



The Association of Investment Companies



# Investment companies and investing for children

Investing some money – either as a one-off lump sum or on a regular basis – is an ideal way to give any child a head start in life. And, because of their generally low charges and long-term performance record, investment companies are a good way of investing on behalf of a child.

This factsheet contains information on Junior ISAs, Child Trust Funds and other Children's Saving Schemes. It will help you understand the different options available when planning to save for a child.

## Why invest in the stockmarket?

It's worth remembering that, although over the short term the stockmarket can be a volatile place, these ups and downs tend to even themselves out over time. Historically the stockmarket has outperformed banks and building society deposits over the longer term, and if you invest when a child is born, you could have 18 years to build up a sizeable investment on their behalf. The sooner you start, the longer and better chance your money has to grow.

What are investment companies?

In a nutshell, investment companies are companies that invest in a diversified portfolio of assets to make money for their shareholders. Investment companies can be investment trusts, venture capital trusts, and offshore and AIM traded investment companies. Investment companies pool investors' money and employ a professional fund manager to invest in a wider range of assets than most people could practically invest in themselves. This way even people with small amounts of money can gain exposure, at low cost, to a diversified and professionally run portfolio, spreading the risk of their investment. Investment companies are listed on a stock exchange and there are over 400 investment companies in the UK responsible for the management of billions of pounds worth of assets on behalf of investors. For more information on investment companies please read our factsheet 'An introduction to investment companies'.

### Why are investment companies suitable for investing for children?

#### **Allows you to pool your money**

When you purchase shares in an investment company you pool your money with all the other investors' money, providing potential economies of scale, in terms of dealing costs and administration.

#### **Allows you to spread your risk**

Each investment company owns a range of investments, so buying shares in only one company effectively gives you a diversified portfolio. As you're not dependent on the success of just one or two investments, this spreads your risk. However, it must be remembered that investment company shares are equity investments and the price of the shares and the income from them can go down as well as up.

#### **Uses professional management**

Each investment company uses professional fund management expertise.

#### **Many have low internal charges**

Many investment companies have low internal charges. Because the boards must act in the interests of shareholders, they work to ensure that 'costs' or the company's internal charges are reasonable and that the interests of shareholders are looked after. Low charges within the company means more of your money is working for you right from the start of your investment.

Put all these benefits together and you have an effective and cost-efficient way to invest in the stockmarket on behalf of a child.

## How to use investment companies to save for a child's future?

Children under the age of 18 are not allowed to hold company shares in their own name. One way around this is for you to invest on their behalf. You can do this through any investment company saving and investment scheme and some management companies have plans specifically for children. You can choose to hold company shares either in your own name and designate on the application form that you are holding them on behalf of a child (by adding the child's name or initials to the form) or you can hold company shares in a bare trust for the benefit of the child.

Holding company shares in a designated account means that the money remains yours but is designated for the child. You have the flexibility to decide when to hand the money over to the child, but you will have to account for any tax arising.

By contrast, holding shares in a bare trust means that the bare trustee's name is on the share certificate as the legal owner and the child is a beneficial owner. The bare trustee may be a different person from the donor. The child will have access to the proceeds of the investment on reaching the age of 18 when the shares can be registered in their name. Until that time, the bare trustee is responsible for looking after the investment on the child's behalf. It may be appropriate to appoint two trustees so if one pre-deceases the child, the surviving trustee can continue to administer the trust. The tax position of the child is examined in the section entitled "What are the tax implications?"

To establish a valid bare trust you will either need to complete a simple declaration of trust form or complete similar documentation provided by the plan manager. This will enable you to satisfy HM Revenue & Customs (HMRC) that the shares are being held in a bare trust. Although HMRC no longer requires that a declaration of trust form be stamped at the Stamp Office it is still necessary to advise them that a bare trust has been established. You can do this by completing the HMRC form 41G(Trust) which can be found on the HMRC website [www.hmrc.gov.uk](http://www.hmrc.gov.uk). Further guidance can also be found in "Trusts – The Basics" on the HMRC website. If you have any further questions about tax issues surrounding the establishment and running of a bare trust you should contact your local tax office and if appropriate obtain legal advice.

