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A Guide For Grandparents

Helping Your Grandchildren With Their Finances

Introduction

The natural order of events suggests that wealth tends to accumulate throughout a working life and into retirement.

This pattern means that older generations are typically wealthier than younger generations. In recent decades the economic position that has evolved in the UK has enhanced this position. Home ownership and house prices have both increased; there were boom times throughout the 80s, 90s and early 2000s, providing escalating wealth for many households. Add to this widespread company pension schemes (especially generous final salary pension schemes) and rising asset prices, and the current 'grandparent' generation has prospered.

The demographic position has also changed, the number of retired people has escalated – as has the number of people in the population (and as a proportion of the population) in the 65+ age bracket.

The resulting position is that in a relatively short space of time, the generation (who are likely to be grandparents) have got very much wealthier in comparison to their grandchildren's generation.

Additionally, the younger generation face many new challenges. Economic predictions suggest a long period of higher taxation, lower predicted pensions, a hard slog to pay for university fees and difficulties getting onto the property ladder.

This guide is an overview of how grandparents can help their grandchildren financially, in some cases very possibly helping themselves at the same time (for example by saving tax).

Given all the changes of the past few decades it is likely that there will be considerable growth in intergenerational financial planning and good reasons why this will be the case.

Note: This is not meant as a technical guide; it is intended to provide ideas and information which will enable readers to take further steps if suitable. However any steps should only be taken after appropriate and individual regulated advice has been received. Although the guide is aimed at grandparents it is likely that the exact same opportunities and ideas will apply to great grandparents as well.

Financial products which are suitable for younger children

There are many products that are suitable for younger children and some that are only available for them.

Junior ISAs

Junior ISAs are long term, tax free savings accounts for children. They are available for children aged under 18, who live in the UK and who were not entitled to a Child Trust Fund (CTF) Account. If they were eligible, they cannot have a Junior ISA.

There are two types of Junior ISA; a cash Junior ISA and a stock and shares Junior ISA. The cash ISA allows for investment into savings accounts, which pay interest and work like a bank or building society account. The stocks and shares version allows for investment into riskier areas, such as shares, corporate bonds and government bonds.

Up to the age of 16 only a parent or an individual with parental responsibility can open a Junior ISA for the child. 16 or 17 year olds can open their own Junior ISA.

The money belongs to the child and cannot be withdrawn before age 18.

Parents have responsibility for 'managing' the ISA (e.g. opening it, choosing the company to open it with, making any changes etc.) up to age 16. At 16, the child can take this responsibility over.

At age 18, the Junior ISA automatically converts to an adult ISA.

£3,720 in total can be paid into Junior ISAs each year. This can be any mix between a cash version and a stocks and shares version.

If a grandparent wants to start a Junior ISA for a grandchild they will need to give the money to the parent to open and place into the Junior ISA, effectively as a gift (see section on gifts regarding the tax considerations around making gifts).

National Savings Children's Bonds

Previously called Children's Bonus Bonds, these are savings accounts from National Savings and Investments. The rules are different for a maturing Bonus Bond which then is reinvested - here are the rules for new investments which go into the Children's Bond:

- A grandparent can invest directly into a Children's Bond for their grandchild.
- The Bonds are made available via 'issues'. Amounts from £25 to £3,000 can be invested in each issue as it is released.
- At outset, a guaranteed annual rate of interest is offered for a period of 5 years.
- Bonds can be encashed before 5 years but with a penalty of 90 day's loss of interest.
- All returns are completely taxfree.
- The Bond will finally mature once it reaches its first 5 year anniversary on or after the child's 16th birthday.

Pensions

A grandparent can pay up to £3,600 a year gross into a Stakeholder pension for their grandchildren even if they are not earning, and the contribution will benefit from basic rate tax relief.

So, under present tax arrangements, for each £1 paid, HM Revenue & Customs (HMRC) will pay an extra 25p, even if the child does not normally pay income tax (assuming 20% basic rate relief for tax year 2013/2014.)

If £3,600 per year gross (known as the 'basic amount') is paid into their pension fund, then it will actually cost the contributor just £2,880 a year, as the income tax relief for the tax year 2013/2014 will increase the contribution to £3,600 a year.

The availability of pensions to any child of any age is a wonderful way for grandparents to help their grandchildren with a long term investment which will bear fruit at the grandchild's retirement point (pensions have to be left invested until the child is 55, under current rules). A huge difference can be made to their final retirement pot with a few annual contributions made when they are a child.

This provides for a real legacy to be created by the grandparent to their grandchild. Although the tax relief is given at source, effectively to the child, it is still by proxy a good way for a grandparent to invest tax efficiently, because for every £100 they invest for the grandchild £125 gets invested.

Financial planning to help grandchildren

Gifts

'The £100 rule'

There is a major advantage that grandparents have over parents when it comes to helping out a child. If a parent puts money into their child's name it can create an unwanted income tax burden on the parent, as follows:

Children have a taxfree 'Personal Allowance' in the same way that adults do this is the amount of income they can receive, for example from savings or investments, before it becomes subject to tax.

Interest on savings is classed as income, but is subject to specific tax rules, depending on who has deposited the money on the child's behalf.

