HOW VAT CHANGES AFFECT PRIVATE SCHOOLS AND WHAT BURSARS COULD DO TO ADAPT

LABOUR'S PLAN TO LEVY VAT ON PRIVATE EDUCATION IS MAKING BURSARS' LIVES EVEN HARDER. WE SHED LIGHT ON OPPORTUNITIES AND RISKS THAT YOU MAY FACE IN THE MONTHS AHEAD.

Supporting private schools as VAT changes loom

Private schools are facing possibly their most difficult challenge in decades. The disruption caused by the pandemic could pale in comparison with the implications of Labour's plan to nix their VAT-exempt status.

Labour intends to remove several tax breaks for private schools, raising somewhere in the region of £1.6 billion that will be added to the state school budget. The average cost of private school education in the UK is about £15,000 a year (not including boarding fees), up 20% in inflation-adjusted terms since 2010. Throwing another 20% of VAT on top is therefore essentially akin to adding more than a decade's worth of price rises overnight.

Another hit to private school budgets would be the loss of the current 80% relief on business rates – that's a 400% increase in a cost that varies massively depending on where a school happens to be. In England and Wales that relief costs the government about £140 million annually. The 80% discount was removed from Scottish private schools back in 2017 after an independent review of business rates.

For a while, it was hoped by some that boarding fees would be left exempt from VAT. However, Labour has unambiguously confirmed that boarding will be included in its legislation (although, fees for state boarding schools will remain exempt).

While this policy requires complicated legislative changes that Labour can't enact overnight, the government has moved fast now that it has been elected. Indeed, given this is one of Labour's few flagship policies, we imagine they will want to implement it quickly. The government has already drafted the bill, which can be found **here**. It has asked those affected to make comments on its plans. The bill will soon be debated by Parliament. Care will be required to ensure the legislation doesn't snag language classes, adult training courses and special needs institutions in its net.

Despite these planned changes, Labour has retreated from ending schools claiming charitable status, largely because of the overwhelming legal complexity of doing so. This means they should still be able to claim gift aid on donations and avoid corporation tax on any surpluses, as long as these are reinvested in education.

Will the sticker price rise?

Many school bursars are in a bind. After almost three years of spiralling costs in the more inflationary post-pandemic world for everything from energy and equipment to staff and insurance, it has been hard to avoid increasing fees. Now, as inflation starts to cool, bursars must determine whether to swallow the VAT levy to avoid making fees unaffordable to some potential and existing customers, or pass on the cost to parents and run the risk of a fall in student numbers that could upend expected income and budgets.

The Institute for Fiscal Studies (IFS) assumes that HMRC will receive an effective VAT rate of 15% (after schools' deductions from input costs), so that's roughly the average amount that we could expect tuition and boarding prices to rise by if all schools pass on the full cost. There are few research papers that investigate the elasticity of demand for private tuition to changes in its price, but the IFS assumes a 15% increase in cost would mean pupil numbers would fall between 3% and 7.5%. Also, the thinktank believes the falls would be back-end-loaded, with little change likely in the first year or two, given parents will be reluctant to move children to a new school unless absolutely necessary.

Prepaid fees

Another phenomenon creating a skew towards more cash now and less later was increasing demand from parents and grandparents to prepay tuition fees to avoid VAT in the future. This was legal under current legislation, but in a recent **technical guidance** note, the government clarified that fees prepaid after 29 July for the January 2025 term or beyond would attract VAT when the new legislation comes into force.

Many schools have had prepayment schemes before, often providing a slight discount to encourage earlier payments to help cashflow. Since Labour unveiled its intention to levy VAT on school fees, interest in these schemes exploded. School bursars need to check that their prepayment plans will actually help parents and grandparents avoid attracting any VAT.

Invoices for prepaid fees must have been carefully itemised to ensure they clearly show the terms, years and pupils to which they relate. Simply including a single line labelled 'prepaid school fees' could come a cropper with the taxman. In its technical note, the government warns that HMRC "stands ready to challenge" any payments made that didn't detail specific terms at set rates at the time.

It may be wise to check whether terms and conditions of prepayment schemes clearly state that prepayment doesn't waive the school's right to recover VAT that may be due from parents and that fees are stated to be "exclusive" of any VAT due.

Recovering VAT on past investments

Under VAT legislation, companies will be able to recover the VAT paid on eligible costs going forwards. This includes most types of goods and services, with the main exclusions being insurance and wages . Given that labour is a huge part of schools' budgets (about 70% on average), savings here are limited.

One of the most powerful means of saving money under the VAT change is under the Capital Goods Scheme. This allows schools to recover the VAT paid on any capital investment of £300,000 (including VAT) or more. Current rules mean schools can reach into the past to reclaim under the scheme going back 10 years. This could mean large tax refunds for some schools – particularly those that have embarked on large capital investment in recent years.

However, bursars need to remain conservative in their estimates here. The amount of VAT that can be claimed under the Capital Goods Scheme falls by 10% for each year into the past. For example, a £500,000 eligible capital investment (on which £100,000 of VAT was paid) made two years ago would furnish a refund of £80,000 (although the refunded amount would be claimed at a rate of £10,000 per year for the remaining eight years of the 10-year period, rather than as an upfront lump sum). In short, bursars shouldn't count their VAT refunds until they receive them.

Lots of cash, lots of liabilities

Big upfront fees can upend budgeting – by receiving years of fees upfront, schools leave themselves at risk of having to pay ever-rising future costs, like energy, wages, and general expenses, yet having received income at yesterday's prices. The difference between your budgeted costs today and those of three or five years hence could be considerable. This needs to be factored into long-term financial models – and, perhaps, into the fees set today.

Receiving much more cash upfront than in the past can be a blessing and a curse. While you have more money to invest and potentially help school funds grow, looming in the future are liabilities – the obligation to cover the costs of educating children for several years to come. This means private schools must pay much greater attention to treasury management. Large amounts of cash need to be kept safe, while also delivering returns that ideally keep pace with inflation. At the same time, schools must retain "unfettered access" to prepaid cash they hold. This requires careful planning and blending cash accounts, government bond investments and potentially high-quality corporate bonds to deliver the best risk-adjusted returns for your circumstances.

Our Liquidity Only service can help with this. We work closely with you to create a plan to invest your short and medium-term cash at attractive rates while ensuring the money is there when it's needed. We manage the whole job so you can focus on running your school. If you're interested, please get in touch with us.

Contact us

If you would like to find out more about our services, please don't hesitate to contact **Mark O'Connor**, Business Development Director, Charities on **020 7597 1309** or **mark.oconnor@rathbones.com**

The value of investments and the income from them may go down as well as up and you may not get back what you originally invested. Tax treatments depend on the individual circumstances of each client and may be subject to change in the future.