The Parent Trap

Many parents want to help their children by lending or giving money to use as a deposit so that they can buy their first home, especially while prices are low. However, complications and difficulties can arise if appropriate advice is not taken at the beginning, and it is unclear whether the money was a gift or a loan.

There are three main ways for parents assist their children in buying their home; by outright gift of money towards the purchase; a loan; or as an investment. All three have tax implications as well as uncertainties if certain circumstances arise.

An outright gift

In this case, the parents need to be aware that if they die within seven years of making the gift, this will need to be brought back into account for Inheritance Tax purposes. It may mean that the child who received the gift may need to pay some Inheritance Tax or it may serve to reduce the transferable allowance of the nil rate band in the case of married couples, meaning that the parents have inadvertently reduced the 'free' allowance available to mitigate any Inheritance Tax liability falling on the estate of the last to die. Furthermore, consideration may wish to be given if there is more than one child, to ensure that any gift is taken into account in their wills so that all children ultimately benefit equally.

A Loan

If the sum provided is intended to be a loan then care needs to be taken. If the parent wishes to have the sum repaid, then it needs to be clear whether any repayments are capital only, or whether any interest is attached to the loan. In the case of interest applying then this can lead to income tax implications for the parent. It is important to establish the arrangement in a formal legal document, preferably at the time the property is purchased. This can prevent confusion and distress if circumstances change. For example, there is a possibility that the marriage or relationship of the child may break down and the parents wish to protect their contribution, or alternatively if one of the parent's dies then the surviving spouse may need to call in the loan to live on. The document does not have to be complicated but can agree a way forward in these circumstances if they are considered from the outset.

An Investment

If a parent wishes to assist their child in purchasing a property but sees the current market as an opportunity to benefit from any future increases then care also needs to be taken. The likelihood is that the parent will want their contribution to reflect a proportion of the purchase price, and receive the benefit of any increases in the same proportion following a sale. Again, care needs to be taken in drawing up a legal agreement about the proportions in which the property is held, responsibility for mortgage repayments and other outgoings, and an agreement on the circumstances the property should be sold to enable the parent to realise contribution, together with any increases, if they wish. The parent also needs to be aware of the Capital Gains Tax implications that may arise if the value of the property does increase, and the steps that may be taken to mitigate this liability.