If parents make deposits into a child's account, then the taxfree allowance of accrued interest is £100 per year, for each parent paying into the account. But, if the interest exceeds £100 per year, the whole amount is taxable on the parent – not just the excess over £100.

However, if the deposits are from grandparents, then the deposit is treated as a gift and any interest earned is considered part of the child's 'Personal Allowance' – and if the interest earned falls below the annual threshold then it is taxfree.

To make sure child's savings interest is not taxed at source, a form R85 needs to be completed when the account is opened.

General gifts

As a result of the tax position described above, it is clear that grandparents can make gifts without the same restrictive consequences that parents may face.

Gifts can be made freely by a grandparent to a grandchild, although the grandparent should be wary of their own tax position, especially their Inheritance Tax (IHT) position. However, there are major allowances which can be used which have no IHT concern:

- Any individual can make gifts of £3,000 per year and these will be exempt from IHT (if a gift has not been made in the preceding year then the unused previous year's allowance can be brought forward, meaning £6,000 can be gifted in that year).
- Unlimited small gifts can be made of £250 a time to different individuals; a very relevant allowance for grandparents who have many grandchildren (but this exemption cannot be used with the £3,000 annual exemption above for the same person).

- There is an unlimited amount that can be gifted 'out of normal income'. This is one of the woolliest of tax exemptions because there is no clearcut definition of what this means. The interpretation is that if the value of the gift does not reduce the income below a level where it affects normal expenditure, it will qualify. For example, if an individual has an annual income of £20,000 after income tax and their annual expenditure is £15,000 then a gift out of income can be made of £5,000.
- £2,500 can be gifted by a grandparent to a grandchild when they marry or enter into a civil partnership.

More significant gifts can be made. However these could be subject to Inheritance Tax (IHT) either at the time the gift is made or later down the line. The rules on larger gifts and IHT are complex and advice should be taken to see what can be achieved and the best way of structuring any large gifts either to reduce or mitigate the IHT or potential IHT liability.

Trusts

Where or when a grandparent wants to make a gift it is always sensible to consider making this into or via a trust. Trusts are an ideal way to make a gift for a variety of reasons, not just the possible tax savings that may be available.

Trusts allow for the grandparent to apply a direction to how the money is allocated. For example, if a grandparent decides they wish to gift £10,000 to their 15 year old grandchild to help with a future property purchase they may want to use a trust to dictate how the money is invested in the meantime and the earliest age that the money can be accessed.

A trust can also protect the money from a divorce or a bankruptcy of the grandchild, where the gift could end up in unwanted hands.

Gifts and trusts combined can offer tax advantages for a grandparent, but, as stated, these are complex areas and should be properly investigated prior to any action being taken.

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Practical areas where grandparents can make a big difference

Helping with Educational Fees

School fees can easily amount to well over £100,000 (in today's money) for a child and it can be a heavy strain on even the better earning parents to afford this out of income. Grandparents can make a substantial difference.

This is especially the case where a grandparent has assets which will be left to their son or daughter later down the line. If that son/daughter is paying school fees out of income then clearly it would be better, if at all possible, for the grandparent to accelerate the gift and dedicate the assets towards the grandchild's school fees.

This saves the parent having to find the costs of the schooling from their taxable income, freeing this up. It may well allow the grandparent to reduce their IHT tax liability as well. The same principle may apply to university fees, although the significant difference here is that the tuition fee is payable by the student (the grandchild) and the likely length of time (3 years in most cases) means the overall strain may not be so great.

It may be that the grandparent would like to save the burden for their grandchild – so that they do not start their working life in debt. Paying the fees would achieve this. The more common situation is helping with the extra costs of university, the living and accommodation costs, which can easily be £4,000-£5,000 per year.

Supporting these could be within the scope of IHT exempt allowances.

Helping with childcare

Many parents now have a significant childcare cost, due to family and work requirements. It is common for grandparents to offer practical day to day help, often looking after children whilst the parents work. One in four working families have a grandparent helping with childcare.

Strictly from a financial point of view this helps as it saves the parent(s) the costs of childcare.

There are very limited financial planning aspects to this, although one thing to be aware of is that the Government has introduced a new National Insurance Credit to ensure that grandparents and other relatives of working age who are providing childcare do not lose out on their basic state pension. The credits, called 'Specified Adult Childcare Credits' are for anyone who is providing care for a young relative under the age of 12 in order to enable a parent to work. If a grandparent has given up work to look after a grandchild this may apply.

Helping with property

A key and highly topical area is around property purchases. The escalation in property prices over the past few decades has made it increasingly difficult for younger people to get onto the property ladder. The biggest issue is often not the affordability of the property or a mortgage to support the purchase but the affordability of the initial deposit.

Naturally people will have different views on this, some may even consider that not being able to buy at the current time is a blessing (perhaps the older generations remember some of the previous property crashes!).

However where a grandchild is seeking to buy a property but is struggling with the deposit, this could be an ideal way for a grandparent to make a difference.

