School fees planning

JOHNSTON CARMICHAEL

Where sharp minds meet

Education costs

With private school numbers on the rise due to the high standard of education on offer, more parents than ever before need to consider how best to plan payment of school fees. Often parents pay for the fees out of ‘after tax’ income. With the top rate of income tax currently 45% (soon to be 46% for Scottish resident taxpayers), private school fees can significantly eat into the family’s net income.

It is therefore essential to finance school fees as tax efficiently as possible. Any school fee planning should take into account the increased costs throughout the child’s life, together with any potential tertiary education costs.

This summary sets out some of the ideas we have as a firm in assisting our clients with the payment of school fees.

Each family’s situation is different and it is important that you take professional advice before making any changes.

Some essential tax related tips

Children under 18 versus children over 18

Tax anti-avoidance rules apply to children under 18, whereby a gift by a parent to an unmarried child under 18 which creates income more than £100 gross per tax year, will continue to be taxable on the parent and not on the child. For example, if you opened an investment portfolio for your child with funds from your own account that generated income of £2,000 in a year, then the whole £2,000 would form part of your taxable income.

These rules do not apply to children aged over 18 and parents can make gifts to adult children tax-effectively, provided the parent retains no interest in the asset given away. This may be of interest to those with children in tertiary education, however capital gains tax (CGT) may apply.

From a CGT perspective, the child either under or over 18 will be subject to CGT personally, even if the gift was made by the parent. Therefore, parental gifts can work from a CGT perspective if passing assets with capital growth to children.

Relatives outwith the parents can make gifts to children under age 18 (grandparents for instance), without the income continuing to be taxable on them. Often it is by means of using grandparents that more sophisticated planning can be undertaken.

It is important to note that the manner in which fees are paid by grandparents can present opportunities and it is worth taking advice to ensure that fees are paid in the most efficient way.

You should ensure that personal allowances, lower rate bands of tax and capital gains tax annual exemptions are used.

Money set aside for school fees planning will grow much faster if taxed at the lowest possible tax rate.

Parents should therefore consider maximising both parent’s personal allowances of £11,500 for 2017/18 (£11,850 for 2018/19), lower rate bands of tax, dividend and savings allowances and CGT exemptions of £11,300 for 2017/18 (£11,700 for 2018/19)

Transferring assets between husband and wife can be done with no CGT implications but there may be issues for unmarried couples.

We can review your personal situation and advise on potential savings.

Sources of finance

Where families have no source to finance school fees and still wish to proceed with privately educating their children, there is the option of extending a mortgage or taking out a bank loan. Consideration should be given to the rates being offered and shopping around will guarantee lowest rates.

Other sources of finance for families can include:

- Liquidating investments held;

- Looking to relatives (i.e. grandparents for financial assistance);

- Financing the school fees through payment of dividends from the Family Company.

Investments

Ideally, parents should start saving for school fees as soon as their child is born. The longer funds are invested, the greater the chance of a better return.

Consideration should be given to the length of time the funds will be tied up, the level of risk which is deemed appropriate and the level of income the investments need to generate in future to meet the school fees obligations.

A number of tax efficient ways to save for school fees exist, including:

- ISAs (each parent can save up to the annual limit each year tax-free (£20,000 for 2017/18);

- Junior ISAs (up to £4,260 in 2018/19) can be added per annum, however although the child can manage the fund from age 16, they cannot make withdrawals until they are 18, so this is really only of benefit for higher education costs);

- Existing Child Trust Funds (no new funds can be started) subject to the same monetary and age restrictions as Junior ISAs;
- Certain Unit trusts (produce gains rather than income which can generate a tax-free revenue stream where gains are realised below the annual exemption);
- National Savings certificates (should they become available again in future are worth consideration), 100% protection on deposits, income is tax free, although normally a cap is applied on the amount you can invest;
- Investment bonds (tax-free withdrawals up to 5% a year are allowed for 20 years and can be carried forward and accumulated if not required in a year). (These could possibly be held within a trust structure).

Our Johnston Carmichael Wealth team can help recommend products to suit your circumstances.

Funding by grandparents

Every child has their own personal allowance, lower rate bands for income tax purposes, dividend and savings allowances and CGT annual exemptions.

Therefore, if grandparents or other relatives (excluding parents) gift assets/funds to children this can be a tax efficient way of planning for school fees. This can also be a useful Inheritance Tax planning exercise.

If the grandparents wish to retain an element of control over the assets they may wish to use a bare trust or more bespoke trust structure.

It is important to set up the correct trust structure for your requirements and circumstances considering all tax implications both for the donor and the trust. We can give advice on this and liaise with your legal advisors, if wished, in order to meet your needs.

Another option, given the recent pension changes which may be of interest to grandparents is using their pension to fund grandchildren's school fees.

Family Companies

When it comes to school fees planning, the ideas implemented depends on the family circumstances and there are a number of ideas whereby family companies can be used as a vehicle for school fees planning. We have summarised a few of these below:

Where there is a profitable, dividend paying family company then involving more of the family in the business can be a potential way of tax efficiently funding school fees.

Grandparents for example could transfer shares to the child's parent as nominee for the child or hold as nominee for the child. These dividends could then be used to pay school fees.

A child would have their personal allowance and the current £5,000 dividend allowance (dropping to £2,000 from 6 April 2018) available to use against dividend income.

Further consideration needs to be given to whether the shares simply be held for the child in a nominee arrangement or within a more protective structure such as a Trust.

If there are a number of children then they could each receive up to this amount in dividends with no tax cost to be borne by them. (Caution again where there are minor children and parental transfers as discussed above).

There are various share restructuring possibilities which we would be happy to discuss with you.

How We Can Help

Johnston Carmichael has carried out various school fees assignments for our clients. No one solution fits all and we treat each client as an individual, providing solutions tailored for their circumstances.

We have specialists in both taxation and financial planning who will help create a bespoke solution for you.

Should you wish to discuss this further please contact:

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