HOW GRANDPARENTS CAN HELP WITH SCHOOL FEES

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Private schooling is an increasingly expensive option. With fees typically rising in excess of inflation, and the recent introduction of VAT, parents who otherwise planned to take the private route may find it is no longer realistic.

As a grandparent, you might be able to help with these increased family costs and potentially reduce the Inheritance Tax (IHT) burden on your own estate at the same time. By planning thoughtfully, you can support your grandchildren's education while optimising your own financial and tax situation.

Whether you're already contributing or considering how to start, this guide will help you structure your support effectively.

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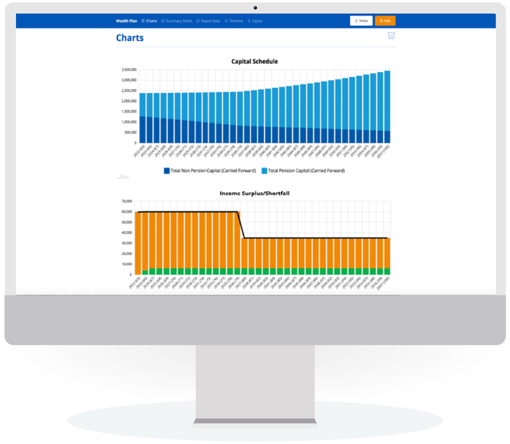
FIRST CONSIDER YOUR OWN FINANCIAL PLAN

The head must rule the heart, and it is essential to first ensure your own financial security. The key questions to ask yourself are:

- **What can you afford to gift?** Determine the amount you can spare while still funding your plans throughout your lifetime, including allowances for unforeseen expenses.
- **Can you sustain regular gifts?** If committing to long-term educational costs, remember that increases often exceed inflation.
- **Can the gift be replicated?** Consider whether you may have future grandchildren also needing support.
- **Where are the funds coming from?** Unless the gift is from surplus income, you will need to manage the sale of existing investments carefully, considering market volatility and tax consequences.

Cashflow planning tools like clarity's Wealth Plan can help you check that all demands on your finances can be comfortably met. Regularly refresh your plan to account for changes, such as higher fee assumptions.



UNDERSTANDING INHERITANCE TAX (IHT)

When a grandparent pays for their grandchild's education, it's classed as a gift for Inheritance Tax (IHT) purposes, even if paid directly to the school. In fact, if the grandparent contracts directly with the school, the gift could even be classed as a CLT rather than a PET (see below). This is not the case for a parent who pays for their own child, where education costs are exempt. Being aware of the potential IHT impact before making any gift is crucial.

Our Planning Research Note on IHT gives fuller details, but the basic points you need to know are:

- **IHT on Your Estate:** IHT is calculated and applied to each individual's assets, not jointly. It is paid on the value of your total estate at death, at 40% with a Nil Rate Band covering the first £325,000 (and a Residence Nil Rate Band for the first £175,000 of qualifying inherited property). IHT can be payable on some gifts made during your lifetime, at 20% on certain gifts above the Nil Rate Band.
- **Types of Gifts:** Gifts fall into one of three categories:
    1. **Exempt Gifts:** Two main exemptions are relevant for school fees gifting, the 'normal expenditure out of income' rule, and the 'annual exemption' (up to £3,000 per tax year).
    2. **Potentially Exempt Transfers (PET):** Gifts to individuals or an absolute (bare) trust. Chargeable to IHT only if you die within 7 years of making the gift. IHT may be levied at 0%, if any nil rate band is available. You can consider a short-term life insurance policy to cover any potential tax if this is a concern. If you die after 7 years, there will never be any IHT charged on these.
    3. **Chargeable Lifetime Transfers (CLT):** Gifts to discretionary trusts. A lifetime IHT charge, paid at the time of gifting, is 20% for any gifts not covered by your available Nil Rate Band (current maximum £325,000). The full IHT charge is payable should you die within 7 years, with a credit for any lifetime IHT already paid.
- **7-Year Rule:** Gifts are only potentially subject to IHT for up to 7 years. The tax tapers off the longer you live after making the gift.
- **Nil Rate Band:** Even if the gift is covered by your Nil Rate Band (£325,000), the use of the band reduces the amount available for use by your estate, potentially increasing IHT on other assets.
- **Who Pays?** The recipient is usually liable to pay any tax, which could be a problem if they do not have the funds available.

