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BANK OF MUM AND DAD
A GUIDE TO LEGAL
AND FINANCIAL
CONSIDERATIONS

BANK OF MUM AND DAD

A GUIDE TO LEGAL AND FINANCIAL CONSIDERATIONS

A simple guide to the legal and financial considerations of helping your child onto the property ladder.

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While we have done our best to ensure the information within this document is accurate, please be aware that the contents of this document is not intended to be a substitute for legal or financial advice and should not be relied upon as such. You should seek independent financial or legal advice from a trusted advisor concerning any particular matters you may have.

OUR EXPERIENCE, CONFIRMED BY THE RESEARCH WE CARRIED OUT WITH THE LONDON SCHOOL OF ECONOMICS, HAS SHOWN JUST HOW COMMON IT IS FOR YOUNG PEOPLE, AND PARTICULARLY FIRST TIME BUYERS, TO RECEIVE A FINANCIAL LEG UP FROM PARENTS OR OTHER FAMILY MEMBERS TO HELP WITH A HOUSE PURCHASE.

With the need to provide constantly increasing deposits, the Bank of Mum and Dad is busier than ever, and according to research conducted by Legal and General is now one of the top ten largest lenders.

With the next generation still struggling to afford a place of their own, it's only natural for parents to want to help where they can by providing some financial assistance. Whilst this is great for their kids, it's really important parents understand the implications. Financial help can be a legal minefield and protecting family assets in the face of unexpected life events is incredibly important. It could also have a big impact on their savings, retirement planning or even day-to-day lifestyle.

Important questions will arise. Is the financial assistance a gift or a loan? If it's a loan, are there any strings attached and how is the lender's interest to be protected? What are the implications if a parent's name appears on the deeds of the property? If it's a gift, how should it be treated if it's given to only one member of a couple?

With a little more awareness and knowledge of the important legal and financial details associated with Bank of Mum and Dad property purchases, it's possible to avoid the stress of unforeseen financial consequences. To help you make the right decisions we've outlined what you may want to consider when helping your child buy their own home.



WAYS TO PROVIDE FINANCIAL ASSISTANCE

There are many ways to provide financial assistance to assist your child onto the property ladder. Financial assistance can be in the form of a gift, loan, acting as a guarantor or joint ownership. Depending on your circumstances you should consider all options before deciding which one works best for you and your family.



A GIFT

A gift is generally the first option parents consider when a child needs help to buy their home. In many ways it's the simplest.

The parent gives their child a sum of money to act as a deposit to allow them to purchase. As long as the lender has written confirmation of this, and there is no expectation that the parent wants the money back then the process is complete.

Depending on the size of the sum likely to be involved and the fact that such arrangements could be scrutinised by HMRC or other third parties in the future, it's always best to document gifts and to keep such paperwork in a safe place or with your solicitor.

One of the biggest concerns for those gifting capital is who might end up with money in the future. There are a number of mechanisms that could be used to help ensure it stays in the hands of the intended beneficiary including preparing a Living Together Agreement (see page 13), a prenuptial agreement and having a valid up to date Will. See page 14 for more information.

If your child is taking out a mortgage with a friend or partner, then legal consideration should be given to who the gift was made to.

It's a good idea to speak to a solicitor about what you want to happen in the event of a relationship breakdown, to ensure your child retains the gift by formalising the arrangement with a contract or trust document. This simply recognises in law the rights of your child to retain the amount of the original gift in the event of a breakdown. This may take the form of creating a trust document called a "Deed of Trust".

Both parent and child should make a Will in the first part to recognize the gift, and in the event of the child dying the money could be returned to the parent.

CONSIDERATIONS

- Allows the widest possible choice of mortgage deals available.
- Lowers mortgage payments.
- May mean the purchase of a "better" home.
- Inheritance Tax (IHT) may be payable if the parent(s) do not live for seven years after the gift is made and the estate exceeds the nil rate band at the time.

INHERITANCE TAX (IHT)

Inheritance Tax may be payable on gifts in some circumstances.

The current IHT threshold (2022/23) is £325,000 per person. It doubles to £650,000 for a married couple - as long as the first person to die leaves their entire estate to their partner. Anything over this limit is subject to a 40% tax bill.

