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I regularly see grandparents who would like to set up some savings for their grandchildren, without upsetting the taxman or creating a tax liability for the children. Grandparents are often better placed financially than parents, but there are a number of issues that regularly crop up when savings for other members of the family are discussed.

Need guidance for saving for grandchildren?

Q. My wife and I want to give the grandkids a good start for university, but what if they spend the savings on “sex, drugs and rock and roll”?

Most of the usual savings vehicles for children transfer the assets to their full control at 18, which may lead some young adults into temptation. Unfortunately most attempts at retaining control past 18 will have undesirable consequences, like paying tax, (if you use a discretionary trust), or keeping the assets from the beneficiary until they are 55, (using a pension contract). One route that is attractive for its simplicity and lack of expense is setting up a savings plan for the minor and keeping the paperwork yourself, until you wish to release the money on their behalf. Make sure that there is an easy trail to find the money if you die or fall ill; assets regularly go unclaimed!

Q. If I give assets away before my death, I understand that my estate may have to pay Inheritance Tax, (IHT), what are the normal allowances?

The annual exempt gifts limit is £3,000 per donor, so a couple could donate £6,000 to the grandchildren in any given year. You can make additional gifts on occasion of a wedding, £2,500 for Grandparents, £5,000 for parents or small gifts of £250, but you cannot double up on the exemptions, so £3000 in total or £250 each, but not both!

Regular gifts, which are part of your normal expenditure, would also be exempt of IHT, but you would need to prove that they were part of normal expenditure and this can be difficult. You will need formal advice in this instance, normally as part of a wider financial plan, say school fees planning or similar.

Q. You mentioned pensions for grandchildren, what are the advantages and disadvantages?

The biggest potential advantage is that pension money goes into trust, so the beneficiary cannot benefit from it until they retire, which is soon to be a minimum of 55; buying a Ferrari at 18 cannot happen! Unfortunately there is no mechanism to release value early, other than ill-health retirement, so once money is paid into a pension scheme it is not available for anything else. A further complication is a limit on the amount that can be paid in each year for someone without earned income, no more than £3,600 gross, (£2,880 net). This is not a solution for everyone and may have consequences up to 75 years from the initial decision, so get specific advice before entering into a contract. Although inflexible, this approach can be very effective, as the recipient will get the benefit of the tax treatment of pension premiums, £3600 worth of benefit for a cost of £2,880.

Q. I've seen a lot of stocks and share savings schemes designed for children, how are they different from the “usual” offerings?

There are a number of heavily promoted savings schemes for children that offer predominantly equity investments designed for long-term growth. Other than the way these are advertised, I find it very difficult to distinguish between these and more conventional unitised investments from the well-known investment houses. Savings made on behalf of a minor by grandparents are not taxed as part of the parent's income, so the use of specific products may make establishing the correct tax treatment easier, but keep a careful watch on the annual management charges, as these may be uncompetitive in this niche market.

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