You can set up a more formal type of trust, which could specify, for example, that the child only receives the income from the investment company at age 25, but you'll have to consult your solicitor for this. As a rule of thumb, the more control you want to retain over the trust, and the more flexibility you want to have over the child's rights to the fund within it the more complicated the trust is likely to be to set up. You should obtain proper legal advice before setting up this type of trust arrangement.

You can find advisers qualified in trust and estate matters from the Society of Trust and Estate Practitioners website [www.step.org](http://www.step.org).

### Child Trust Fund (CTF)

The Government-sponsored Child Trust Fund (CTF) started in April 2005. Each child born on or after 1st September 2002 was eligible for a voucher from the Government for at least £250 to start the account (£500 for children from low income families) which was topped up again with the same sum as the child reached age 7. However, Government contributions for CTFs stopped on 1 January 2011.

Children born on or after 1 January 2011 will not be eligible for a Child Trust Fund but will be eligible for a Junior ISA. CTF accounts already set up for eligible children will continue to benefit from tax-free investment growth; as before, no withdrawals will be possible until the child reaches the age of eighteen. Family and friends of the child are still able to contribute additional amounts to the CTF, up to a limit of £3,600. This limit was raised on 1 November 2011 to keep it in line with the new Junior ISA. It will still be possible to change the type of CTF account and/or move it to another provider.

The first CTF account will mature in 2020. When a child turns 18, the CTF can be rolled over into an Individual Savings Account (ISA) so that the fund will not be subject to income or capital gains tax.

### Junior ISAs

The 'Junior ISA' (JISA) was launched on 1 November 2011 and is a new product designed to enable and encourage long term saving for children. Children born after 1 January 2011 are eligible for a Junior ISA. Friends and family are able to contribute up to £3,600 each tax year into a child's JISA. Children can hold one cash and one stocks and shares JISA at the same time up to an overall limit of £3,600 per tax year.

As with an 'Adult' ISA, the account will be tax free and funds placed in the account will be owned by the child, although they will be locked in until the child reaches age 18. When a child turns 18, the Junior ISA can be rolled over into an Individual Savings Account (ISA) so that the fund will not be subject to income or capital gains tax.

### School or university expenses

Investing for school or university fees, where you are trying to achieve a certain level of return within a specified time frame, is very different to investing without a specific need or goal. Knowing roughly how much money you will need, and by when, should help you choose what's most appropriate for you.

### Splits and zeros

Split capital investment companies may also be suitable vehicles for investing over a specific time frame. Splits are companies with a portfolio of investments just like conventional investment companies, but they issue two or more different types of share with specific rights and entitlements to the income and/or capital returns of the portfolio.

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One of the common share classes within a 'split' is a zero dividend preference share, or 'zero' for short. Zeros have a fixed life and offer a predetermined, but not guaranteed, capital return on your investment on a specific date in the future. As splits have varying wind-up dates, you could invest a series of lump sums in a variety of different zeros with differing maturity dates over the period of the child's education. This way you can plan to realise your investment as and when you need it.

Investment companies offer a range of exposure to risk through portfolio and market diversification, use of gearing (borrowing) and capital structure (the types of shares offered and their entitlements). As with conventionally structured investment companies, each split is unique and the share types within them will vary in risk exposure. It is important that you research any potential investment in a split very carefully before investing and take advice from a financial adviser if you are unsure.

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Split capital investment companies have a unique and complicated structure and should be carefully researched. To learn more about them call: 0800 085 8520 for a factsheet or download from [www.theaic.co.uk](http://www.theaic.co.uk)

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### Child's Pension

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Since 2001 it has been possible to start a pension for a child. In most cases, contributions of up to £3,600 gross, £2,880 net, can be made to a child's pension each year. It is possible to pay in more than this but no further tax relief will be given on the contributions. Investment companies, given their low charges and long-term performance, are particularly suitable for this purpose.