IHT THRESHOLDS

Years between gift and death	Tax due
Death less than 3 years	40%
3-4 years	32%
4-5 years	24%
5-6 years	16%
6-7 years	8%
7+ years	0%

HOW CAN YOU REDUCE THE IMPACT OF IHT USING CURRENT ALLOWANCES?

1. Use the allowance for individuals to give gifts worth up to £3,000 a year without incurring any IHT.
2. Individuals can pass on larger amounts of money free of IHT, so long as they live for seven years after making the gift.
3. Take account of the 'normal expenditure out of income' rule – if you give gifts out of your income and, in doing so, don't damage your standard of living, they are exempt from IHT, and there is no upper limit.
4. Spread your giving over a number of years, rather than paying out a lump sum.
5. Leave something to charity in your will. This "gift" is not taxable and also has the added benefit of lowering the tax rate on the rest of your estate from 40% to 36%.
6. Trusts are often used in IHT mitigation but they do need careful consideration. Assets placed into trusts are not exempt from taxes as they could attract entry, exit and 10 year periodic charges.
7. Don't give away too much too soon – otherwise you could be dependent on your children.



A LOAN

An alternative to an outright gift is to make a loan. Under these circumstances it needs to be very clear what the expectations are around when it is to be repaid. The only safe way to do this is via a solicitor who will draw up a contract detailing how the loan is to be repaid and by when. Another point to think about is if you'd be prepared to write the loan off in the future, and under what circumstances?

Loans will be looked at by the mortgage provider when assessing suitability and be viewed as an outstanding debt alongside the mortgage being borrowed. Some mortgage lenders are likely to decline a mortgage application where the money loaned is going towards the deposit, however a loan could be used to help with other costs associated with buying a house such as stamp duty or legal fees.

– Loan Agreement

Even within a family, or possibly especially within a family, it is wise to ensure that the terms of a loan are clear. From the outset it's important that all parties understand that the loan is not a gift, even if it might become one at a later date. The terms of the loan can be set out in a Loan Agreement. This would cover aspects including the length of time before the loan is meant to be repaid, a specified repayment date, the amount of any repayments, what would happen in the event of a default and any other terms agreed between the parties.

– Declaration of Trust

Where your contribution will be used to fund a joint purchase, are both purchasers contributing equally to the cost of the purchase and the running costs of the property? If not, you should consider a Declaration of Trust - a legally binding document which records the financial arrangements between joint owners of a property and anyone else who may have a financial interest in the property. This will help to protect any unequal shares, document who will be responsible for the monthly expenses and to record how much each party would receive should the property be sold in the event of the relationship failing.

– Charge against property

Registering a charge against the property turns an unsecured loan into a secured loan and will mean that, in the worst case scenario, a sale of the property can be forced in order to repay the debt. Often such an agreement will require the consent of the property owner's mortgage lender.

While loaning money to your child can go a long way in helping them onto the ladder, there are some additional complications:

1. Can you afford it?
2. If you are loaning with a partner, are you both in agreement?
3. A good rule is to lend only what you can afford to lose.
4. Put it all in writing – what the money is for, the terms of repayment, how much interest (if any) you'll charge.
5. What happens if payments are missed?
6. As with a gift make sure all parties make a Will.

CONSIDERATIONS

- Not all lenders will accept this arrangement as it affects affordability of the applicant.
- It may limit the number of mortgage deals available.
- There may be additional solicitor costs.
- It may place a strain on the parent / child relationship, especially if payments are missed, or the loan is not repaid when expected.
- Consideration needs to be made about what will happen in the event of death of any of the parties involved.

CASE STUDY:

WE AGREED IT WAS A LOAN BUT DIDN'T PUT ANYTHING IN WRITING

1. Tom is buying a property and is getting some money from his mum to help fund this.
2. Tom and his mum are required by his mortgage lender to document that the money being provided by Tom's mum is a gift.
3. Tom and his mum view the requirement of his mortgage lender as a formality but agree between themselves that Tom's mum is providing a loan. However, they don't make a formal Loan Agreement and Tom agrees to pay back the money as and when he can.
4. Tom defaults on his mortgage and the mortgage lender takes possession of the property.
5. The property is sold by Tom's mortgage lender and as there was no formal agreement made regarding the loan, his mum is not entitled to any repayment whatsoever.
6. To make a bad situation worse, Tom's mum dies within seven years of him purchasing the property and Inheritance Tax must now be paid on the money she 'gifted' to him. On a sum of £50,000, tax of up to £20,000 could be payable.

