Did you know?

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Helping the kids buy a home and protecting parent's interests

A recent survey of Australians aged 50 and over has revealed that parents give $22 billion a year to their adult children to help them get established, buy property and tide them over tough times."[1]

Parents naturally want to help their children get a start in life, particularly since the property market is so hard to break into. The desire to help is further intensified if there are grandchildren on the way. This is all well and good, but what are the issues that these benevolent parents should consider?

Gift, loan or other?

One way to help adult children buy a home is providing them with money to help with a deposit. The gift may be given directly or contributed to a First Home Saver Account, a tax-effective way to save for a home. The problem with gifting is that the money is not protected in the event your child is married or in a relationship, and your child and partner then separate or divorce. In the event of a relationship breakdown, the gift becomes part of the joint assets of the relationship. Another issue with gifting is where parents intend to receive the age pension within the next 5 years. Any asset or amount over or above $10,000 gifted by a single person or couple in a single financial year or above $30,000 over a 5-year rolling period impacts on parents' pension entitlements for 5 years.

A better way to provide support and to protect parents' interests is through a written loan agreement. Even though children may view this as an expression of distrust, a written agreement would give all parties certainty about what has been agreed and what is expected of everyone. It would show the family that they are serious about repaying the loan. A loan agreement would ensure that the parents' rights are protected in the event a child's relationship with his or her spouse or partner broke down. It would also be helpful in preventing sibling jealousy with respect to parents' assets and future inheritances.

Another option is for parents to provide guarantor support for their children by providing either the parents' home or term deposits as security. Financial institutions offer a variety of options. The Commonwealth Bank has a facility called Guarantor Support, which would enable a child – through parental support – to borrow more funds than they could otherwise or purchase the property that they want rather than having to settle for a cheaper alternative.

Finally, parents could consider buying the property jointly with their children, but this would mean the parents would have their names on the title deeds. For both guarantor support and joint ownership of property, parents need to be aware that they are fully liable for their child's loan obligations.

As further protection, parents who gift or lend money can insist that their child and spouse or partner enter into a binding financial agreement to ensure that the gift or loan is repaid if the relationship fails. These agreements can be made either before or during a marriage or de facto relationship.

Parents should always obtain specialist legal and taxation advice when setting up a loan for their children. That said, here are some options to consider:

- Should the loan be on interest free or commercial terms? Generally speaking, the more commercial the terms of the loan, the more likely the courts will be to view the loan as neither an asset of a relationship between a child and spouse/partner nor a financial resource of the child. The child should make repayments of the loan principal or pay interest at least annually
- If interest is charged, will it be fixed or variable or pegged to a bank interest rate?

[1] Study commissioned by the National Seniors and presented to the Australian Institute of Family Studies conference on 26 July 2012 ,cited in article published in the Sydney Morning Herald viewed 26 July 2012 <http://www.smh.com.au/lifestyle/life/generation-iou-parents-fork-out-22-billion-a-year-to-help-their-adult-children-20120725-22r11.html2012>

- Should the loan be open ended or does it need to be repaid within a certain time frame?
- Should parents request security over the debt, even through the agreement is classed as a personal debt?

On the last point, one practical form of security is a caveat over the property. A caveat simply provides notice that a person claims a particular unregistered interest in the property, but it is not as powerful as a mortgage, which creates official rights over the property. In a bankruptcy context, failing to take security over the child's assets may mean that other creditors get paid before the parent.

The importance of life insurance

Regardless of the way parents decide to financially help their children purchase a home, life insurance on the lives of children and even their partners should be considered. If illness, injury, or even death were to happen to an adult child who had just purchased home, it would be quite likely that the child – even one with a spouse or partner – would have trouble meeting mortgage repayments and could possibly even lose the home. The consequences would be compounded by the fact that the parents have provided funding, one way or another, with a potential impact on their retirement plans.

However, given that the child has just spent all his or her savings on the home purchase and associated costs, life insurance affordability would be an issue. Given this minimal cash flow, parents can also assist in this area, particularly as this would protect both themselves and their children. With lump sum covers (term life, TPD and trauma cover), the easiest way to do this is to set up a non-super (ordinary) life policy owned by the parents on the life of the child. This ownership structure would satisfy CGT exemptions under section 118-300 ITAA97 for term life (as the parents would be the original beneficial owners of the policy) and section 118-37 ITAA97 for TPD and trauma. These exemptions would also apply for cover over the life of the child's spouse or de facto partner, so all lump-sum insurance proceeds would be tax free to the parents.

The good news is that given the age of the children, insurance premiums should be relatively low. The level of cover should at least be the amount of the loan or gift, so that the parents would not have a shortfall if an insurable event occurs. Income protection for the child should also be considered. This must be owned by the child to ensure that a tax deduction can be claimed, but of course the parents could also help out financially. Once the loan is repaid, the parents have the option of transferring the insurance cover to their adult children, so they could assume premium payments.

Summary

Most parents naturally want to help their children get started in life, and often provide a gift or a loan to help with a home deposit. The benefit of a properly documented loan is that it protects family finances in the event of an adult child's relationship breakdown.

Life insurance on the adult children should be considered in order to protect the asset and parental financial support. The initial premiums can be paid by the parents and are relatively affordable given the age of the lives insured.