GANDER TAX SERVICES

School and University fees planning through trusts

Purpose

To utilise personal allowances of those in education to assist in paying the fees thereon.

Summary

Trusts are a useful way of significantly reducing the costs of universities and schooling by utilising the personal allowances of those in education, but without giving them assets outright. For example, for a 45% taxpayer, expenditure of £8,000 would require gross income of £14,545; by transferring the income stream to a trust for children, the gross income required would be reduced to £8,000. Additionally, as principal private residence relief is available, the trust could purchase property for the beneficiary to reside in whilst at university, and CGT can be avoided on the gain.

Method

The method will depend on the age of the child, as, before reaching the age of 18, if the settlor is a parent, any income received from the trust by the child will be taxed on the parent.

- If under 18:
  - Where possible, a grandparent should settle the trust as the income will then be taxed on the grandchild, thereby utilising their personal allowance and basic rate band.
  - If the above is not possible, the income should be retained in the trust until they are 18, at which point it could be paid out to cover fees and any tax paid by the trust can be used as a tax credit by the children. In the interim, the focus could be on capital growth.
- If 18 or over, the trust can be settled by a parent and income will be taxed on the child.

There is a great deal of flexibility here, including as to how income can be split, thereby allowing for various children and grandchildren of different ages and requirements, whilst ensuring fairness.

Case Study

Paul and Linda settle investments of £400,000 into a trust for their children: Stella, who is 17, and Michael, who is 16. Upon reaching 18, each will receive an interest in possession on their respective half of the income. The average income per annum is £20,000.

When Stella reaches 18, accumulated income of £5,500 is paid to her to cover university fees. A tax credit is available relating to tax paid by the trust, giving her a repayment of £4,500. In the following years, she is taxed on income of £10,000 per annum, thereby paying no income tax.

When Michael reaches 18, his share is used to buy accommodation at university, with a room rented out. The accumulated income is paid out as above; the rental income is paid to Michael with no income tax arising. When Michael leaves university, the house is rented out to other students.

Four years later, the parents decide to bring the trust to an end and to give Stella and Michael the assets. The overall gain on the investments is less than the annual exemption for the trust; meanwhile, the gain on the property is covered by principal private residence relief, which covers the last three years of ownership – even though Michael didn't reside there during that time – with the letting exemption covering up to £40,000 of gain. Therefore, no CGT arises.