ACTING AS A GUARANTOR

The parent can act as “Guarantor” for the mortgage which means that in the event of non-payment the parent(s) becomes liable for the mortgage payment, or settlement of the mortgage.

However, you would not need to act as guarantors for the entire term of the mortgage loan. As soon as the affordability criteria have been met, by salary increase for example, the lender could remove the parent(s) from the loan thereby freeing them from any ongoing liability.

A sensible view would be to ensure that your child has taken out Income Protection Insurance, to provide cover if they were unable to work due to illness or made redundant.

Although your capital is preserved, you have taken on the responsibility for payment of the mortgage if your child could not, so you may also need to consider your own Income Protection Insurance.

CONSIDERATIONS

- It will limit the number of lenders and deals available.
- There may be an effect on future borrowing of the parent as this would probably need to be declared on any loan / credit agreements the parent wanted to take out subsequently.
- You would need to consider if you could afford to pay your child’s monthly mortgage payment if they are unable to.
- The length of time they are acting as guarantors could mean you may have to delay your retirement date.



TAKING OUT A JOINT MORTGAGE

Whichever parent has the highest income, could take out a joint mortgage with the child using their income to improve affordability. This is generally not a first choice as there are additional costs involved.

If going down this route you may want to consider the tax implications of Stamp Duty Land Tax and Capital Gains Tax.



– Stamp Duty Land Tax (SDLT)

Registering as a co-owner of a property can be a good solution but there can be serious tax implications, which are now exacerbated by the higher rate of SDLT that applies to those who are named owners of more than one property. Avoiding this can be tricky as, even if you rearrange the ownership of your existing assets, SDLT will take into account property registered in the name of any spouse or civil partner, as well as that registered in your name.

Even setting up a trust arrangement, whereby the property is held by the named owners, but an interest is reserved in favour of the benefactor, is not a clear cut solution and HMRC will look beyond the legal ownership when making its assessment.

Some suggest registering a charge against a property in the same way that any mortgage loan would be secured, but if the property is already subject to a mortgage this would require that lender’s consent and there is also the question of how to record the agreed terms; when will repayment be made? Will it be by instalment or single lump sum? Will interest be charged? What happens if something goes wrong?

– Capital Gains Tax (CGT)

If you’re directly involved in purchasing a property with your child and you already have your own home, it will be construed as an investment on your part. As such it will be subject to tax when it is sold. The rate of CGT for residential property is currently 18% for a basic rate taxpayer and 28% for a higher rate tax payer. The annual allowance for capital gains is £12,300 for an individual or £6,150 for a trust during the 2022/23 tax year. Married couples can combine their allowances for jointly owned assets.

As a part owner of a second property you’ll pay the proportion of the growth in value between buying and selling, attributable to your share of the property. However estate agent fees, legal fees and SDLT are considered allowable costs that can be deducted from the exposure to CGT.

CONSIDERATIONS

- If you own your own home, the new property would be taxed as a second home and an additional 3% Stamp Duty Land Tax would become payable.
 - When the house is sold in the future, your share may result in a Capital Gains Tax bill of up to 28% on the increased value, as it is not your main residence.
 - The mortgage term may take you past your desired retirement date which may mean the lender requires proof of income in retirement, or delay in the retirement date.
 - The situation becomes complicated if your child has a partner, or subsequently wants to own the home with a partner. Taking the parent(s) off the mortgage and putting the new partner on involves solicitor's costs and would be subject to the agreement of the mortgage lender.
 - There would also be implications for any future loan / credit arrangements as this new mortgage would likely need to be declared on any future applications. If there is any further lending required by you – such as for your own second home or for an investment property – then this is likely to be restricted by existing commitments made with your child.
- Tax legislation and the levels of relief depend on your individual circumstances and the location of the property being purchased and may be subject to change at any time.