Other ideas

Invest in the grandchild's business

With youth unemployment a serious problem in the current climate and the internet offering easier opportunities to start businesses, it is likely there will be a growth in the number of younger entrepreneurs in the UK. Grandparents could take a stake and invest in their grandchild's business venture. This could even be structured with some tax efficiencies for the investing grandparent. There is obviously the usual caveat about families and friends in business not always being a good mix; however assuming this can be overcome, a grandparent as an investor can be a fabulous way of a grandparent setting their grandchild on their way.

Help with financial education

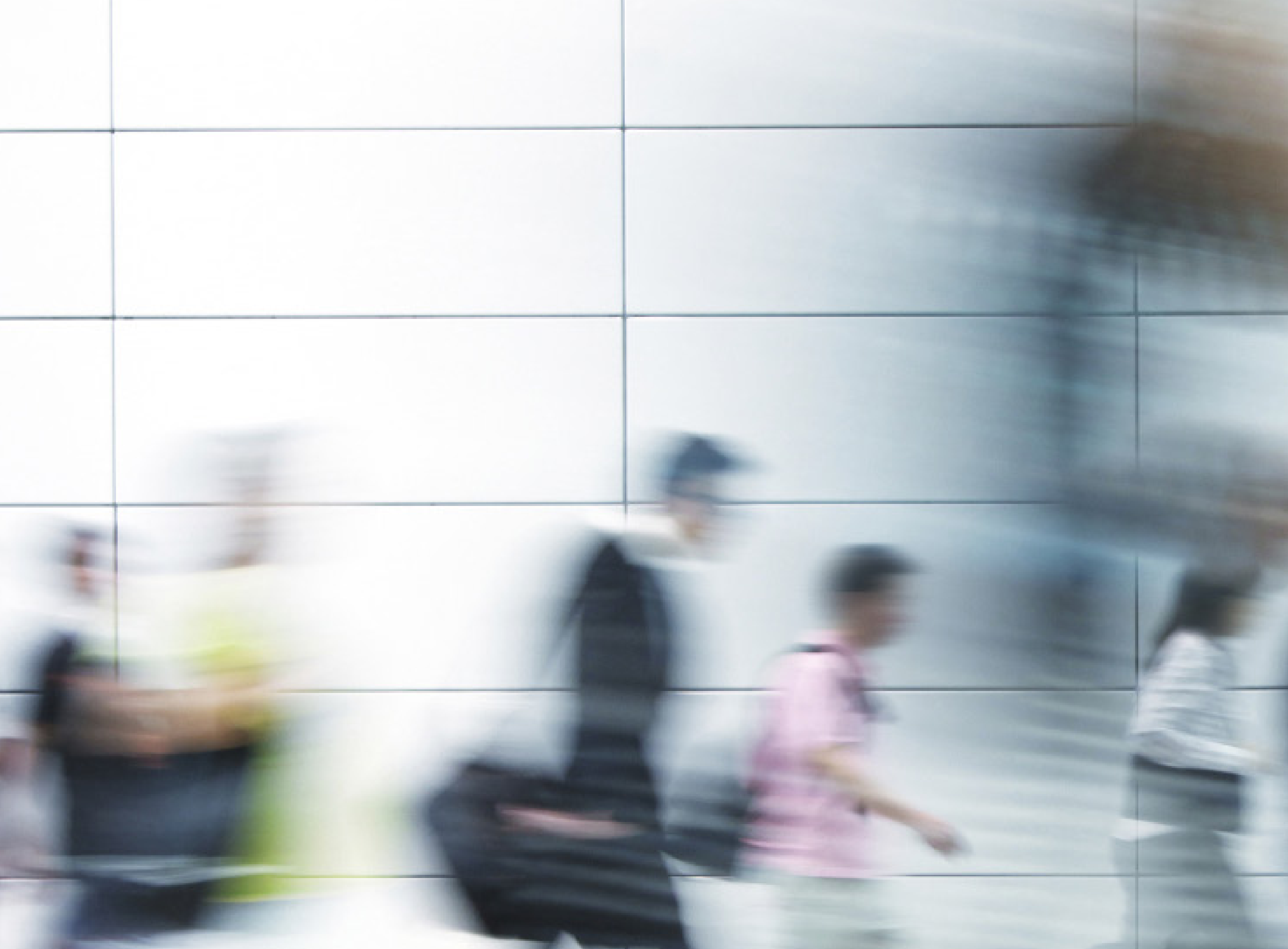
One of the biggest influences could be one which does not directly or immediately involve any financial transaction; the gift of a good book or an educational course could be of more long term value than any monetary item. There is no part of the current school curriculum which provides a personal financial planning education. Most school leavers finish school and go into the workplace without having any financial knowledge.

Helping a grandchild with a grounding in finances could pay greater dividends than any investment made on their behalf.

Getting help and advice

Grandparents have many options when it comes to helping their grandchildren. The help and support can often be structured to help all the parties involved. There are also some pitfalls to be aware of. We are here to help with any of these requirements and we are experienced in supporting families with these matters. Advice can be a crucial element in making sure the best methods of extending help through the generations is achieved.

The information contained in this guide was prepared in January 2014 and was based on the rules and regulations, limits and allowances in existence at that time.



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