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Independent schools update

Inside this issue:

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Impact of COVID on the Independent School Sector

The outbreak of Covid 19 has had far reaching consequences for the sector. There are key themes which are now emerging as we talk to our clients:

Cashflow forecasting

Financial modelling will be more important than usual for Independent Schools. We recommend using scenario planning techniques where there are uncertainties. These allow you to stress test your "normal" model with the potential impact of: a further lockdown, slow paying parents, lack of lettings income and a reduction in pupil numbers (those who cannot afford to continue a private school education or because overseas students cannot attend). If you prepare these in sufficient detail, you will be able to see quite quickly the sensitivity of the model to different assumptions.

Some schools will have sufficient reserves to allow them to react comfortably to the crisis, whilst for others the economic impact could have an unsustainable outcome. It is crucial for governors to know if they are in this position with sufficient time runway to be able to make important decisions.

Serious Incident Reporting

The Charity Commission requires charities to report serious incidents, and expects prompt, full and frank disclosure when they happen.

In early June 2020, the Charity Commission published revised guidance to supplement its existing publications regarding serious incident reports. The revised guidance includes a new table of examples to help trustees decide if an incident is reportable particularly in light of the current crisis. They have clarified that having to take action to meet government rules such as closing premises should not be considered a significant incident. It is the impact of the action on the charity which is key to determining if this should be reported.

The guidance states that the Charity Commission would normally expect charities to report financial losses where they exceed either £25,000 or 20% of the charity's income. However, they have confirmed that these thresholds do not apply when considering losses relating to the pandemic and the Trustees should focus on the significance of the impact of any losses rather than the amount.

Governors should consider at each meeting whether the key issues they are discussing constitute a serious incident.

Financing

We have seen positive stories of schools being offered the support they need from their lenders including loan repayment holidays, covenant waivers and overdraft facilities for the short term. During this difficult financial time, it is really important that bursars are in close contact with their Bank Relationship Manager.

Don't forget to ensure due process is followed where additional finance is secured. Section 124 of the 2011 Charities Act requires governors to obtain and consider proper advice, in writing, before they enter into any agreement where the school's assets are provided as security. The individual providing the advice should be someone who the governors reasonably believe to be qualified by ability and have practical experience of financial matters and who has no financial interest in the advice given. This could be an employee of the school or a governor.

Working together

Despite this time of crisis there is an overwhelming sense of support for each other within the sector and a willingness to offer ideas to get through this pandemic together. Schools will certainly emerge from this with different strategies to support income generation and the provision of education in the future along with new risks on their risk registers.

We also expect to see further consolidation in the sector with an increase in mergers over the next 12 months to take advantage of synergies and shared overhead costs. If you are considering starting merger talks don't forget that due diligence is key. This is important for both parties to the potential merger to ensure there is a cultural, structural and financial fit.

Fraud

The current crisis has meant many changes in our working practices, whilst fraudsters are wording harder than ever to take the easy pickings created as a result of Covid. We would recommend that schools review their operating policies and controls to ensure that they are still fit for the current environment or whether they need updating, particularly where some of the team are still working at home.

Communication is more key than ever to ensure those double checks are still operating effectively. Specific attention should be paid to the controls in place and whether they are adequate to reduce the risk of fraud. There are some helpful virtual fraud training sessions available and it may be a good idea to ensure all the finance team and Governors undertake one of these to remind themselves of the need to be constantly vigilant.

Debt collection

As the crisis continues, the long term impact on the UK and worldwide economy could mean that, whilst debt collection to date has been surprisingly positive for Independent Schools, the sector could see an increase in bad debts.

Schools should ensure their credit control functions are more robust than ever and Trustees should decide on their policy to deal with non-payers arising from the impact of Covid on their personal circumstances.

Gift aid from subsidiaries

We have previously highlighted the rules regarding the payment of gift aid from a trading subsidiary within 9 months of the year end in order to claim relief from corporation tax. This payment must be made in cash and there must be sufficient reserves to allow the subsidiary to make the payment. The consequences of Covid could mean that there is a significant trading loss in the current period which means that the subsidiary no longer has sufficient reserves to make a donation to relieve the tax on prior year profits. In this instance, there are options available to the trading subsidiary, for example a carry back of trading losses to reduce the taxable profit in the previous period instead.

However, these options do need to be carefully thought through to ensure the school does not unwittingly end up in a position where it is lending funds which might not be seen as being in the best interest of the charity. Each situation will be different, and we recommend the expected outcome is modelled carefully to ensure tax is not paid unnecessarily.

