DUFTON KELLNER

CHARTERED ACCOUNTANTS

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Using The Business To Pay For School And University Fees

The focus in this article is on an owner-managed company paying for school and university fees. By contrast, a sole trader would be paying fees from after-tax income, as would partners – however both could have employees who may benefit from the strategies.

Education can be expensive!

School fees at primary school level can range from £11,000 (day school) to £20,000 (boarding school) and at senior school from £12,500 (day school) to over £34,000 (boarding school) per annum. A lifetime of privately-funded education could cost in excess of £500,000, and that's before university fees are applied. Typically, a university student will pay £9,000 for tuition and require around £15,000 per annum for accommodation and food a year. These costs often have to be paid when the parents of the student are close to retirement and require funds themselves for later life.

Where third parties can fund education costs, the savings to the student and his or her parents can be significant. If the parent is a 40% taxpayer, then paying £15,000 worth of fees will actually cost £25,000 after tax is paid.

Education fees – payment options

A company or employer can help in a number of ways:

1) **As part of a remuneration package** – the employer pays the education fees and the employee pays tax and NICs on the payments made. If a 40% taxpayer, in this way the fees are covered and the cost to the employee is around 50%. It may be much less if a 20% taxpayer; however, the fees are added to income to determine the tax rate.

2) **Salary sacrifice** – part of salary is sacrificed for education fees. The employer does not pay more, and you receive less income.

3) **Employer scholarship scheme** – a scheme can be set up by the employer to pay education fees. This can be tax effective, but must apply to all employees. Usually payments should be discretionary for tax purposes. 25% or less of the payments made from the trust fund in the year of assessment should be scholarship payments provided as a result of employment for no benefits-in-kind tax to apply (See ITEPA 2003, ss 211-215). Employers can pay bursaries and scholarships, but the construction of the scheme is important for tax benefits (mostly tax-free in the hands of the scholar, possibly taxable in the hands of the parent employee).

4) **Employer childcare schemes** – these are usually for much younger children but can be used for private education.

Children up to the age of 15 (or if disabled, 16) may benefit where employers offer employees up to an extra £55 per week for child care, tax and NIC free. There are also childcare voucher and government schemes available for younger children.

5) **Child owning shares** – the child could purchase shares in the company. The child, a taxpayer in his own right, can receive dividends to help pay for education fees. A grandparent could give the child cash to buy shares. The cash donor should not be the parent; otherwise the parent could be taxable on the dividends, not the child (ITTOIA 2005, s 629). The child as a taxpayer has the first £10,600 of income tax–free, and will also qualify for the new £5,000 'dividend nil rate' from April 2016.

6) **Employing the child** – the child could be employed full-time (after completing A levels). The child could then attend a full-time university or technical college, and up to £15,480 per annum can be paid to the child tax and NIC free by the business (see ITTOIA 2005, s 776 and SP 4/86).

7) **Employee loans** – as part of an education fees subsidy plan, the employer might make a loan to pay fees and also to pay the interest payments on the loan. The cost to the employee is only a tax charge on interest arising. However, the employee can have beneficial loans up to £10,000 before tax charges apply. The loan itself can later be written off (and a tax charge applied) or paid off by the employee.

8) **Director's loan account** – where the director/parent has a loan account credit balance with the company, this is his money. The parent could use some of those funds to pay education fees, or charge the company a commercial rate of interest on the loan account balance to help in doing so (although the interest will be taxable in the director's hands).

Practical Tip :

Explore the different options in paying education fees from the business – some could be tax-efficient. Expert advice may be required.

IN THIS ISSUE

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Transferring Rental Income – Anti-Avoidance Problems?

Some individuals who own investment (e.g. buy-to-let properties) may wish to transfer rental income to someone else, whilst retaining ownership of the property.

For example, a parent may wish to pass on rental income to adult children, perhaps to provide their offspring with additional funds for further education, or help them to save towards buying a property of their own.

Share and share alike

The parent (in the above example) may be content to transfer an interest in the property to the child, and to share the rental income between them. The gift of a property interest will generally be treated as a disposal at market value for capital gains tax (CGT) purposes. If the property is standing at a large capital gain, the parent may only wish to transfer a small interest to the child (e.g. 10%), to keep the gain as low as possible (n.b. this immediate CGT problem can often be overcome by creating a trust for the child and claiming holdover relief; however, trusts are outside the scope of this article).

