Taylored Money
Clear Thinking • Positive Solutions

Taylor & Taylor
Financial Services Ltd

Gifting to Grandchildren

www.taylortaylor.co.uk
01204 365 165

"Simplicity is the ultimate sophistication."

Leonardo da Vinci

Taylor & Taylor Financial Services Ltd
94 Chorley New Road, Bolton, BL1 4DH

01204 365 165
01204 846 838
www.taylortaylor.co.uk
info@taylortaylor.co.uk

Contents

Professional independent advice for your financial well-being.

Introduction

Many of our clients want to better understand the options they have for putting money aside to help their grandchildren.

We have therefore put together this short guide, which takes you through the various options open to you. The guide also considers the interaction between helping your grandchildren and reducing the amount of Inheritance Tax (IHT) payable when you die.

When you have read the guide, if you have questions, or would like to know more, then please do not hesitate to get in touch with us by calling our office on **01204 365165** or emailing: **info@taylortaylor.co.uk**

Section One: Investment Options

There are several options for making investments for grandchildren.

The most suitable option will depend on your individual circumstances, your objectives and the anticipated investment timescale.

For example, Junior Individual Savings Accounts (JISAs) would not be suitable where the investment objective is to pay school fees, as the capital can't be accessed until age 18. Similarly, you could theoretically make a pension contribution for a grandchild. However, based on current pension rules they wouldn't usually be able to access the capital until age 57 at the earliest.

Junior ISAs (JISAs)

Junior ISAs became available from 1st November 2011 and are designed as a tax-efficient way to save for children, which they can access when they reach 18.

The current Junior ISA allowance is £4,128 per child for the 2017/18 tax year, increasing to £4,260 per child for the 2018/19 tax year.

The main features are outlined below:

Eligibility: All UK resident and ordinarily resident children under the age of 18 who do not have a Child Trust Fund (CTF) are eligible for a Junior ISA.

Anyone with parental responsibility for an eligible child can open a Junior ISA for that child. It may therefore be necessary for your grandchild's parents to open the account, into which you can then make the contributions.

From the age of 16, eligible children can open a Junior ISA for themselves.

It is also now possible to transfer a Child Trust Fund into a Junior ISA.

Investments: Both Cash and Stocks & Shares Junior ISAs are available.

Children can hold up to one Cash and one Stocks & Shares Junior ISA at a time; two accounts in total. The qualifying investments for both Cash and Stocks & Shares Junior ISAs are the same as for the adult equivalents:

Stocks & Shares: Individual shares or bonds, or pooled investments such as open-ended investment funds, investment trusts or life assurance investments.

Cash: Usually a bank or building society savings account.

In portfolio planning terms, it is normally prudent to consider wrapping your ISA allowances around the investment assets which have the highest growth potential, for example stocks and shares. That way, you potentially get the most out of the tax efficiencies they offer you.

Taxation: Investment returns within an ISA are exempt from Income Tax. Therefore any tax paid by the fund managers of an investment that you hold within an ISA can potentially be reclaimed by the ISA manager.

Assets held within an ISA are also exempt from Capital Gains Tax on their disposal. Capital losses on other assets held outside of an ISA cannot be offset against gains within the ISA investment.

Any interest received from a Cash Junior ISA will be exempt from tax.

If the Junior ISA holder dies, the value will be included in their estate for Inheritance Tax (IHT) purposes.

Contributions: The overall Junior ISA contribution limit is £4,128 per person for the 2017/18 tax year, increasing to £4,260 for the 2018/19 tax year. This can be split between Cash and Stocks & Shares in any proportion.

The contribution limit is usually indexed annually by CPI.

Unlike ‘adult’ ISAs, where the investor can open and subscribe to new ISAs in each tax year, a child can only hold up to two Junior ISAs and no more than one of each type at any one time. Perhaps confusingly, between the ages 16 and 18 they can hold one of each type of JISA as well as an ‘adult’ cash ISA. Any person or organisation can contribute to a child’s JISA.

Control: Accounts are owned by the child and withdrawals are not normally allowed until he or she turns 18. However, a person with parental responsibility manages the child’s Junior ISA until age 16. This person is known as the ‘registered contact’. From the age of 16, children have the right to manage their own account.

The Junior ISA effectively becomes an ‘adult’ ISA at age 18 but without affecting the normal entitlement to make ISA contributions.