Planning Research Note on IHT

USING THE EXEMPTIONS

The easiest way to avoid the impact of IHT is by making gifts which fall into an exempt category, and immediately fall outside your estate. There are two exemptions here which might help.

GIFTING FROM INCOME

If you are **paying fees regularly, out of surplus income**, the **normal expenditure from income** exemption means these gifts are immediately exempt from IHT. This exemption applies only where you absolutely do not need to dip into capital to make them.

Good record keeping is essential to demonstrate that you genuinely had surplus income and intended to make regular gifts. See the HMRC form IHT403 for the income and expenditure details required.

A simple letter to the child's parents outlining your intentions to pay fees at the outset can help to show a regular intention to pay and will also help to avoid any misunderstandings within the family. You should also consider whether and how support could continue if you die before you intend your help to cease.

Download HMRC IHT403 Form

ANNUAL EXEMPTION

Smaller gifts from capital may be covered by the **IHT exemption of £3,000 per tax year**.

You can also carry forward any unused annual exemption from the previous year, potentially allowing up to £6,000 to be gifted free from IHT. This exemption is per individual donor, and so couples could gift up to £6,000 in a year (or £12,000 with carry forward) with no IHT implications. This is the total amount you can give as a donor, not an amount you can give to each donee.

SETTING UP A FUND FOR THE FUTURE

For larger sums, or perhaps where there is some uncertainty in the timing and amounts required, there are more tax-efficient options than keeping funds in your estate. Any gift now will start the 7-year clock ticking and potentially reduce or eliminate any IHT impact. Don't forget, you can consider life insurance to cover any liability should you die within the 7-year period.

However, a larger lump sum is unlikely to be spent on school fees all at once and so IHT is not the only issue to consider. Options for gifting vary in their implications for simplicity, control, flexibility, IHT efficiency, and tax on fund income and growth:

- **Gifting to Parents:** this is a simple PET, but you lose control over the funds.

  This can work if you don't mind the parents being able to use the funds for other purposes (or future children), or potentially splitting funds on divorce. The parents would need to be happy managing the investments. Any tax due on income and growth would be based on their own position. This may not be very efficient if they are already using their allowances and lower rate bands, and the fund would fall into their own estate on death.

- **Absolute (Bare) Trust:** this is also a PET, but the funds are effectively gifted to the child.

  The trust can be used to fund the child's maintenance and education until the child is legally able to take ownership (age 18, or 16 in Scotland). This gives more comfort that the funds will be used only for that child, but flexibility is lost for other uses. If the funds are not depleted by age 18, the child's maturity level may mean they are not spent wisely. Tax on income and growth is based on the child's position, which can enable an efficient use of the child's allowances and lower rate bands.

- **Discretionary Trust:** this is a CLT which offers control and flexibility, but immediate Lifetime IHT may be payable unless covered by the Nil Rate Band.

  Entire categories of potential beneficiaries can be defined, and trustees have discretion over distributions. This can be a suitable solution to cover all current and future grandchildren (for a variety of purposes), but professional tax and investment advice is recommended due to the potential complexity of trust tax rules. Tax rates can be high, unless specific 'wrappers' (e.g. offshore insurance bonds) are used.

SETTING UP A FUND FOR THE FUTURE

There is no one-size-fits-all solution; the best route depends on your own priorities and circumstances. The table below gives a high-level comparison of the different options, assuming that all IHT exemptions have already been fully used.

Gift to:	Simplicity	Control	Flexibility	Inheritance Tax	Income and Capital Gains Tax
None (keep funds yourself)	High	High	High	No IHT reduction	Based on your own tax position
Parents	High	High	Moderate	Gift is a PET	Based on the parents' own tax position
Absolute (Bare) Trust	Moderate	Moderate	Low	Gift is a PET	Based on child's own tax position
Discretionary Trust	Low	High	High	Gift is a CLT	Trust taxation applies

For more details on trust structures and taxation, please refer to our Planning Research Note on Trusts. Please also note that many new trusts now need to be registered with the Trust Registration Service, in addition to registering for self-assessment where applicable.

Planning Research Note on Trusts

Trust Registration Service