Teachers Pension Scheme

Employer contributions to the TPS scheme increased to 23.68% in September 2019. Since the announcement of this 40% increase in employer contributions, Independent Schools have been carefully considering their future involvement in the scheme. The impact of Covid on the sector is making this decision even more important for some schools and bringing it back to the top of the agenda for those Governors who previously postponed a decision.

The latest actuarial valuation of the TPS is in progress. The outcome will not be known until at least early 2022, however it is expected that the net result is likely to be another increase to the employer contribution.

It is estimated that, as of November 2020, around 170 independent schools have left the TPS since early 2019.

Trustees should ensure their discussions on this matter are clearly documented as this decision will have a significant impact on the future of the School. A reminder of some questions to consider:

- Is the increased cost to the school the best use of charitable funds and is it sustainable in the longer term?

- Is there a risk that contributions will continue to increase in the future?

- Could the TPS introduce a cost to withdraw from the scheme in the future?

- What alternatives are available to the School and how would you choose and administer the governance in relation to a different pension scheme offering?

- How would you implement any consultation process in relation to this change and how would this affect staff moral and retention?

- How would an exit from the TPS scheme affect the School's ability to recruit quality teaching staff in the future?

- If the School decided to stay in the TPS how frequently should the decision be reviewed?

The DfE announced on 11 November 2020 that it has agreed that from Spring 2021 private schools will be allowed a "phased withdrawal" from the TPS. This will allow independent schools to choose to opt out of TPS participation for future teaching staff whilst permitting existing staff to remain as active members. New teachers would then be enrolled into an alternative pension scheme.

Draft regulations will be subject to consultation. It is the intention that the final regulations will come into force in spring 2021 and independent schools will be able to request phased withdrawal from then.

Perhaps this is an alternative to full withdrawal from the scheme for the Trustees to consider, but how will this be perceived as fair for new starters?

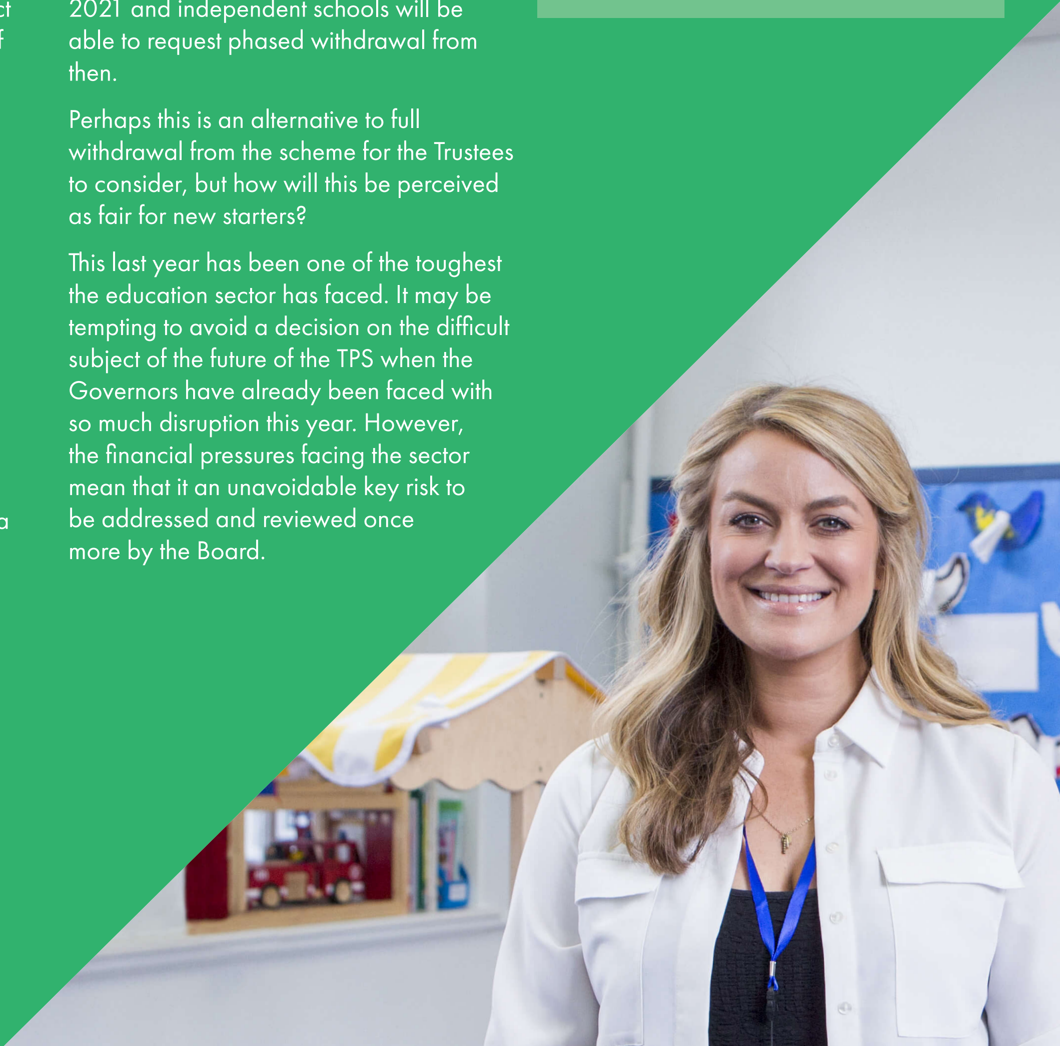
This last year has been one of the toughest the education sector has faced. It may be tempting to avoid a decision on the difficult subject of the future of the TPS when the Governors have already been faced with so much disruption this year. However, the financial pressures facing the sector mean that it an unavoidable key risk to be addressed and reviewed once more by the Board.

