There are many benefits with the junior Isa which sweeps aside many of the problems of investing for children

Welcome the junior Isa

THE EXPERT

Paul Kennedy

I doubt the little darlings will greet the launch of the junior Isa on November 1 with the same gusto as they would a new gaming console but advisers should be brimming with excitement.

Hitherto, investing for children has not been without its tax problems and legal issues. The junior Isa will sweep many of these aside, will provide additional advantages over the previous child trust fund and offer possibilities for added inheritance tax and capital gains tax planning.

Like the adult Isa, investment returns from a junior Isa will be free from personal liability to income and capital gains taxes. It might be argued that since most children are non-taxpayers, there is no great benefit. It is true that the "tax-saving" as such may not be as great for a child as for an adult but that is too simplistic and also ignores other useful attributes. First, it surely makes sense to consider a tax-exempt wrapper irrespective. Second, investment returns within a junior Isa will not count towards the child's personal income tax or CGT allowances, so those allowances remain available for other investments or any earnings that may arise. Third, the junior Isa can be rolled over into an adult Isa at age 18. This means the child can take a large tax-exempt pot into adulthood and when they become a taxpayer, the normal tax savings of an adult Isa will kick in.

Unlike the adult Isa, anyone can contribute to the junior Isa allowing parents, relatives and friends to save for the child in a single vehicle. This ought to be preferable to the fragmentation created when individual investments are all over the place.

No tax is payable by any contributor to a junior Isa and, importantly, that includes the parents. This means the current income tax anti-avoidance rule on parental gifts to children that generate more than £100 gross income, will not apply. This has been a distinct problem in the past for parents who want to save for their child, as income from relatively small gifts would end up taxed on them and not the child.

Contributions to a junior Isa do not affect the child's own allowance for a cash Isa at ages 16 and 17, so there is no conflict here.

However, perhaps somewhat oddly, the parental anti-avoidance rule does apply to income from parental gifts invested in such a cash Isa.

Because minors cannot hold many types of investment, it has often been necessary for adults to invest in their name on behalf of the child. Here, it has always been important for tax and legal purposes to keep proper records of the gifts to show it is the child's money as opposed to the adults.

Junior Isas automatically make clear that the child is the beneficial owner of the investments without the need for formal legal documents such as trusts or deeds of gift.

Another benefit is that the junior Isa manager should be able to receive gross interest distributions from income funds. With directly held funds, even where the child is a non-taxpayer, payment must be net and the tax recovered from HM Revenue and Customs in conjunction with junior Isa contributions. This would deliver a potential IHT saving of £1,200 in addition to tax-free return for the child or children.

The gift will also be safely locked away for the child at age 18 with nobody else able to get their hands on it.

The small gifts exemption is also available but don't forget this cannot be used in combination with the annual exemption and only applies where no more than £250 is gifted to an individual.

Any contributions over the exemptions should be a potentially exempt transfer. There may also be opportunity for adults to use their annual CGT allowances to realise tax-free gains for onward contribution to a junior Isa.

The junior Isa does come with strings attached. No withdrawals can be made until age 18 except on death or terminal illness. For some, this will be a disadvantage, for others an advantage. The child will have automatic access to the money at age 18. If that is an issue, then traditional methods of investing using a trust may still be appropriate.

Overall, for parents and grandparents, along with other relatives and friends, who want to provide a foundation for a child's financial future, the combination of potential tax benefits coupled with the simplicity of investing make the junior Isa a welcome addition to the tax planning store.

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