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Grandchildren's education trust

Funding your grandchildren's school and university fees through a trust can bring a range of benefits.

At a glance

- A grandchildren's education trust (GET) is a trust to pay for your grandchildren's education
- It can reduce the inheritance tax payable on your death
- You will need to choose between a discretionary trust (flexible) and a bare trust (fixed)
- It can be possible to transfer up to £325,000 (for an individual) and £650,000 (for a couple) to a GET, without incurring an inheritance tax charge
- A discretionary trust involves higher set-up costs and more ongoing administration

What is a grandchildren's education trust?

A grandchildren's education trust (GET) is a trust under which your grandchildren are the beneficiaries. The aim is to provide a pot of money from which payments can be made to fund part or all of your grandchildren's education.

Establishing a GET involves transferring your chosen assets (which could include cash and/or investments) into a trust. You are known as the "settlor" and you can also be a trustee, alone or alongside other trustees of your choosing. The trust deed sets out the terms on which the trustees are to manage the trust assets and covers issues such as how and when to distribute the funds.

Why create a GET?

One of the principal reasons for creating a GET is to help your children fund the cost of your grandchildren's education. Not only does this relieve your children of a significant financial burden, it also removes capital from your estate, which could reduce the inheritance tax payable on your death. In addition, holding funds in a GET may reduce income tax and capital gains tax payable on relevant income and investments.

What do I need to think about when creating a GET?

Neither you nor your spouse can be a beneficiary of the trust. You will not have any access to the income or capital – so you must be completely confident that you can live without recourse to the assets in the GET.

If you are satisfied that you are in a position to transfer assets and/or investments into a GET, you will need to think about the type of trust structure that would best suit your family's circumstances – i.e., a **discretionary trust** or a **bare trust**.

What is a discretionary trust?

A **discretionary trust** can be used when you have a group of people you would like to help, but you are unsure exactly how, when and in what proportions. For example, a discretionary trust would be ideal if you already have some grandchildren, but anticipate that more will appear in the coming years.

In addition to your grandchildren, you may also include other potential beneficiaries, such as your children. For inheritance tax purposes, you and your spouse must be excluded from benefitting. Discretionary trusts can also be made very flexible by including powers to add people or charities to the group of beneficiaries in the future.

A discretionary trust gives the trustees wide powers over the investment and distribution of funds, which they must exercise in the beneficiaries' best interests. The beneficiaries have no fixed right to receive capital and/or income, and distribution of funds is at the trustees' total discretion. This may have the advantage of protecting the trust fund if a beneficiary has any creditors or gets divorced.

What is a bare trust?

Under a **bare trust**, assets are held on behalf of a list of specific beneficiaries – all of whom must be alive when the trust is created. Therefore, each grandchild's share of capital and income has to be defined at the time the trust is created, and there is no flexibility for making changes or adding grandchildren who are born later.

Essentially, the funds are treated as belonging to the beneficiaries and, when they reach 18, they are entitled to have the assets transferred to them. However, while a beneficiary is under 18 years of age, the trustees have control of the administration of the funds and, through their choice of investments, they can exert some control over the flow of income. It is not uncommon for the trustees to continue to administer and invest the funds after the beneficiaries reach 18, but this can only be done with the beneficiaries' agreement.

Bare trusts are ineffective as asset protection vehicles as the beneficiary is treated as owning the assets held in trust for them.

On the death of a beneficiary, the assets held in trust for them form part of their estate. This may be of particular concern where a beneficiary dies without a will. As a child under 18 can only make a will in extremely limited circumstances, any funds held in trust for them will almost certainly be distributed in accordance with standard intestacy provisions.

What inheritance tax will be payable?

Depending on the value of the assets and the availability of any reliefs and exemptions, there may be an inheritance tax liability on:

- Assets being transferred to a discretionary trust
- Assets being held in a discretionary trust
- Assets being transferred out of a discretionary trust

An individual can transfer up to £325,000 and a couple can transfer up to £650,000 into a discretionary trust without incurring an inheritance tax liability. Please speak to us for detailed advice on the inheritance tax position. A gift into a bare trust is treated as a "potentially exempt transfer", meaning there is no immediate inheritance tax charge on the gift and there will be no charge at all if you survive the date of the gift by seven years.

What about income tax?

Income that is generated on the assets held in trust will be subject to income tax. If the income is paid to your grandchildren, or used for their benefit to pay school fees, the tax burden may be reduced.

What will our capital gains tax liability be?

If the trustees realise a gain on the disposal of an asset, capital gains tax may be payable.

Assets standing at a gain can be transferred into a discretionary trust without an immediate capital gains tax charge, providing that neither the settlor, nor their spouse or minor children, can benefit under the trust. Any gain on the assets can be "held over", which means that the trustees acquire the asset at the value at which the settlor acquired it.

It is not possible to "hold over" the gain on a transfer of assets into a bare trust, so there may be capital gains tax to pay on the transfer

What costs and administration are involved?

A **discretionary trust** deed and the letter of wishes to accompany it are longer and more detailed than the documentation required for a bare trust, so the set-up costs are higher. The reporting requirements of HM Revenue and Customs (HMRC) for a discretionary trust can also be onerous. The trustees have to meet regularly to discuss investing the funds and using the capital and income effectively for the beneficiaries' benefit; they also have to produce annual accounts.

The HMRC reporting requirements for a bare trust are simpler. While there is still a need to produce annual accounts, if the income is mandated to the beneficiaries the accounts are relatively simple to prepare. The trustees have to meet regularly to discuss the investment of the funds but, as they have no discretion as to their distribution, the overall administration of the trust is simpler.

Which trust is right for us?

A discretionary trust requires more careful planning, but it can be an extremely useful tool in catering for unknown beneficiaries and circumstances, whereas a bare trust has a simple, rigid structure and is more helpful in certain circumstances. The choice of the correct trust and how it should be structured is one on which professional advice should be sought.

Ultimately, a GET is an important estate-planning tool that can provide tax and other benefits to you, your children and your grandchildren, over both the short and the long term.

Meet our experts

Our experienced team operates nationwide. For further advice, please get in touch with your local contact.

John Grundy
Partner | Birmingham
T +44(0)121 456 8212
john.grundy@mills-reeve.com

Andrew Playle
Partner | Leeds
T +44(0)113 388 8470
andrew.playle@mills-reeve.com

Chris Belcher
Partner | Cambridge
T +44(0)1223 222 618
chris.belcher@mills-reeve.com

Elizabeth Field
Partner | Norwich
T +44(0)1603 693419
elizabeth.field@mills-reeve.com

Sarah Cormack
Partner | London
T +44(0)20 7648 9232
sarah.cormack@mills-reeve.com

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