Brexit

The UK left the EU on 31 January 2020 and the period of transition ends on 31 December 2020. As schools are already familiar with accepting non-EEA pupils, the fact that they will have to follow this same system for students from the EEA should not create a significant additional administration burden.

Employing EU citizens will become more complicated. Schools will need to ensure that existing EU workers have applied under the EU settlement scheme for the appropriate status to ensure they can continue to be employed beyond 30 June 2021 and any new EU citizens seeking work from 1 January 2021 in the UK will need to get a visa in advance.

There is still the significant uncertainty of the impact of the "Brexit Effect" (on top of the Covid effect) on the demand for UK independent school places, this includes a recession in the UK economy, future currency fluctuations and the possible withdrawal of international employers based in the UK.



Off-payrolling rules

The planned implementation date for the introduction of the off payroll working rules in the private sector has been delayed again but only until April 2021. For a School, these rules may apply where you receive the services of a worker through an intermediary – perhaps a personal service company. From 6 April 2021, the responsibility for deciding the tax treatment for the worker moves from the intermediary to the School which is receiving these services.

The new rules will apply to any school which is not "small" i.e. that meet 2 or more of the following conditions:

- an annual turnover of more than £10.2 million
- a balance sheet gross asset total of more than £5.1 million
- more than 50 employees

If your school falls into these criteria, for every contract you have which falls within these rules you must determine the employment status. We suggest that this exercise is carried out as soon as possible. For example, you should look at how you engage your IT consultants, peripatetic teachers or maintenance staff. In addition to determining the employment status of your subcontractors, you may need to pay them through your payroll from 6 April 2021 when previously you have paid a purchase invoice.

If you engage with an individual directly on a self-employed basis you should also undertake steps to confirm the appropriate status for tax purposes. If they would be employed for tax purposes you will need to operate payroll reporting on their payments.

New sources of income – Corporation tax and VAT

The current economic environment may mean that independent schools need to look to alternative sources of income to generate the level of surplus that they have historically managed to achieve. It is generally accepted that Schools should aim to generate a surplus in the region of 10% of fees. This is to ensure there are sufficient reserves to reinvest in the fabric and technology within the school.

It is important when planning to bring in potential new sources of income that VAT and corporation tax implications are properly considered.

- Does this new source of income fall within the VAT exemptions of the provision of education?
- Does this income fall within the corporation tax exemptions of your primary purpose or an activity which is ancillary to the primary purpose?

If you are not sure of the answer to either of these questions, then you should seek advice to ensure the new activity is structured correctly.

As an example - a school may be considering extending its e-learning provision beyond the temporary package designed to continue engaging its students during a period of enforced social distancing as a result of Covid. If a package of online learning solutions is offered to pupils outside of the UK, the school should carefully consider the VAT implications of this electronic supply of services which may trigger a requirement to register for VAT in each local country where the provision is received. HMRC advise that an online course consisting of downloadable content which is supported by a live tutor would not be electronically supplied and therefore fall outside these rules but if the whole process is automatic then the position would be different. This is an area where the provision of a new service could easily have unforeseen VAT consequences.

Accommodation benefit rule changes

With effect from 6 April 2021, HMRC will be removing the "representative occupier" concession which provided exemption from a benefit-in-kind charge arising on their employer provided living accommodation.

It may be that an employee role previously covered by this concession, will still be covered under the statutory exemptions for living accommodation where it is either necessary for proper performance or customary for better performance.

Schools should review the accommodation currently provided to employees and consult with HMRC to confirm eligibility for exemption where appropriate. Where accommodation provided to employees is not covered by statutory exemptions, this will be subject to a benefit-in-kind charge each year.

If you have any questions on any of the topics covered in this update please contact us to arrange to speak with one of our specialists in London, Kent and Sussex.

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