CHILD TRUST FUNDS

The Child Trust Fund goes live this month and the government has been busy sending nearly two million children a £250 voucher. How does the scheme work and what will it mean for you?

The Child Trust Fund (CTF) is a new savings and investment plan designed to give children a financial head start in life. Under the scheme, the government will give all eligible children at least £250 to be invested in a special account until they are 18. There will be a range of accounts to choose from and friends and family will be able to top it up.

Who's eligible?

Any child born on or after 1 September 2002 is eligible. Unfortunately, you won't be able to open a CTF account for any child born before this date.

How much will my child receive?

That depends on when your child was born and how much you earn. Most children will get £250. If you have older eligible children (born between 1 September 2002 and 6 April 2005), you will receive slightly more (up to £277) because you've had to wait for accounts to become available since they were first announced in 2003.

Children in families with lower incomes (earning less than £13,910 a year and receiving Child Tax Credit) will get an additional £250 paid directly into their accounts. The government will also make another payment into the account on the child's seventh birthday, with a higher payment for children in lower-income families. These amounts are yet to be decided.

How do I claim it?

That's the easy part. There are no claim forms to fill in. In fact, you don't have to do anything (except decide which company's CTF to choose). If you receive child benefit, your voucher will automatically be sent to you. You'll receive an information pack setting out what you need to do next. This will include a list of providers and distributors from which to choose – at the moment, more than 70 companies will be offering CTF accounts. You can open a CTF account as soon as you receive the voucher.

How much can I pay into the account?

Once you've opened the account and paid in the £250 voucher, you can add your own money. The maximum you can pay in is £1,200 a year. Government contributions and interest don't count towards this limit, however. Anyone can pay into the account, so if you encourage friends and family to contribute, it could grow to a decent sum in 18 years' time. The start date for each year is your child's birthday, except in the first year, when it will start from the date the account is opened.

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I might not know how much other people are putting in. What happens if more than £1,200 is paid in?
It's up to the provider to make sure this doesn't happen. It should have systems in place to alert it when you reach the limit. If the provider accidentally accepts more than £1,200, it will return the excess to the person who paid it in. If you think it's likely that contributions will mount up to more than £1,200 in a year, you can set up a separate savings account from which to feed money into the CTF after your child's next birthday.

Will the Inland Revenue get a share too?
CTFs have the same tax rules as Isas. This means that, despite being touted as tax free, share-based accounts (including stakeholders) are liable for income tax at 10 per cent on any dividends received (see 'Different types of account', below, for types of CTF). There is no liability to capital gains tax. Savings accounts are therefore the only truly tax-free CTFs.

Most other types of children's savings and investments are subject to the '£100 rule'. This means that, if interest received by a child from money or an investment given to them by a parent comes to £100 or more a year, it is taxed as the parent's own income. This restriction doesn't apply to CTF accounts.

How much can my child expect to receive in 18 years' time?
It depends on how much goes into the account, how you invest the money and what charges you have to pay (see 'Different types of account', below). The fees charged on accounts investing in shares could eat into your fund so much that you are just as well off with a savings account – without the risk. For example, if your share-based investment grows by 7 per cent a year and you're charged 1.5 per cent,

Different types of account

There are three main types of CTF: savings accounts, accounts that invest in shares, and stakeholder accounts. Not all providers could give details of their accounts in time for this article, but there's more information at www.which.co.uk/childtrustfunds. Best Buys will be published online in June, and in the August issue of the magazine.

SAVINGS ACCOUNTS
A CTF savings account acts just like an ordinary savings account, except the interest is tax free. This is the safest and simplest option, especially if you're uncomfortable with the idea of investing your child's money in the stock market. But the money may not grow as much as if it was invested in shares. If you choose this option, check rates regularly and switch if necessary.

SHARE-BASED ACCOUNTS
Accounts that invest in shares will include investments such as unit trusts, open-ended investment companies (Oeics), and some types of life insurance funds. Historically, investing in shares has usually provided a better return over the long term than savings accounts. It's a riskier option, though, as the share value can go down as well as up. But you might be prepared to take the risk for the possibility of a higher return, especially over an 18-year period. However, there will be annual charges to pay – usually a percentage of the value of the fund. These vary from 0.5 per cent up to 1.5 per cent or more. With some accounts, you may have to make regular deposits or there may be a minimum monthly investment. There may also be initial charges to pay.

STAKEHOLDER ACCOUNTS
All providers must also offer (or make available through another provider) a stakeholder CTF that invests in the stock market. Unlike other accounts that invest in shares, stakeholder CTFs have to meet certain conditions regarding the types of investments allowed. They must hold a spread of investments across different markets, sectors and securities. On or before your child's 13th birthday, the money will start to be moved to lower-risk investments (such as cash or government bonds) to protect it from falls in the stock market (this is known as 'lifestyling'). Although these measures are intended to reduce risk, the return still isn't guaranteed. There will also be charges of up to 1.5 per cent a year, which will eat into the fund.

