Tax planning for children

In theory, providing financially for your children should be a relatively straightforward exercise, but in practice it can present a number of difficulties from a tax perspective.

Income tax

Although children are entitled to the same income tax personal allowance as most adults (£12,500 for 2020/21), tax rules operate to prevent parents from transferring income to their children in order to benefit from lower tax rates. Where a parent gives money to an unmarried child under the age of 18, and income over £100 is generated, the income is taxable on the parent who provided the funds under the “parental settlement rules”.

Despite these rules straightforward opportunities, acceptable to HM Revenue and Customs, still exist to help provide for children tax-efficiently.

For example, grandparents may be able to provide funds for their grandchildren because the parent settlement rules do not apply to them.

During 2020/21, opportunities are available to generate up to £20,500 of tax-free income from capital provided by grandparents. This may be achieved by combining your child’s personal allowance, £1,000 personal savings allowance, £5,000 savings starting rate and £2,000 dividend allowance.

In addition, government-backed investment products provided by National Savings and Investments (NS&I), as well as Junior ISAs and the Child Trust Fund can all play a useful role in sensible income tax planning for children. The Junior ISA subscription limit for 2020/21 amounts to £9,000.

However, sometimes a more bespoke approach may be appropriate, depending upon your child’s stage in life and your objectives.

Capital gains tax (CGT)

Children are entitled to the same CGT allowance as adults (£12,300 for 2020/21).

The parental settlement rules mentioned above in relation to income tax do not apply to CGT, so there may be scope for parents to transfer more capital value to their children than income.

For example, in some circumstances, it may be possible to transfer assets in your name, such as shares, to your adult child through a suitable trust so that these can eventually be sold in their name to use up their annual capital gains allowance. Care must be taken to ensure there are no unwanted tax consequences and note that the actual ownership of the asset must transfer to your child; in other words such transactions must be genuine and with “no strings attached”. We can assist with this type of planning.

Of course, some assets cannot be legally owned by a child and in these cases the creation of a bare trust with, perhaps, parents acting as trustees, may be a solution to holding these assets and also of putting the question of ownership beyond doubt.

Education costs

Providing funds to pay for your children’s education costs may be high on your agenda. Whilst income tax relief is not available on education fees directly, in many cases, planning can be undertaken to ensure that school fees are paid in a tax-efficient manner. This could perhaps be achieved through income distributions to your child from an appropriate family trust, or through the assignment to them of segments in a life policy to be encashed in their name.

We can advise about the creation of suitable UK trusts established for this purpose as well as the tax consequences of encashing onshore or offshore life policies.

Tax-efficient solutions also exist for the problem of providing accommodation for your child whilst they study at university.

Through careful planning, your child may not only be able to gain a foothold on the property ladder, but also receive,

potentially tax-free (through the full use of various income tax allowances), income that could be used to help fund the costs of their tuition fees or other living expenses.

If ownership is structured correctly other conditions are fulfilled, the future sale of the property could also be free of CGT.

Pension provision

Looking to the more distant future, your concern may be to help contribute to your child's income much later in life, perhaps when they come to retire.

It is generally never too early to start contributing to a personal pension and contributions made earlier in life could help give the pension fund a significant boost in value later. Contributing to a stakeholder pension on behalf of your child may be a suitable option for this purpose. In addition, the tax relief they will receive will add an extra 25p for every £1 invested – subject to a maximum gross annual investment of £3,600 if they are non-earners.

The value of investments and any income from them can fall and you may get back less than you invested.

Acceptable Tax Planning

We may provide tax planning services, tailored to a client's individual circumstances, for the purpose of mitigating their UK tax exposure through the use of effective and reliable methods, acceptable to HM Revenue & Customs, in a non-aggressive manner.

We provide advice about UK direct personal taxes only (income tax, national insurance [NIC], capital gains tax [CGT] and inheritance tax [IHT]).

We do not:

- provide tax advice associated with UK indirect taxes (such as value added tax [VAT], customs duties, stamp duty land [SDLT] tax or stamp duty reserve tax [SDRT])
- provide UK corporation tax advice
- provide tax advice relating to any overseas tax jurisdictions
- design, promote, or condone structures or arrangements which exploit tax legislation artificially in order to obtain a tax advantage.

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