# Helping the younger generation

International Tax Personal tax

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*Meg Saksida* examines the tax implications of the various ways in which parents can help university-age children financially

### Key Points

### What is the issue?

*The Financial Times'* 2018 Millennial study showed that 77% of their Millennial sample had received some form of financial support from their parents. But have they gifted tax efficiently?

## What does it mean to me?

It seems to be, that generational wealth maintenance now relies more on the generosity of the older generation. Most of the younger generation are receiving this support.

## What can I take away?

There are many possible solutions giving an optimal tax outcome for both parties.

Typically, young people aspire to do at least as well in life as their parents. In previous generations, with the right attitude to study and work, this was generally achievable. Rising house prices, inflation, the burden of student loans and other demographic factors however, mean such aspirations are becoming increasingly difficult.

In 1960, not only did the older generation have The Rolling Stones and Stevie Wonder, but the average cost of a house in London was £2,189 (source: *Nationwide* ). In these years where 'Doc Martens' and paisley were the height of fashion, the salary for an executive officer was £1,140 (source: *UK Parliament*). That is 52% of the price of an average house. Statistics from 2018 show the percentage is now around 12% and that is using a generous £28,028 average salary (source: *BBC*).

Our younger generation, the 'Millennials' are having a tough time of it. They are struggling to get on the housing ladder, struggling to pay their rent, and – poor things – they listen to music from Kanye West. It seems to be, that generational wealth maintenance now relies more on the generosity of the older generation.

Most of the younger generation are receiving this support. *The Financial Times'* 2018 Millennial study showed that 77% of their Millennial sample had received some form of financial support from their parents. But have they gifted tax efficiently?

Let's look at a couple of examples, and some possible solutions giving an optimal tax outcome for both parties.

Say Anthony and Amanda, both aged 50, working full time and in the 45% and 40% income tax bracket respectively, decide to pay the university expenses for Tilly aged

19, so she doesn't have to work through university. They have available £650,000, currently earning 3% interest, generating £19,500 income gross per annum, enough to cover her annual living costs. They can either pay Tilly the cash lump sum, or pay her the income arising from it to cover her costs.

## Cash giving

### Gifting the income

If Anthony and Amanda gift Tilly the interest from the lump sum, from an IHT perspective either the 'maintenance of the family' (although Tilly is over 18, she is in full-time education) or 'regular gifts out of income' would serve to exempt the gift. Although the parents retain control of the capital, the downsides of this arrangement are that the capital will still be in the parents' estate for IHT, and higher rate/additional rate income tax (with only one of them entitled to the (lower) £500 tax free personal savings allowance) will be already incurred on the net income paid out to cover Tilly's expenses.

### Gifting the lump sum

In order to benefit from Tilly's basic rate status for the income, Anthony and Amanda would need to gift Tilly the lump sum of the cash outright. There would be no CGT on the gift as the asset (cash) is exempt. For IHT purposes it would be a 'Potentially Exempt Transfer' (PET) and would only become fully chargeable if the couple did not survive for the next seven years. If this happened, Tilly, as the donee, would need to pay any IHT due.

The advantages are, assuming the couple do live for seven years, firstly the £650,000 would be outside their estates at death, saving IHT at 40%, and secondly, the interest income would be taxed directly on Tilly at basic rates, rather than the higher or additional rates incurred by her parents. However, even though the income tax has been reduced, the problem with direct gifting, is that Mum and Dad would lose control of the capital. Even if Tilly is sensible and responsible £650,000 is a lot of responsibility for a 19 year old.

A more risk averse way to achieve a similar tax advantage may be to put the capital into a discretionary trust. Anthony and Amanda could make themselves trustees of the trust, thereby retaining some control as to when and how much of the trust fund is distributed to Tilly.

The tax benefits are three-fold. Firstly, the gift of cash into the trust is CGT free. Secondly, as long as the gift is under the £650,000 joint nil rate bands, although it will be a ‘Chargeable Lifetime Transfer’ (CLT) for IHT purposes, it will be chargeable at 0%, and not become chargeable at a maximum of 40% unless Anthony or Amanda do not survive for the next seven years. If this happened the trustees would be responsible for paying the IHT.