Transfers: It is possible to transfer Junior ISAs between providers.

However, previous years’ Junior ISA subscriptions can only be transferred if the transfer doesn’t result in the child having two accounts of the same type. A transfer from a Cash Junior ISA to another Cash Junior ISA or a Stocks & Shares Junior ISA to another Stocks & Shares Junior ISA must involve the transfer of the entire contents of the ‘old’ Junior ISA.

As a result of the transfer, the child must still have no more than one of each type of Junior ISA.

It is not currently possible to transfer from a Child Trust Fund (CTF) to a Junior ISA or vice versa. However, this rule is under consultation with HMRC.

Access: The funds contained within a Junior ISA must remain invested until the child reaches the age of 18 and they can only be accessed by the child.

The Government has confirmed that it will be possible, when the child reaches the age of 18, for the proceeds to remain within a tax-free environment.

> **“Any person or organisation can contribute to a child’s JISA.”**

Pensions

Making contributions to a pension on behalf of grandchildren can be an option for grandparents who would like to help build a fund for their grandson or granddaughter to use in later life.

The main features are outlined below:

Contributions: Current legislation permits individuals to make pension contributions on behalf of other individuals, including grandparents on behalf of their grandchildren. These are known as 'third-party' contributions.

Contributions that are made on a third-party basis are treated as gifts to the donee (your grandchild, the pension scheme member). For tax relief purposes they are treated as though the donee had paid the contribution into their pension themselves.

The donor of the contribution, the grandparent, is unable to claim any tax relief for the gift.

In a single tax year, you are able to make a pension contribution of £2,880 on behalf of your grandchild. This would be topped up with tax relief to £3,600. You could use one of the annual exemptions we will consider later in this guide to cover the pension contribution and keep it out of your estate if the exemption had not been otherwise used.

Taxation: Tax relief will be applied to any contributions as detailed above.

Under current rules, your grandchild will be able to draw 25% of the fund as taxfree when they reach retirement. The remaining fund will be taxed at their marginal rate of income tax at the time.

Access: Contributing to pensions on behalf of your grandchildren will help build a fund for their retirement, although they will not be able to access until the minimum pension age at the time.

This is likely to be a minimum of 57, with further increases in line with the State Pension Age expected in future years.

Section Two: Use of Trusts

You can gift funds into Trust for your grandchildren to have access to once they reach the age specified in the Trust rules. There are different types of Trust as follows:

Flexible Trust

When the Trust is set up you will specify a main beneficiary or beneficiaries. The Trustees can choose who actually benefits from a wide class of beneficiaries, although in most cases they will make an appointment to the beneficiary or beneficiaries specified by you.

Absolute or Bare Trust

As the Settlor, you will specify the beneficiary or beneficiaries when the Trust is set up and this cannot be changed. With a Bare Trust, the beneficiaries are entitled to access the funds from age 18. Again, this cannot be changed.

Discretionary Trust

A Discretionary Trust is a legal arrangement which allows the owner of an asset, the Settlor, to give their asset to a trusted group of people, the Trustees, who look after it. In the future, they pass it on to some people from a group that the Settlor has decided (the Beneficiaries).

The Trustees have discretion about which of the Beneficiaries to pass it on to, how much each will get and when they will receive it. When an asset is looked after in this way, it is said to be 'in Trust'. The asset which is in Trust and any income received from the asset are called the 'Trust Fund'.

Main Benefits of using a Discretionary Trust

Using a Discretionary Trust has lots of practical and financial benefits. For example:

Inheritance Tax: It should help to ensure that any money paid out from the Trust would not be part of your estate, helping to minimise Inheritance Tax.

Quicker payout: It should help to ensure that the money paid out from the underlying asset can be paid to the right people quickly, without the need for lengthy legal processes. When you die, your personal representatives will need to obtain probate so that they have the authority to deal with your estate. In England and Wales, either a 'grant of probate' or 'grant of letters of administration' is issued to your personal representatives. This process takes time; if you die without having made a will, it takes even longer. Since the Trustees are the owners of assets placed in Trust, they do not have to go through this process in order to make a claim.

Control of funds: By placing your asset in Trust, you can indicate who you want the proceeds to be paid to. A Trust can control when the Trust Funds will be paid out. This can ensure that children receive some financial support from the money, but do not have full access to it.

Who is involved in a Discretionary Trust?