If the parent gifts a 10% property interest to their adult child, can this allow a larger share of property income (e.g. 50%) to be allocated to the child? HMRC seem to accept that it can. In its Property Income manual, HMRC states (at PIM1030): *'Where there is no partnership, the share of any profit or loss arising from jointly owned property will normally be the same as the share owned in the property being let. But joint owners can agree a different division of profits and losses and so occasionally the share of the profits or losses will be different from the share in the property. The share for tax purposes must be the same as the share actually agreed'.*

Thus, it would appear that if there is a written agreement between the parent and child (before the rental income arises) setting out their respective income entitlements, income can potentially be allocated in different proportions to their ownership of the property.

Settlements Trap:

However, care is needed. For example, the 'settlements' anti-avoidance rules can apply to counter any income tax saving for the parent if (s)he can benefit from the property interest gifted (ITTOIA 2005, s 625), or if the child is a minor (see s 629).

For example, if the property interest is gifted on condition that the adult child (a basic rate taxpayer) returns the property interest to the parent (a higher rate taxpayer) after a fixed time period, HMRC is likely to consider that this arrangement is a settlement, and tax the parent on the child's share of the property income (see HMRC's Trusts manual at TSEM4200).

Transferring income only

In the above example, instead of transferring a 10% property interest to the child, the parent may wish to transfer the right to a proportion of rental income instead, based on the assumption that the income will be treated as the child's for tax purposes, at the cost of perhaps a small capital gain for the parent on disposal of the right.

However, such an arrangement is potentially 'caught' by income tax anti-avoidance legislation regarding 'transfers of income streams' (ITA 2007, Pt 13, Ch 5A). This legislation applies broadly where a right to 'relevant receipts' (which could include rental income) is transferred to another person without a transfer of the asset (i.e. the property) from which the income arises (ITA 2007, s 809AZA).

If these provisions apply, the person making the transfer is generally chargeable to income tax on a 'relevant amount' in the same way, and to the same extent, as the relevant receipts would have been chargeable but for the transfer of the rights to the income stream (s 809AZB).

Practical Tip :

An effective transfer of property income for tax purposes is likely to involve the transfer of an interest in the underlying asset. However, such a transfer (e.g. a buy-to-let property interest) gives rise to other tax implications (e.g. CGT and inheritance tax), which must be considered 'in the round', to prevent unwelcome surprises.

How Employees Can Sell Shares Without Paying Tax!

Many owner-managed companies have 'key' employees. The company owners may wish those employees to become shareholders. However, unless the employees pay full market value for the shares, there will normally be income tax (and possibly National Insurance contributions) implications to consider.

This problem is alleviated to some extent by the availability of certain 'approved' employee share incentive arrangements, such as the enterprise management incentives (EMI) scheme (ITEPA 2003, Pt 7, Ch 9; Sch 5). However, there is another form of 'tax approved' share ownership which, unlike share option arrangements such as the EMI scheme, gives rise to immediate share ownership.

Shares for rights

'Employee shareholder status' (ESS) broadly involves the employee agreeing with the company in writing to forego certain employment rights in return for shares with a market value of at least £2,000. No payment must be made for the shares.

The employment rights given up include the right not to be unfairly dismissed (except where the dismissal is automatically unfair or for a discriminatory reason) and the right to statutory redundancy pay (see Employment Rights Act (ERA) 1996, s 205A for the affected rights).

Tax and ESS

Tax incentives were introduced to encourage take-up of this status. The tax features of ESS shares broadly include:

- acquisition of the shares - employees who acquire ESS shares are generally treated as having paid £2,000 for them (ITEPA 2003, ss 226A–226D). Thus the first £2,000 of the market value of the shares is not taxable, and is also free of National Insurance contributions (SI 2001/1004, reg 22(11));

- disposal of the shares – a capital gains tax (CGT) exemption is available to the individual on a gain from the first disposal of ESS shares (TCGA 1992, ss 236B–236G). The CGT exemption applies to qualifying shares issued or allotted to an employee under an employee shareholder agreement with a total unrestricted market value not exceeding £50,000 on receipt (see examples in HMRC's Capital Gains manual at CG56725).