Thirdly, the interest generated by the capital in the trust, although initially taxed at the rate applicable to trusts at 45%, will ultimately be taxed on Tilly at her basic rate. This is achieved through a tax repayment via her self-assessment. The ultimate taxation of the income would not only save 20 or 25% in comparison with her parents, but she should also be able to use her full personal allowance, and will be entitled to an £1,000 of personal savings allowance, both that could be set against directly against the income.

In addition to the costs of establishing and running a trust however, there are some downsides to consider. If the cash required to generate enough income for Tilly exceeds the joint nil rate bands, a 20% ‘entry’ IHT charge will be levied on the excess amount, payable six months after the end of the month the trust was set up or 30 April if later. Exit charges and 10-yearly charges are also incurred inside the trust as a discretionary trust is inside the relevant property regime. These are both charged at a maximum of 6%. Further, HMRC is consulting on potential changes to trust taxation.

## Asset giving

Instead of gifting cash, Anthony and Amanda may choose to buy a house for Tilly that she can live in during the university years and beyond. If they retain ownership of the house, the benefit to Tilly is only living in the house, so again for IHT purposes this gift would be exempted by the ‘maintenance of the family’ exemption. However, by the parents purchasing the house themselves, the SDLT would be an extra 3% as it would invariably be their second home. This is an additional cost of £19,500 on a £650,000 purchase and represents the approximate cost of a full year for Tilly at university.

It would be more tax efficient to gift the cash to Tilly, resulting in a PET for IHT purposes, and she can then purchase the property herself. The advantages are the same as directly giving cash described above, but again this arrangement retains the risk (albeit reduced) of Tilly having full control over the asset. Anthony and Amanda would need to be careful that they didn't receive anything other than an insignificant benefit in the house in the future, to ensure the pre-owned asset rules did not apply.

Sometimes parents wish to give assets that they already own, for the next generation to either benefit them from the income or for them to use. The problem is that if they are not CGT exempt assets, there may be a CGT charge if the gain on the disposal of the gift is more than the annual allowance. Gifting is deemed to be a chargeable disposal and gifting to a connected party renders the consideration at market value, irrespective of whether any proceeds were received. This could leave the parents with a 'dry' tax charge, i.e. tax without cash.

Continuing with our example, if the £650,000 was a house purchased by Anthony and Amanda in 2000 for £220,000, and they gifted this to Tilly, they would be liable to a CGT charge of £56,924 each, assuming each had a full annual allowance (2018/19 rates).

**Directly**

If the house was gifted directly to Tilly, the tax on the gain would become payable and need to be found from other funds owned by Anthony and Amanda. No holdover relief would be available under S260 as this would be a PET and not chargeable for IHT. No holdover would be available under S165 either as a residential property is not a business asset. Again only a 'de-minimis' benefit could be retained by Anthony and Amanda to ensure the Gift with Reservation of Benefit rules would not apply.

**Into a trust**

If the parents chose to give the property into a trust, although the IHT implications would mean the gift would be a chargeable lifetime transfer and the tax would be at 0% (under the nil rate bands) they could benefit from holdover relief. Holdover relief under S260 is available if both CGT and IHT are chargeable as a result of a transaction. Because Tilly is over 18, the holdover relief is not denied on the basis that the trust is settlor interested, as this only applies to spouses/CPs and minor children.

By deferring the gain to the trust, the tax on it will not actually need to be paid until the trust disposes of the asset. However, as this asset is residential property, in which Tilly will live, she will probably expect main residence relief on any future gain in the trust. Since 10 December 2003 a choice needs to be made to either have holdover relief or PPR on the gain in the trust, so if holdover relief is claimed by Anthony and Amanda, no PPR would be available on any future gain in the asset in the trust.

### Business property

If the asset were business property, such as shares in an unlisted trading company, s 165 holdover relief may be used to defer the gain. A trust does not need to be used to be eligible for this relief, but like gifting cash, if a trust was not used full control of the shares would be given to Tilly.

## Summary

There are tax efficient ways to benefit the younger generation through giving. A trust may be better than direct giving as it enables the older generation to retain some control of the asset, but enjoys the same benefits as direct giving. If an asset is to be gifted, it is better to gift one not standing at a gain for CGT, or to simply give cash. If the asset is pregnant with a gain, a business asset is better than other property to gift as holdover relief will be available on both a direct gift and a gift into a trust. Be careful gifting residential property into trusts. Either holdover or PPR can be claimed, but not both.