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## What are the features of children's investment schemes?

### Flexibility

You can invest monthly or make a lump sum investment or a combination of both – perhaps topping up your investment occasionally with a windfall or bonus. You can increase or decrease your regular payments (subject to the minimum for the particular scheme you are in) and even stop investing and start again at a later date if you want to. Remember that equity investment is for the longer term and you should carefully evaluate your objectives and reasons for investing before making a decision to change or dispose of your investment.

Each scheme may offer several investment companies that can be held within it, normally those under the management of the scheme operator. You can hold more than one company's shares within a scheme and hold as many different schemes as you want. For instance, if you are investing for income, you could invest in several different investment companies each paying dividends in different months to give you a regular income.

### Low minimum investment

With minimum monthly payments starting from £50 in some schemes and lump sums or occasional top-ups from £250, you can start to build your investment up from a low initial base.

### Regular saving

One of the advantages of regular saving is known as 'pound-cost averaging', which means that the variable highs and lows of the share price will be smoothed out over time. This is because you buy fewer shares when the price is high and more when the price is low, taking away some of the risk of market timing that can occur when buying shares with a lump sum. The result of this is that in a falling market the average price you pay for your shares over a given period is lower than the average market price.

### Low costs

A savings and investment scheme provider will collate the buying orders from all the monthly investors within a scheme for a given month and place the total as one bulk deal with a stockbroker. By pooling all the investors' money the manager is able to negotiate a discount on the dealing costs. These cost savings are passed on to you, making savings and investment schemes a cost effective way to invest regularly in the stockmarket.

Scheme providers usually make an additional charge to cover the costs of administering the scheme. These costs will be detailed in the provider's literature, and you should investigate the total costs involved before investing.

### Simple administration

Once you have decided which scheme you want to invest in, the scheme providers will send you all the paperwork you need. You just fill in the forms and enclose a cheque or direct debit details and leave it to the scheme provider to do the rest.

#### More information

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Savings and investment schemes are often referred to as a “wrapper product”. This is simply a “wrapper” within which an underlying investment is held. You can put your money into an ISA, a savings and investment scheme or a pension scheme. You can invest monthly or make a lump sum investment or a combination of both. Most investment company shares are available through these schemes which are usually run by the management companies of the relevant investment company. The AIC website [www.theaic.co.uk](http://www.theaic.co.uk) has details on the schemes offered by Member companies and their managers.

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#### Important information about investment companies

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Investment returns are not guaranteed and past performance is not necessarily a guide to the future. Exchange rate fluctuations may cause the value of the underlying investment to go up or down.

Investment companies can borrow money or “gear” to invest in more shares using the existing portfolio as collateral. Companies that use significant levels of gearing may be subject to sudden and large falls in value and you could get back nothing at all.

An investment company's share price may not reflect the underlying value of the shares, known as its net asset value (NAV). Commonly investment company shares trade at a discount to their NAV, for example where a company's NAV is £1 and its share price is 90p it will be trading at a 10% discount. Conversely, if the share price is 110p and the NAV is 100p then it will be trading at a 10% premium. The level of discount/premium of a share price and whether it is rising or falling can be a factor when deciding to buy or sell an investment company's shares.

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## What are the tax implications?

When setting up any investment scheme you need to take a close look at the tax situation, not only how it affects the child, but also how it affects you or any other donor. One of the most important questions to ask yourself is whether you will have to pay tax on the child's investment income. This really depends on who is gifting the investment to the child and what their relationship is.

### For parents

If you have made investments on behalf of your child, which generate an income of £100 (gross) or more a year, the income will be deemed to be part of your income and you will have to pay income tax on it. (The only exception to this will be additional contributions to a Child Trust Fund or Junior ISA.) If each parent gifts money to the child separately, the income threshold for the child will rise to £200 (gross) before either parent incurs a tax liability. This applies until the child is 18, provided they remain unmarried.