There are three important roles:

The Settlor: The person giving away their asset is called the Settlor. Once the Settlor has put their asset(s) or capital into Trust, they no longer personally own them and have limited rights to say how they are dealt with. However, the Settlor is usually one of the Trustees. It is possible to have joint Settlors, for example on a joint life insurance policy placed into a Trust. The Settlor chooses the Trustees and the Beneficiaries and can give the Trustees guidance on how they would like the Trust Fund to be used via a letter of wishes.

The Beneficiaries: The people who can receive payment from the Trust Fund are called the Beneficiaries. The people who may be a Beneficiary are listed in the Trust Deed, but no Beneficiary is guaranteed to receive any of the Trust Fund.

The Trustees: The Trustees take legal ownership of the Trust Fund from the Settlor. They then look after the Trust Fund and will make arrangements for payments to the Beneficiaries. The Trustees have discretion about which Beneficiaries named in the Trust will receive the Trust Fund and when. However, they must act in the best interests of the Beneficiaries at all times and can only do what is allowed in the Trust Deed.

Cancelling the Trust

It is not usually possible to cancel a Trust arrangement. However, there may be circumstances when a policy or asset can be taken out of Trust. You should contact your legal adviser for advice.

Inheritance Tax and Discretionary Trusts

Whilst a policy in a Discretionary Trust will not usually form part of your estate for Inheritance Tax purposes, on some occasions there is a potential for an Inheritance Tax charge to apply.

Entry charge

Where an existing policy or asset is placed into a Discretionary Trust, an entry charge may apply. Currently, individuals have an annual gift exemption of £3,000. As such, if the open market value of a policy falls within the annual exemption and provided that this allowance is not used for other gifts, there will be no entry charge.

If no exemption applies to the asset placed into the Trust, the value of the asset should be added together with the value of all chargeable lifetime transfers made by the Settlor in the seven years immediately prior to setting up the Trust.

If this exceeds the nil rate band applicable at the time the Trust is created, Inheritance Tax will be due on the excess value of the gift at the lifetime rate.

The nil rate band is currently £325,000 (up to and including the tax year 2017/18) and the lifetime rate is 20% if the Trustees pay any tax (and an effective rate of 25% if the Settlor pays any of the tax).

Periodic charge

An Inheritance Tax liability may arise on each 10-year anniversary of the creation of the Trust. The charge is based on the value of the property in the Trust, which is referred to as 'relevant property'.

The maximum rate of tax that can be charged on the relevant property is currently 6%. This applies to the value of the assets which exceed the applicable nil rate band.

Exit charge

An Inheritance Tax liability may arise when capital leaves the Trust. For example, a charge may arise where the Trustees pay the policy proceeds to a beneficiary following a claim. This will usually only happen if the Trustees paid an Inheritance Tax charge on the last 10-year anniversary or at the start of the Trust (if that was less than 10 years ago).

In either case, the rate of tax payable as an exit charge is a maximum of 6%. However, this rate only applies to the value of the assets in excess of the nil rate band available to the Trust.

Death of the Settlor

An Inheritance Tax liability could arise if the Settlor dies within seven years of making a chargeable transfer into the Trust. Inheritance Tax will be due on the excess value if the value of the gift together with the value of all chargeable transfers (including potentially exempt transfers that have subsequently become chargeable due to the Settlor's death, made by the Settlor in the seven years prior to the gifts in to the Trust) exceeds the nil rate band applicable at the time of the Settlor's death.

This will be at the death rate of up to 40%. However, any entry charges paid can be deducted from this liability.

Taper relief should also be available to reduce the amount of tax payable for gifts made prior to three years before the Settlor's death. With respect to the Settlor's estate, it should also be noted that the nil rate band available to the Settlor's personal representatives would be reduced by the value of any chargeable transfers made by the Settlor in the seven years before death.

Death of a Beneficiary

The death of a beneficiary under the Discretionary Trust is very unlikely to have any Inheritance Tax consequences for the Trust.

Reduced Inheritance Tax Rate for Charitable Donations

A reduced rate of Inheritance Tax from 40% to 36% may apply where 10% or more of a deceased's net estate is left to charity. For details of whether this might be applicable to you, please speak to your Solicitor.

Bare Trusts

A Bare Trust can also be used to gift money into Trust for grandchildren. The gift into a Bare Trust is classed as a Potentially Exempt Transfer rather than a 'Chargeable Lifetime Transfer' as with Discretionary Trusts.

