Children, grandchildren and yet-to-be-borns: providing for their futures

The arrival of a child always prompts hopes, aspirations and plans. Some, inevitably, are about money: providing funds for education, travel, a deposit for a first home or a nest egg. It all means saving and investing, and you can't start too early.

"Many people look at what they have to spare, think it can't ever be enough and decide there's no point starting. They couldn't be more wrong," says Christine Ross, a client director at Handelsbanken Wealth Management.

"Always remember that compounding growth and interest work in your favour. Start small and the money will grow in the years up to when your child or grandchild reaches 18. So, the first rule is 'set aside something rather than nothing.' And the second is just as simple: 'the sooner you start, the better'."

Guarding against inflation

No investment is a sure thing but even modest inflation will significantly erode the value of cash savings over the span applicable to providing for children or grandchildren. Investments are usually more productive, though care has to be taken to find the most tax-effective approaches.

"I remember how grandparents used to buy shares on behalf of their grandchildren and hold them for years. They were on to something. It's now more usual to buy into investment funds with broad-based portfolios of equities, bonds and property. Stock market investments can be volatile but shares tend to yield significant returns over the long term."

A junior ISA is a good place to start providing for a child as it can hold up to £4,368 in cash or investments, free of tax, and contributions can be made each tax year. At 16, he or she also becomes eligible for an adult cash ISA with a current annual allowance of £20,000; you can transfer the 'junior' fund that has built up into this when the beneficiary becomes 18. That can all add up to a considerable amount.

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Children have tax allowances too

Christine points out that children, like adults, have their own income tax allowance which allows them to receive income of up to £12,500 a year tax-free. But bear in mind that should interest, or investment income, arising from capital gifted to a child by their parent top £100 a year, then the entire amount will be taxed on the parent. This, however, is not the case when the capital is gifted by a grandparent or other friends or family members.

Profits from investments are liable to capital gains tax (CGT) but everybody has an annual CGT allowance of £12,000. This includes children. Parents and others can invest on behalf of a child. If the allowance has been used in full, then CGT will be payable at a rate of 10% for basic rate taxpayers and 20% for higher rate taxpayers – in both cases, significantly lower than income tax. Whilst investments will be held and managed on behalf of the child, at age 18 the child is entitled to take full control of the investment – something parents or grandparents may want to consider.

The longer term

What about children yet to be born? Parents or grandparents can invest in anticipation of an impending arrival, and transfer the money to a child’s account upon birth. “Of course,” says Christine, “all the accumulated principal and income becomes theirs absolutely at 18. Should there be any doubt about your youngster’s capacity to handle money you can reinvest the funds into a longer-term arrangement while they’re still 17. But the best course is to educate your kids about money and savings early on.”

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Inheritance tax (IHT) naturally looms large in such matters. We all have the right to give away £3,000 a year in gifts without becoming liable for IHT and any unused exemption can be carried forward for one year, totalling £6000. And anyone can give away as much as they want tax free providing they live seven years after the gift has been made. “And here, once again,” notes Christine, “friends and family can play a helpful role. Everyone enjoys a further exemption for ‘gifts out of surplus income’, that is to say money over and above what’s needed to maintain their standard of living. There must be an intention to carry on making gifts of a similar amount on a regular basis for several years, though there’s no obligation to carry on should circumstances change. All such gifts are immediately outside of the donors estate, for IHT purposes.”

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