CASE STUDY:

WE DIDN'T REALISE THE IMPLICATIONS OF SDLT

1. Mr and Mrs Hall wish to help their daughter purchase her first home.
2. Their daughter intends to purchase a property with her partner.
3. Mr and Mrs Hall are wary of their daughter's partner so wish to be named as joint owners of the property as they believe this will ensure it cannot be sold or re-mortgaged without their consent.
4. As Mr and Mrs Hall own their own property, their daughter will now have to pay SDLT at the higher rate. On a purchase of £250,000 an additional £7,500* of tax would be payable.
5. There are several ways in which Mr and Mrs Hall can protect their interest in the property and prevent it being sold without their consent. Mr and Mrs Hall seek legal advice from a solicitor acting on their behalf on the arrangement which best suits their personal circumstances.

*based on rates from 23 September 2022 for a property based in England.

STAMP DUTY LAND TAX

THE EFFECT OF HIGHER RATES

In recent years the Government has introduced a higher rate of SDLT for property purchases where the buyer already owns a property.

How could the higher rates affect you?

If you're helping your child onto the property ladder, this may have a big impact on the amount of SDLT charged. If, at the end of the day on which the purchase is completed, any of the purchasers will own more than one property, the higher rates will apply.

The Government has gone to great lengths to ensure that the new SDLT rules cannot be circumvented easily. Firstly, the rules specify that if the property is being purchased jointly by more than one individual, the higher rates will apply if any one of the purchasers would be subject to the higher rates in their own right. Secondly, if any spouse or civil partner of any one of the purchasers would be subject to the higher rates then higher rates will apply, even if that spouse or civil partner is not named as a purchaser.

What are the "higher rates"?

When buying a property, SDLT rates apply to the amount of the purchase property price that falls within each band, rather than applying a flat rate to the entire purchase price

At standard SDLT rates, for a property worth £300,000 the tax calculation* would be:

£250,000 at 0%
£50,000 at 5%
Total tax = £2,500

*based on rates from 23 September 2022 for a property located in England. Different rate bands apply to first time buyers and properties located in Wales.

However, if the property is being bought by anyone who already owns a home, the higher rates will apply.

This will add an additional amount of tax equal to 3% of the total purchase price. Whereas the standard rate of SDLT is nil on the first £250,000 of the purchase price, there is no such "nil rate band" for the higher rates.

STANDARD RATES

Purchase Price	Standard Rates
Up to £250,000	0%
£250,001 - £925,000	5%
£925,001 - £1.5m	10%
over £1.5m	12%

HIGHER RATES

Purchase Price	Standard Rates
Up to £250,000	3%
£250,001 - £925,000	8%
£925,001 - £1.5m	13%
over £1.5m	15%

SDLT rates from 23 September 2022 for a property located in England. Different rate bands apply to properties located in Wales.

With the higher tax rate applying on a property worth £300,000 the tax calculation* would be:

£250,000 at 3%
£50,000 at 8%
Total tax = £11,500

Quite an increase!

STAMP DUTY LAND TAX

Are there exemptions if the property being purchased will replace a main residence?

Thankfully, yes! There is an exemption to allow for the scenario in which the owner of more than one property is selling their main residence and buying a property to replace it. Where the sale and purchase complete simultaneously, the higher rates will not apply. However, should the transactions not complete on the same day, there is a time limit of three years in which both transactions must complete if the exemption is to apply. If the purchase completes before the sale, the higher rates will apply but the purchaser can recover the additional tax paid on the completion of the sale, provided this takes place within the time limit. There is also an exemption if the purchaser will own more than two properties but only due to the fact that they have inherited an interest of less than 50% in another property. In this case the higher rates will not apply.

Is there any relief for first time buyers?

If all named purchasers are first time buyers they can claim relief from SDLT provided the purchase price is no more than £625,000. First time buyers will pay 0% on the purchase price, up to £425,000 and 5% on the remainder up to £625,000.



PARTNERS, FRIENDS AND TENANTS



Are you helping your child to purchase a home together with a friend or partner, or will they rent a room to a tenant? What else do you need to consider?

– Living Together Agreement

If you're helping a child who's unmarried but buying with a partner, they should consider a cohabitation agreement otherwise known as a Living Together Agreement (LTA). This can be necessary whether you're gifting, loaning or acting as a guarantor and is the perfect opportunity for you all to discuss and record any third party contribution made towards the purchase of the property and how it will be dealt with in the event of a breakdown in the relationship.