No income tax charge arises if exempt employer shareholder shares are sold back to the company (i.e. on a payment by the company for a purchase of its own shares from the individual), if that individual is not an employee (or office holder) of the employer company (or associated company) at the time of disposal (ITTOIA 2005, s 385A); and

- for the company – corporation tax relief is available to eligible businesses upon the acquisition of shares by employee shareholders. The employee's deemed payment of £2,000 for income tax purposes is disregarded for the purposes of the relief provisions (CTA 2009, Pt 12 'Other relief for employee share acquisitions') where an employee shareholder acquires ESS shares (CTA 2009, s 1038B).

However, the income tax treatment on acquisition of the shares and the CGT exemption on disposal are subject to qualifying conditions. These include that the employee (and any connected individual) must not have a 'material interest' (as defined) in the company (or relevant 'parent undertaking') when the shares were issued or allotted, or within one year previously (ITEPA 2003, s 226D; TCGA 1992, s 236D).

Businesses awarding ESS shares may submit share valuations to HMRC in advance of the award, and HMRC will agree valuations for tax purposes where possible. Any such agreement will be effective for 60 days (www.gov.uk/government/publications/guidance-on-the-income-tax-treatment-of-employee-shareholder-shares).

Practical Tip:

General guidance for those considering ESS is available on the Gov.uk website (www.gov.uk/guidance/employee-shareholders). However, before agreeing to ESS status, the employee must obtain advice from a relevant independent adviser about the terms and effect of the agreement (and there is a seven day 'cooling-off' period between obtaining that advice and the agreement being made). The reasonable costs of relevant advice must be met by the company (ERA 2005, s 205A(6)-(7)), and will not normally be a taxable benefit-in-kind (see ITEPA 2003, s 326B), or earnings for NIC purposes (SI 2001/1004, Sch 3, Pt 10, para 24).

ESS will not be suitable in all cases. However, it is a potentially useful alternative to other share incentive arrangements available. The 'pros' and 'cons' of ESS and share incentives should be compared in each specific case.

Personal Tax

Losses And Tax Credits

If you are self-employed and usually make large profits, but incur a loss for one year, then you may be eligible to claim working tax credits or universal credit for that year.

It is worth submitting a protective claim during any year for which you are uncertain of the level of your income as you can only backdate claims for one month from the date of claim.

Case Study:

John is married to Mary, who does not work. They have one child age 10.

John usually makes £100,000 per annum as a self-employed consultant.

However, he has just lost his major customer and as a result is likely to make a loss this year, and so submits a claim to working tax credits. It turns out he does make a loss, and is eligible to receive tax credits.

Property Tax

Valuing Land

A capital gains tax (CGT) charge may arise on the disposal of land. In order to calculate the capital gain or loss arising, a valuation is required where:

- The land was owned at 31 March 1982 (in order to determine the 'base cost' of the property).
- The disposal was a bargain not at 'arm's length'.
- The disposal was to a connected person.
- There is a part disposal of the land and the usual part disposal basis is applied, which requires a valuation of the retained part.
- There has already been a part disposal and the 'alternative basis' of calculation has not been used.

Calculation

- Valuation – professional advice is required.
- 'Alternative' basis – the land disposed of is treated as a separate asset – HMRC will accept any 'reasonable and fair' method of apportionment of the base cost.

Case Study:

Where a CGT computation requires a valuation HMRC offer a free valuation check. This service is available only after the disposal has been made but before completion of the Tax Return, so you cannot ask for a check in advance of sale. Should HMRC's valuation differ from the taxpayer's valuation, HMRC give alternatives and reasons.

Business Tax

Pay Interest On Account Balances

If a director has a credit balance on his or her loan account, opportunities exist for paying interest on the balance.

Although the interest will be taxable in the hands of the director, no NIC is payable. This makes it preferable to paying a salary.

To keep HMRC happy the interest should be at a commercial rate and not excessive.

The interest paid is deductible in computing the company's profits as long as it is actually paid to the director (rather than merely credited to the director's account) within 12 months of the end of the accounting period.

Case Study:

Derek has lent money to his family company to fund expansion and his director's account has a credit balance of £50,000.

The company pays interest at a rate of 4% per annum. The interest received by Derek of £2,000 a year is taxable and must be included on his self-assessment return. However, no NICs are due.

The company enjoys a corporation tax deduction for the interest paid.

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