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SCHOOL FEES: HOW CAN EXTENDED FAMILY MEMBERS LEND A HAND?

Many families contend with paying school fees running into hundreds of thousands of pounds per child over the course of their education. Most parents pay for these fees out of post-tax income or capital savings if needed.

This guide examines some tax efficient arrangements that other family members (typically grandparents) can use to contribute to these costs.

OUTRIGHT GIFTS

Depending on their recipient, gifts by individuals domiciled within the UK are taxed on one of two alternative bases. Gifts to trusts are dealt with below. Where gifts are made to individuals, or for their benefit, they will not be subject to inheritance tax if the person making the gift (the "donor") survives it by seven years. These gifts are known as "Potentially Exempt Transfers" ("PETs").

If the donor does not survive by seven years, their available "nil rate band" (the allowance for inheritance tax, currently a maximum of £325,000 for each individual) will pass tax-free, but the balance will be taxable at up to 40%.

As a result, if other tax-efficient methods of giving (e.g. gifts from surplus income, see below) are unavailable, PETs are usually the easiest method for family members to contribute toward expenses such as school fees.

REGULAR GIFTS OUT OF SURPLUS INCOME

Making regular gifts out of surplus income is even more efficient, as there is no need to wait for seven years before the gift ceases to be relevant for inheritance tax.

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This statutory relief only applies where gifts are made on an ongoing basis (as would typically be the case for school fees), out of income rather than capital, and where they leave the donor with enough income to continue their usual standard of living.

It is possible to make a binding promise that you will continue to meet termly school fees, and this promise would be sufficient evidence of intention that subsequent payments would immediately fall outside of your estate for inheritance tax purposes. This would leave your nil-rate band untouched and available for other lifetime gifts or to reduce the tax payable on your death.

TRUSTS FOR SCHOOL FEES

A third option, whilst slightly more complex, has a significant added advantage from an income tax perspective. Instead of making outright gifts, you could instead put money into trust for, say, grandchildren. It is possible to put your entire available nil-rate band of up to £325,000 (or £650,000 per couple) into trust every seven years without incurring up-front IHT. This trust can then be used to pay for school fees and/or other costs and expenses, e.g. university fees, housing costs etc.

If school fees had been paid outright out of income, this would be done net of income tax. Conversely, payment out of a trust can be more efficient as the grandchild could reclaim tax paid by the trustees if their income tax allowance is available. This is because the trust and its income are treated as the grandchild's. Importantly, had the trust had been set up by a parent the trust and income would be treated as belonging to the parent and be taxable on them.

CONCLUSIONS

There are therefore several ways for people other than parents to contribute to school fees and save some tax in the process. While outright gifts and regular payments out of surplus income are simple and effective, in some cases the added income tax benefit of a trust may be preferable. In each case, it is important that specialist advice, taking into account all relevant factors, is taken in advance of any gifts being made.

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