Beneficiaries, detailed at outset, cannot be changed and will become entitled to the Trust proceeds at age 18. This means they can access the capital from age 18, even if you don't feel they are mature enough to use the money sensibly at that time.

Trustees

With most Trusts you will automatically be appointed as a Trustee. You should select one or more additional Trustees, for example relatives or friends who are at least 18 years of age.

Trustees' statutory powers and duties are set out within the Trustee Act 2000 and include:

- The need to exercise reasonable skill and care in selecting and monitoring the investments within the Trust and ensuring that all Beneficiaries are treated equitably
- The need for investments to be suitable and adequately diversified
- The need for Trustees to take 'proper' (i.e. professional) advice when selecting investments for the Trust
- The need to take into account tax considerations
- The risk profile of the Trustees
- Costs of administering the investment

The Trustees have control over the investments within the Trust. Whilst they must act in accordance with the terms of the Trust Deed, it is essential that you choose your Trustees very carefully, particularly those that will continue to act following your death. Being a Trustee means that you will have a great deal of control over the running of the Trust and choice of investments.

Section Three: Inheritance Tax

Investing money for your grandchildren can also have help to reduce any Inheritance Tax (IHT) paid when you die.

Gift allowances

There are gift allowances available to you that could be used to make gifts to grandchildren without there being any immediate IHT consequences.

Annual exemption

An individual can give away £3,000 in each tax year without paying IHT on the value of the gift. You can carry forward all or any part of the £3,000 exemption you don't use into the next tax year, but no further. This means you could give away up to £6,000 in any one year if you hadn't used any of your exemption from the year before, or up to £12,000 for a couple.

Gifts that are part of your normal expenditure

Any gifts you make out of your after-tax income, but not your capital, are exempt from IHT if they are part of your regular expenditure and do not affect your lifestyle. This includes monthly or other regular payments to someone, including gifts for Christmas, birthdays or wedding / civil partnership anniversaries.

It's a good idea to keep a record of your after-tax income and your normal expenditure, including gifts you make regularly. This will show that the gifts are regular and that you have enough income to cover them and your usual day-to-day expenditure without having to draw on your capital.

Small gifts

You can make small gifts, up to the value of £250, to as many people as you like in any one tax year (6th April to the following 5th April) without them being liable for Inheritance Tax.

You can't give a larger sum: £500, for example, and claim exemption for the first £250.

Wedding gifts / civil partnership ceremony gifts

Once the grandchildren are older, wedding or civil partnership ceremony gifts to either of the couple are exempt from IHT up to £2,500 each from grandparents.

You must make the gift on or shortly before the date of the wedding or civil partnership ceremony. If the ceremony is called off and you still make the gift, this exemption won't apply.

> "You can make small gifts, up to the value of £250, to as many people as you like in any one tax year."

Combining allowances

You can use your 'annual exemption' with other exemptions, but not with small gifts. For example, you could combine it with the 'wedding / civil partnership ceremony gift exemption'. So, if one of your grandchildren marries or forms a civil partnership you can give them £2,500 under the wedding/civil partnership gift exemption and £3,000 under the annual exemption. A total of £5,500.

Potentially Exempt Transfers (PETS)

Gifts to your grandchild, either direct or into certain types of Trust* and not covered by one of the above exemptions, are known as a 'Potentially Exempt Transfer' (PET). A PET is usually free of Inheritance Tax if you live for seven years after you make the gift.

It should be noted that if you die within seven years of making the gift and IHT becomes due, it is the recipient of the original PET who is liable for the tax. This individual may not necessarily be one of the beneficiaries of the estate.

*Gifts into certain types of Trusts are treated as PETS, however this does not apply to all Trusts and specialist advice should be sought before making a gift into Trust.

Gifts with Reservation

If you make a gift with strings attached, technically known as a 'gift with reservation of benefit', it will still count as part of your estate, no matter how long you live after making it.

For example, if you give your house to your grandchildren and carry on living there without paying them a full commercial rent, the value of your house will still be subject to Inheritance Tax.

For more information on helping your grandchildren, reducing the amount of Inheritance Tax payable when you die, or any other concerns you may have, please get in touch by:

Phone: **01204 365 165**

Email: **info@taylortaylor.co.uk**

Taylor & Taylor Financial Services Ltd

94 Chorley New Road, Bolton, BL1 4DH