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School and University Fees: Planning Ahead

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For parents, grandparents and other family members alike, providing younger generations with a private education and a university degree is a common objective.

The average private school fees are now around c£16,700 per annum (Independent School Council 2017), and often higher, and continue to grow ahead of inflation. University tuition fees are up to £9,250 per annum, with living expenses on top.

The cost of a first-class education can therefore be a considerable and long-term financial commitment, particularly for larger families. While some may be able to simply meet the costs from ongoing earnings and income, planning ahead can be crucial, and there are a number of tax-efficient planning opportunities all should consider.

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Investing for the future

If starting early, up to thirteen years at school and another three (or four) at university provide a relatively long investment time horizon for family members to invest on behalf of children. Over such periods, despite the volatility of investment returns, a diversified portfolio including risk assets such as equities is likely to provide higher returns relative to cash in the bank, and therefore reduce the amount that needs to be set aside in the first place. Indeed, the value of cash can be eroded by inflation over the longer term, and therefore cash should generally only be considered for fees falling due in the short term.

Using your own allowances

The simplest strategy is often to invest in one's own name, to build a fund from which to draw as and when school and university fees later fall due. This may be relatively tax-efficient, to the extent that such investments for children can be sheltered within one's own tax allowances, though this has the potential disadvantage of delaying when gifts are effective for Inheritance Tax purposes.

Prepaying school fees

Schools with a charitable status often offer discounts to those paying school fees up front as a lump sum, as it allows them to invest the funds tax-free themselves. This can provide a degree of certainty as to the level of future school fees, and be a tax-efficient approach where individuals would have incurred tax had they invested the monies themselves.

Using trusts

Parents are partially precluded from using their children's allowances, as anti-avoidance rules mean any income generated (in excess of £100 per annum) is taxed on the parent. However, this restriction does not apply to others, so gifts from grandparents and other family members can often be invested very tax efficiently.

Children cannot legally hold investments until age 18, but in the meantime a simple bare trust structure can be used, with trustees holding monies on the children's behalf, and making withdrawals from the trust as and when education costs become payable.

Bare trusts are therefore commonly pre-funded by family members (besides parents) who want to contribute to a child's education, given this brings forward the point at which a gift is effective for Inheritance Tax purposes, and any income and capital gains are subsequently taxed as if held directly by the child.

The child's income tax allowances and capital gains tax (CGT) exemptions are all available, including their personal allowance (£11,850 per annum), savings rate band (£5,000), personal savings allowance (£1,000), dividend allowance (£2,000) and CGT exemption (£11,700), which can together shelter relatively sizeable tax-free income and capital gains.

One thing to consider, however, is that the child is legally entitled to any remaining funds from age 18, for any reason. These might be used towards university costs, but if benefactors or trustees would prefer greater ongoing control, a discretionary trust structure could be used instead, though the tax treatment differs from that laid out above, and is generally less favourable.

Using the children's ISA allowances

Parents, grandparents and other family members who are comfortable with the children having access to their money in adulthood should consider using the various ISA allowances available.

Junior ISAs are available to any child under the age of 18 (those with existing Child Trust Funds can transfer into Junior ISAs). The Junior ISA allowance for the 2018/19 tax year is £4,260.

A Cash ISAs allowance is also available to any child aged 16 and over. The ISA allowance is £20,000 for the 2018/19 tax year, and is in addition to the Junior ISA allowance. From the age of 18, the ISA allowance can be used to fund any type of ISA, including a Stocks and Shares ISA.

Investments held within Junior ISAs and ISAs can grow free of income tax and CGT and can be accessed from age 18 onwards (or age 16 for Cash ISAs), making them potentially well suited for funding university costs.

Using offshore bonds

Another way to provide for education costs is through the use of an offshore bond. Funds within an offshore bond are able to grow broadly tax-free, and tax may only be payable when sizeable withdrawals are required from the bond.

Offshore bonds allow individuals to withdraw up to 5% of the initial investment each year, without an immediate liability to tax. This provides at least 20 years of withdrawals of a known amount, without any immediate tax implications, and could be used to meet school and university costs.

An offshore bond is often combined with a bare trust or discretionary trust structure and, provided the withdrawals remain within the 5% allowance, there may be no tax to pay, even if the trust is funded by parents rather than grandparents.

Once the child reaches age 18, the offshore bond can be assigned to the child directly, who may also be able to surrender the bond without any tax, using their tax allowances.

Making the most of scholarships and bursaries

Scholarships and bursaries are offered by schools and universities but also can be issued by some charities and trusts. Scholarships tend to be based on achievement, such as for academic, sporting or musical ability. Bursaries are also available, though can be means-tested.

Taking out student loans

Though many are alarmed at the level of debt that today's students can accumulate, and the headline rates of interest payable (up to 3% above the rate of inflation – currently 6.1% per annum), very few students are fully affected as the terms applicable to student loans are different to commercial loans.

The loan is currently only repaid at a rate of 9% on income over a threshold (£25,000 gross in 2018/19). Those whose income does not exceed the threshold – for whatever reason – do not need to make any repayments, and the repayment period runs for a maximum of 30 years before the balance is written off.

As a result, it may be worth considering taking a student loan as a cheap and flexible form of borrowing, though there are of course many factors at play.

By extension, families may wish to prioritise funding school fees over university costs, as any borrowings to help fund school fees are unlikely to be on such flexible terms.

Are you covered?

Consideration should be given to the need for sufficient insurance in place to cover education costs in the event of death or the inability to work. This is particularly important if fees are to be paid from earnings. Occasionally such cover is offered as part of the package from the school, or otherwise it can be taken out on a standalone basis.

Final thoughts

Discussing these options with a suitably qualified, professional adviser will help you get organised, prioritise your objectives, and ensure you do not miss out on appropriate opportunities. Investing a small amount of time now can save lots more in the long term, as well as providing peace of mind. Many of these considerations naturally link into other aspects of financial planning, such as inheritance tax and estate planning.

If you have any questions on the above, please do not hesitate to contact me or your usual Saunderson House adviser.

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