### Grandparents, other relations or friends

The income tax situation is different if you are a grandparent, friend or other relation of the child. Any income generated by gifts made from those other than parents is treated as the child's. Children have their own personal tax allowances, but it is likely that investments on behalf of a child will be focused on capital growth rather than income, reducing the likelihood of an income tax liability for the child.

As with all questions of tax, the issues can be complicated and you should therefore take advice if you are uncertain about your position. Inheritance tax planning, like making a will, is often put off but can help ensure that more of your wealth passes to your children rather than to the state.

### Inheritance tax

If you decide to make a gift to a child you should be aware of the Inheritance Tax (IHT) implications. The HMRC produce the "Inheritance Tax: Customer Guide", which is available on their website [www.hmrc.gov.uk](http://www.hmrc.gov.uk) or by calling their order line on 0845 302 0900.

Both the parent of a child and the donor should keep records of the date and amounts of any gift. Certain gifts are exempt from IHT.

- Annual gifts up to £3,000 to one recipient or split between several individuals. If unused the gift can be carried forward to the next tax year only.
- Any number of gifts up to a total of £250 per recipient per year. Unused amounts cannot be rolled forward. These are regular gifts financed out of one's normal expenditure. The donor must be able to maintain his or her normal standard of living.
- Wedding gifts of up to £5,000 to each of your children. For grandparents the limit is £2,500 and other individuals can give up to £1,000.
- Gifts for the maintenance of your family and children under eighteen or in full-time education.

Gifts over and above the limits set out above which are held in a bare trust will be counted as a potentially tax exempt transfer and, provided the donor lives for seven years after the gift is made, there is no inheritance tax liability. If the donor dies within seven years the value of any gifts will be assessed on a sliding scale depending on the number of years between the donation of the gift and the donor's death. In the tax year 2011/12 IHT is not levied on estates worth less than £325,000. Once this threshold is breached IHT is levied at 40% on any amount in excess of this limit. However, money held in a designated account will be treated as part of the donor's estate for the purposes of inheritance tax.

Donors should also give careful consideration to making a will. A will should be periodically reviewed as your circumstances change. Making a will can reduce the IHT that might otherwise be levied on your estate. This is a complex area and individuals should take appropriate legal and financial advice. It is important to remember that levels and bases of and reliefs from taxation are subject to change

### How to invest

#### Investing with advice

You can go to a professional financial adviser, who will give you advice on what to invest in. Together you can work through all the factors that affect your decision, including your needs and available funds, the performance figures for different companies, and the outlook for different sectors. Your adviser can then advise you on whether investment companies are a suitable investment for you and how to make your investment.

The AIC website [www.theaic.co.uk](http://www.theaic.co.uk) has further information about getting financial advice or you can find a Certified Financial Planner by calling the Institute of Financial Planning on 0117 945 2470 or by going to [www.financialplanning.org.uk](http://www.financialplanning.org.uk).

#### Investing without advice

If you are prepared to select your own investment company you can choose whether to go direct to a stockbroker or an execution only dealing service to buy shares for you. Or you can approach a fund management group to invest via a wrapper product. The AIC website [www.theaic.co.uk](http://www.theaic.co.uk) has further information on wrapper schemes.

#### Summary

Investment companies are a good way to save for children as they are an effective and cost-efficient investment vehicle which provides exposure to a diversified portfolio. The flexibility and accessibility of investment companies due to their low minimum investment levels and ability to spread risk makes them an ideal way to give any child a head start in life.

Investors who are unsure whether this investment is suitable to them should obtain independent advice from their professional adviser.

## Notes

## For further information

### Visit our website

Our website is a good place to start if you want to learn more about investment companies and find detailed information on all our member companies. You can find it at [www.theaic.co.uk](http://www.theaic.co.uk).

### Information factsheets

The AIC publishes a range of factsheets which are available free of charge by calling 0800 085 8520 or can be downloaded from our website.



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