# A guide to pensions for children and grandchildren

## How can I provide pensions for my children and grandchildren?

Current legislation allows third party payments to registered pension schemes.  Parents and grandparents can consider providing tax efficient savings for children no matter what their age is.  You could, in effect, start paying into a child's pension as soon as they are born, however, not all pension providers permit this option.  There are several reasons why you may wish to contribute to a relative's pension scheme as opposed to considering gifting capital sums.

- Inheritance Tax planning (IHT).
- Capital gifts are normally set up in complicated Trusts which require Trustees and a lot of paperwork.
- Certain Trusts provide benefits at age 18, which may be deemed too early for responsibility, even though the IHT mitigation is completed.
- Avoiding gifting restrictions.
- Avoiding the recipient spending the money at an early age.
- Providing tax efficient savings for future generations.
- Allocating funds which cannot be touched until the earliest age of 55, rising to 57 in 2028.
- Any regular gifts you make out of your after-tax income, not including your capital, are exempt from IHT. These gifts will only qualify if you have enough income left after making them to maintain your normal lifestyle.
- Tax relief on your contributions.
- High rate tax relief if your child is earning and paying high rate tax, even though they have not paid the premiums.

There is, understandably, reasonably regular 'air time' given to investing for children to meet the costs of higher education and 'getting on to the property ladder'.  Tax efficient savings such as NISA (invested in by a parent or grandparent in their own name), JISA and collectives held in trust (giving control and tax efficiency) are all referenced in connection with regular savings.  Offshore bonds (assigned after age 18 or held in a trust) can be very effective for those with lump sums.

As well as the 'nearer term' needs of education and property purchase, many parents and grandparents also have concerns about what the longer term financial future of their children and grandchildren will look like.  They see that, for many, even once through education and even married or in a long term relationship, saving is still very difficult.  For parents and grandparents who have the wherewithal (and especially those who would be attracted by strategies to reduce their own IHT liability), contributing to a pension arrangement for a child could look very appealing.

At a very simple level, a contribution of £2,880 will be grossed up to £3,600.  Over a reasonable period, this could grow (with tax free growth on the funds) to a worthwhile pension fund.  Please see the following table for examples of the value of a contribution for a limited time frame and the effects of compound growth over the longer term.

When contributions are made by third parties to a pension for a child, the amount paid (but not the HMRC contribution of tax relief) is regarded as a lifetime transfer, but it will be exempt (as normal expenditure or within the annual gift exemption of £3,000) or potentially exempt, so will rarely give rise to any adverse IHT implications.

For example, Mr & Mrs White have a recent grandchild and wish to look at tax efficient gifting to create a savings legacy for their grandchild.  They contribute £2,880 every year for 15 years at a net cost of £43,200.  In 55 years' time this is worth £574,231.  During the period the invested funds of £54,000 are outside of the estate for IHT purposes and the child cannot obtain access to the pension fund until they reach the earliest permitted pension age.

**The following table assumes a 5% net return after provider and adviser charges**

| Contribution £3,600 gross £2,880 net | Value 5 years | Invested funds | Net cost | Value 30 years | Value 35 years | Value 40 years | Value 45 years | Value 50 years | Value 55 years |
|---|---|---|---|---|---|---|---|---|---|
| Stopping after 5 years | £20,887 | £18,000 | £14,400 | £70,730 | £90,272 | £115,212 | £147,043 | £187,669 | £239,518 |
| Stopping after 10 years | £20,887 | £36,000 | £28,800 | £126,150 | £161,002 | £205,484 | £262,256 | £334,712 | £427,187 |
| Stopping after15 years | £20,887 | £54,000 | £43,200 | £169,572 | £216,421 | £276,215 | £352,528 | £449,925 | £574,231 |

Some advantages of this strategy:

- Regular payments leaving your estate.
- Contributions receive 20% tax relief.
- Invested funds roll up in a virtually tax free environment.
- No complicated Trust structures.
- Children cannot access funds until the first permitted statutory retirement date.

If you would like to discuss any of the information provided in more detail, please contact your MPL adviser or enquiries@mplltd.co.uk.

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