– Tenancy Agreement

If your child intends to allow another person (e.g. a partner or friend) to live at the property, a Tenancy Agreement can be a good idea. They may also want to consider a LTA to set out the responsibilities and rights of each party. This will make it clear who owns what (not just the house) and also sets the expectations for meeting the costs of living and, importantly, what would happen if the relationship were to end.

It's always wise to give thought to how any relationship may evolve in the future.

Does the agreement anticipate marriage, separation and even remarriage? Does it provide for the arrival of children? If not, it may well need revisiting. Following a divorce, should one of the parties decide to remarry, any agreement may cease to be binding and so one should consider the need for a pre-nuptial or post-nuptial agreement to deal with such eventualities.

CASE STUDY:

WE DIDN'T THINK A TENANCY AGREEMENT WAS NECESSARY

1. Mr and Mrs Lloyd are helping their daughter purchase a property. Their daughter's partner will be living there but won't be named as an owner of the property.
2. No documentation is drawn-up to formalise the arrangements.
3. Mr and Mrs Lloyd's daughter later decides to separate from her partner but he refuses to leave the property.
4. As no Tenancy Agreement was prepared at the outset, the property cannot now be sold without the partner's co-operation. The partner is able to hold Mr and Mrs Lloyd and their daughter to ransom as they cannot sell the property while he remains there.

OTHER CONSIDERATIONS

WHAT ABOUT A WILL?

However if you do decide to help, it is good financial planning to create a will. It's highly likely that both you and your offspring will need to update your wills. It's always worth considering the implications on your estate when buying and selling property or assisting someone else to do so. If the sum being provided constitutes an early inheritance does this need to be taken into account in your Will to ensure fairness in respect of any other children?

CONSIDER YOUR SAVINGS

Unless there are significant assets, helping a child will have an impact on current savings and lifestyle. It may be limited if wealth is sufficient, but nevertheless should form part of the consideration.

If savings are affected, parents should consider how this affects their financial planning for later life, such as supplementing their pension or care home costs.

Please be aware that none of the information provided should be taken as legal advice. Each situation needs to be examined by a legal professional in detail to determine the best legal advice before proceeding.



FURTHER READING

In conjunction with the London School of Economics, we published a report, **'The Bank of Mum and Dad: how it really works'**. This report reveals the results of an extensive academic study into how families approach parental help when buying a property.

We also produced a guide **'How to run the Bank of Mum and Dad'**, which outlines some of the key issues that parents and adult children need to consider when it comes to providing or receiving family financial help, and **'A Conversation Guide'** to help family members through those difficult discussions when it comes to financial support.



The report and guides can be downloaded from our website:

familybuildingsociety.co.uk/bomad

OTHER HELP

FAMILY BUILDING SOCIETY

The Bank of Mum and Dad: how it really works
familybuildingsociety.co.uk/bomad

Generational Divide
familybuildingsociety.co.uk/generational-divide

Family Mortgage
familybuildingsociety.co.uk/Family-Mortgage

ADVICE AND CHARITIES

Citizens Advice citizensadvice.org.uk

Money Helper moneyhelper.org.uk

National Debtline nationaldebtline.org

GOVERNMENT AFFORDABLE HOME OWNERSHIP SCHEMES

Own Your Home ownyourhome.gov.uk

BROKERS AND INDEPENDENT FINANCIAL ADVISERS

British Insurance Brokers' Association biba.org.uk

Unbiased.co.uk unbiased.co.uk

Vouchedfor.co.uk vouchedfor.co.uk

FINANCE

Financial Ombudsman Service financial-ombudsman.org.uk

Moneyfacts moneyfacts.co.uk

PROPERTY

Property mark propertymark.co.uk

Deposit Protection Scheme depositprotection.com

Help to Buy helptobuy.org.uk

The Letting Protection Service Northern Ireland
lettingprotectionni.com

The Letting Protection Service Scotland
lettingprotectionsotland.com

Safe Agent safeagents.co.uk

New-homes new-homes.co.uk

Ombudsman Services ombudsman-services.org

Onthemarket onthemarket.com

The Property Ombudsman tpos.co.uk
reallymoving.com

Rightmove rightmove.co.uk

Royal Institution of Chartered Surveyors rics.org

Self Build Portal selfbuildportal.org.uk

Shelter shelter.org.uk

UK Association of Letting Agents ukala.org.uk

FOR MORE INFORMATION CONTACT OUR
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