How to boost your grandchildren’s finances

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It can often make sense to skip a generation when passing on money CORBIS

The three-generation family that was once the norm is being replaced by the four-generation tribe, much like the royals, from the Queen and Prince Philip down to Prince George and Princess Charlotte and their Phillips and Tindall second cousins. With people living longer, Paul Killik, founder of Killik & Co, the stockbroker, says that it increasingly makes sense for people to give money to grandchildren and great-grandchildren during their lifetime rather than leaving it to already well-established middle-aged children. This has the advantages that grandchildren (or greats) benefit from help with costs such as education and getting on the property ladder, and from long-term compound interest on investments. It can cut your family’s inheritance tax liability too.

Killik says: “The biggest reason to help the younger generations is the huge effect of compounding over the long term. It means that a small amount invested for a young child makes a terrific difference later.”

Here are six ways you can help your grandchildren or great-grandchildren, with options for all budgets.

1. Junior Isa

Junior Isas (Jisas) allow adults to put up to £4,080 a year into stocks and shares or savings on a child's behalf, benefiting from important tax breaks. Children receive the money as a tax-efficient Isa nest egg at age 18 — helpful towards university costs and as the basis for further savings. Fidelity Personal Investing points out that putting away only £20 a week could deliver £27,127 at 18, assuming a return of 5 per cent a year, less charges of 1.1 per cent. Only parents and legal guardians can open a Jisa for a child, but grandparents and others can contribute thereafter. Children who have child trust funds (CTFs), the predecessor children's savings scheme, were previously excluded from Jisas, but transfers from CTFs to Jisas have been permitted since April.

Given the long-term nature of the investment, advisers typically advise taking some investment risk, rather than sticking with "safe-haven" cash. Killik tips Neil Woodford's Patient Capital Trust an ideal Jisa investment. This is a new fund that invests mostly in small, fast-growing companies, alongside some established blue-chips.

2. Pension

Starting pensions for grandchildren might sound bizarre — it's hard to imagine little Oscar or Grace at 70 — but makes total sense. If you pay £300 a month into a pension from your grandchild's birth to age 18, he could have a pot of £579,000 at 65 for a cost of £52,000; that's without him making further contributions after 18. If he paid the same amount into a new pension from 25 to 65, the value would be £345,000 at a cost of £115,000: double the cost for half the value. The figures, from Hargreaves Lansdown, are based on growth of 5 per cent and charges of 1 per cent.

Adults can put up to £3,600 a year into a Sipp or stakeholder pension on behalf of a child at a cost of £2,880, that's £240 a month, thanks to the existing tax relief system. Again, only parents or guardians can start pensions for children, but other people can contribute afterwards.

3. School fees

Private school fees have risen fast in relative terms over recent decades and are now beyond the means of most professional parents. According to Killik's latest Private Education Index, the average cost of a 14-year education at private day schools stands at £286,000. Boarding costs are £468,000. It's very common for grandparents who have benefited from rising property prices and smart stock market investments to pay some or all of these costs; after downsizing, for example. Many families now send children to state primaries before going private — you can save almost £100,000 by starting a private education at age eleven, rather than four. Despite the costs, there's potentially an excellent return on investment. In the report, Killik says that if you had invested capital in UK equities over 20 years, an annualised return would have been about 4.1 per cent. "By contrast, private schooling gives a wage premium over those who attended state school of 7 per cent by six years after graduation. Another study puts the premium at 20 per cent by age 33. In this sense, private education seems to outperform other investments."

4. Property deposit

The larger the deposit a first-time buyer puts down, the better the rate he or she can secure. Homebuyers need a deposit of at least 5 per cent in today's market — that's £7,500 on a property costing £150,000. Gifting £15,000 (little more than one term at Eton) would enable your grandchild to get a 90 per cent, rather than 95 per cent deal, provided they meet the lender's criteria.

Jonathan Harris, of Anderson Harris mortgage brokers says: "Increasingly, the bank of grandma and grandpa is being called upon to help with deposits. Someone with a 5 per cent deposit could get a two-year fix at around 4 per cent. If you had 15 per cent to put down the rate falls to around 2.3 per cent, or 1.5 per cent for a 35 per cent deposit."

5. Bare trusts

When grandparents put money into a bare trust with a grandchild as the beneficiary, any income earned counts as the grandchild's for income tax and capital gains tax purposes — which often means there will be no tax bill on investment proceeds. (This treatment does not apply where parents set up the trust.) Trustees can access the money at any time, so the trusts are useful for paying school fees, for example. A possible downside is that the beneficiary gets full control at age 18. Setting up a bare trust is considered a potentially exempt transfer, which means that no inheritance tax is due on the money if you live seven years from that date.

Some fund managers and platforms supply forms for you to set up a trust on behalf of a named beneficiary when making an investment. Otherwise it's advisable to use a solicitor, although these are the simplest trusts and you can theoretically set them up yourself.

6. Financial education

Many people reach their 20s with no understanding of stock markets, pensions or tax returns. Helping to give your grandchildren some financial knowledge can provide a real head start. You could give small sums to younger grandchildren and encourage them to save, or talk about your own life experiences. Grandparents and grandchildren can often talk more easily than parents and children.

Paying for young adult grandchildren to have an initial review with an independent financial adviser can get them thinking about goals. This will cost about £500 — you can find advisers at unbiased.co.uk. You could also flag free sources of information, such as the Money Advice Service, at moneyadviceservice.org.uk

Cutting your inheritance tax bill

● Inheritance tax (IHT) is payable at 40 per cent on anything you leave at death above the threshold of £325,000. You can leave your estate to a spouse or civil partner with no IHT payable and can transfer your allowance of £325,000 with it — so a married couple can leave £650,000 before the tax kicks in.

● You can reduce your estate's IHT liability by giving away money during your lifetime. The tax is not payable on gifts to a spouse or civil partner. If you give your money to other family members such as grandchildren, the value of the gift won't be counted as part of your estate for IHT purposes, provided you live for seven years after making the gift.

● If you die within three years of making a gift, IHT is payable in full. If you live for between three and seven years, it's payable at reduced rates.

● You can also give £3,000 of gifts each tax year, with IHT waived immediately. This can be carried over for one tax year, so the maximum you can give under the "annual exemption" rule is £6,000. There's no IHT on wedding or civil partnership gifts worth up to £5,000 for a child, or £2,500 for a grandchild or great-grandchild.

● No IHT is due on individual gifts of up to £250. You can give as many people as you like up to £250 in one tax year, but the exemption is not valid if you've already given them gifts under a different exemption such as the £3,000 rule.

● You can make unlimited regular gifts from income, provided you're able to maintain your normal lifestyle. This could include regular payments into a grandchild's Jisa, for example.

- From 2017, a £175,000 allowance will be phased in that means you can leave your home to children and grandchildren tax-free when you die. This is per person and can be transferred to your partner when you die, so couples will be able to pass on homes worth up to £1 million with no IHT charge.

Find out more at gov.uk/inheritance-tax and moneyadviceservice.org.uk.