP or Junior ISA. For more information on our charges and rates please refer to our website at youinvest.co.uk.

Regular investing

Regular investing allows you to apply a regular discipline to your child's investment strategy and avoids you having to anticipate market movements. The price at which you buy investments can vary significantly, especially at times when stock markets are volatile. Regular investing gives you the opportunity to smooth out the impact of short term movements in the price of an investment or range of investments.

With us you can invest regularly in over 2,100 funds within our funds universe and in any FTSE 350 share, selected ETFs, ETCs and investment trusts.

Convenience

Our online functionality allows you to monitor the progress of your child's investments from your own computer, 24 hours a day, 7 days a week. You can make payments into their Junior ISA or Junior SIPP by Direct Debit, and investments can be bought or sold in seconds, at the touch of a button.

Strength and experience

AJ Bell Youinvest is part of the AJ Bell Group, which is a financially secure and regulated company.

With assets under administration of £44.2 billion, AJ Bell has a history of demonstrating strong, consistent, growth. This makes us one of the biggest low-cost online investment platforms and stockbroker services in the UK.

We've succeeded by staying true to our beliefs, by understanding your needs as a DIY investor and by providing award-winning accounts, backed up with excellent service at a low cost.

To find out more about AJ Bell visit ajbell.co.uk.

You can open a Junior SIPP or Junior ISA with us today – just visit youinvest.co.uk

Please note that both tax rates and the favourable treatment of ISAs and SIPPs may change in the future.

This information is based on current legislation, HMRC guidance and tax rates which may change in the future.

Please remember that the value of investments can go down as well as up, and you may not get back your original investment. We do not offer advice about the suitability of our products or any investments held within them. Should you require financial advice you should consult a suitably qualified financial adviser.

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