Gordon Brown announced the Child Trust Fund in the 2003 Budget

PHOTOGRAPHY DUNCAN SMITH, WINPENNY PHOTOGRAPHY, REUTERS you're left with a return of 5.5 per cent. Yet providers of CTF savings accounts are currently offering interest of around 5 per cent. Any investment fund with these charges is going to have to work pretty hard to better that by any significant amount. Of course, the savings rates may change so, if you choose this option, you should review the account each year when you get your annual statement and switch if necessary to get the best deal.

Bearing all this in mind, after 18 years, £250 plus, say, another top-up of £250 on the child's seventh birthday would grow to around £1,000 in a savings account paying 5 per cent interest.

The figures start to get more interesting when you add in extra contributions. Top it up by £10 a month and you could expect around £4,500 in a savings account paying 5 per cent each year. Making the maximum contribution of £1,200 a year (£100 a month) could boost it to around £36,000 (worth £23,000 in today's money).

Who can access the money?

Only your child will be able to access the money and, once you've made a contribution, you can't take it out. But your child will have to wait until they are 18 to get their hands on it. At this point, they can spend the money however they like – the cash can be withdrawn or invested further.

If I choose a share-based account, will I be able to invest in an ethical one?

Yes, some companies will be offering ethical investments. For example, Co-operative Insurance Society has launched an ethical stakeholder CTF. Funds are invested in a unit trust that tracks the FTSE4Good UK Index. To be listed on the index, companies must meet certain criteria, including working towards reducing their environmental impact. It excludes tobacco producers and weapons manufacturers but does include oil and drugs companies.

You can change accounts whenever you like

What if I change my mind about the type of account I want?

You can change accounts whenever you like and there are no restrictions on the number of transfers you can make during the life of the CTF. This applies to internal transfers from, say, a savings account to a share-based one with the same provider, or externally to a new provider. Transfers should take place within 30 days of your request. Although there are no specific fees for transferring, stamp duty and dealing charges may still apply with share-based accounts.

What if I don't open an account?

Every voucher has an expiry date of one year after the voucher was issued. If you don't open an account before that expiry date, the Inland Revenue will open a stakeholder account for your child. You'll receive information about the account from the provider allocated. Remember, this is a share-based account and you may be taking on more risk than you want, so it's best to open a CTF account yourself as soon as you receive the voucher.

Will I still be able to claim the CTF if I live abroad?

Your child will be eligible for the CTF only if you are a Crown servant stationed overseas – in the armed services, for example. If you live in the UK and then move abroad after you've opened a CTF, you can keep the account and continue paying into it, although you won't receive the extra government top-up if you are abroad when your child turns seven. If you return to the UK having lived abroad, you'll receive a voucher automatically when you claim child benefit.

'This is a really good incentive to save for the children'

Helen and David Salomon have three children: Anthony, three, Elisa, two, and Anna, three months. Helen welcomes the Child Trust Fund. 'This is a really good incentive to save for the children, especially with the spiralling cost of further education,' she says. 'Even though we already have savings accounts for Anthony and Elisa, I feel more inspired to save in earnest with this grant because they will be given such a good starting point.'

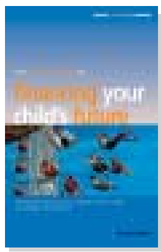
Elisa will receive £277 because she's older, and Anna will receive £256. As Anthony is too old to be eligible, Helen and David want to put money aside for him, too. Children's savings accounts are a simple way to do this, so they could stick with Anthony's Best Buy Halifax account (see 'Money Monitor', p31, for other Best Buys). Children's Bonus Bonds from National Savings & Investments are another option, paying a fixed rate of 4 per cent until the child is 21 and a bonus after five years. But they may find better rates on the high street.

If David and Helen are prepared to take more of a risk, they could invest their money on Anthony's behalf in a pooled fund, such as an investment trust or unit trust. Alternatively, they could set up a bare trust, which means they would act as trustees but the money would automatically go to Anthony when he reaches 18.

On reflection, Helen and David have decided to continue topping up Anthony's Halifax account, paying in a set amount each month to match the contributions they plan to make to Elisa and Anna's CTFs.

The Salomons welcome the Child Trust Fund

WHICH? BOOKS



For more about saving for your children, see *The Which? Guide to Financing your Child's Future*, £10.99. Order by phone on **0800 252 100** (quote code FYCF), or online at **www.which.co.uk/ bookshop**