



Independent Schools Newsletter

Summer 2019



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Foreword

Over the last year the key headline topics for Independent Schools have not changed significantly but the focus and emphasis has shifted and major challenges remain.

For Independent Schools the last year has brought many challenges and a renewed focus on risks. It seems that just as one area is managed, a new and more difficult one emerges. It's also a case that some older issues have raised their heads again. One thing is for certain, however, complacency and lack of planning to deal with these matters will only result in a significant downside. Yet also in many instances areas that were a challenge, including compliance matters have provided some opportunity.

This newsletter examines a number of areas that will be of interest to Independent Schools with articles that highlight the issues and also try to turn them into advantages.

One of the major challenges in the year has been the increase in the cost of Teachers Pension contributions, a shock

to any financial system as rates move up by 7.2%. Whilst there has been much debate in the sector as to the continued viability of being part of the Scheme, schools have also faced the fact that the increase will be funded in the maintained sector. Although that has been confirmed on a one year basis, it seems unlikely such funding will cease, given the parlous financial state of many such schools.

For the moment and to remain competitive many Independent Schools are operating a watching brief, waiting to see if there are developments which might make alternative arrangements more desirable and in the meantime reviewing budgets for fees, capital projects and in some cases teacher numbers to adjust to the large increase in costs. Our article also looks at how schools might look to improve fundraising to assist with the financial position.

International schools and international liaisons remain popular although they also bring significant financial risk if not managed carefully. Many arrangements do take time to bring any sort of worthwhile financial return. However, it is also the case that there needs to be a proper understanding of the structures needed and the management of operating across international tax regimes. Our article focuses specifically on those issues.

The issue of VAT being added to school fees still remains a background matter, but with on-going political uncertainty the potential implications still need to be understood and planned for. At a higher level there is little doubt that the possible financial benefits to the Treasury mooted by those promoting the idea have been overstated. The question is whether the political will to introduce it would outweigh the financial and social impact. Our article in this area examines the ability of schools to be able to bear or pass on the costs, but also looks at mitigating factors such as the ability to reclaim more VAT than at present and planning measures which should be helpful to schools, particularly those with provision for boarding.

General charitable status is not a new challenge and rears its head periodically. It has done so again very recently and our article revisits the background to charitable status and particularly the nature of public that schools undoubtedly provide but must continue to focus on and demonstrate.

A year ago everyone was coping with the challenge and the seemingly endless list of regulations and traps that would be brought about by the introduction of GDPR. In general the sector was better placed than many to understand and to cope with the

regulations. In more general terms this has meant better control of data and better data organisation. The ability to analyse and benefit from such a wide data pool has not yet been explored to a significant degree. We examine the processes that can be used to take data management away from compliance to produce better analytics and thus to add value to business decisions.

Finally, schools have always had their challenges in terms of employment, whether in managing accommodation benefits or payment of staff bills etc. A developing challenge arises for schools in relation to 'off payroll working', known as IR35 for people who provide services to the school but are not on the payroll. This is currently in a consultation period but it is vital schools understand what is being looked at and plan appropriately. Our article will help you do exactly that.

Overall the sector is healthy and in many cases we have seen increases in pupil numbers and an improvement in the financial health of our school clients. Of course complacency and a failure to plan ahead must be avoided, so whilst the areas of challenge may change the volume and appearance of new ones does not.



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Managing uncertainty through innovation

Independent Schools are facing uncertain times with new risks and challenges. To manage these risk schools must seek new, varied, innovative and untested strategies in order to achieve financial stability. With uncertainty comes opportunity to refresh traditions and, seen from a positive angle, these challenges can be a driving force for adopting new more efficient, more effective ways of providing outstanding education.

The TPS contribution increase from September 2019 (up from 16.48% to 23.68%) is one of many recent cost increases that is driving up the financial pressure on independent schools. Governing bodies are striving to provide outstanding education, with world-class facilities, and impressive bursary levels, whilst simultaneously facing rising costs and pressure to minimise fee increases. This is leaving independent schools managing unprecedented challenges both operationally and financially. With other potentially costly changes on the horizon, such as possible changes to the Business Rates Relief, now is the time to plan and take action to ensure future financial stability.

Naturally, and correctly, schools will first look to their cost base to identify opportunities, but with many of the costs fixed, at least for the short to medium term, options for significant financial progress in

this key area can be limited or slow to deliver. Alongside cost cutting, many schools are seeking methods of spending money in such a way as to produce maximum positive impact. Schools, for example, are using technological advancements to shift from revision (via homework) to pre-lesson preparation, a change that has the potential to increase teaching effectiveness and in the long-term, potentially, to reduce teaching time and thus cost.

To manage budgets schools may look to cut-back on their capital programmes, pushing in to the future any builds that can be delayed without impacting on the education provision, pupil retention or pupil recruitment. This too comes with potentially significant downsides. Repairs and maintenance, in particular, have the potential to be more time-consuming and more expensive with each passing year.



Alongside the emphasis on cost reduction an additional opportunity is available to Independent Schools; innovative income generation. A number of Independent Schools are already generating funds from non-fee related sources, such as international schools and nurseries, and in doing so those schools are reducing the pressure on fees and in some cases are able to build up unrestricted reserves, allowing them to cushion the impact from unexpected cost increases. An investment in nurseries, for example, can have a doubly positive impact by both attracting and supporting a pipeline of pupils into the junior school, whilst simultaneously easing the pressure on “drop off” for working parents with the added benefit of any profits from the nursery being invested in the school that will educate their children.

Despite access to a network of stakeholders and alumni that other charities crave, the traditional individual donation income stream from these warm supporters is relatively limited across the sector and for some schools is an area of untapped potential.

In order to fundraise successfully from individual donors, independent schools need to develop three key components:

An understanding of the financial needs of the school.

Without a clearly articulated need for funds the messaging will be unclear and ultimately unsuccessful. An understanding of the need will help structure the targets and deadlines for a successful fundraising campaign. Key capital projects are easiest in many ways to fundraise for but Independent Schools should not be afraid to message the need for funds to cover core costs, explaining to potential donors the vital role they can play in continuing

the current levels of outstanding education provision by the school into the future.

An understanding of potential donors. Mapping of stakeholders to understand who is likely to give, when and for which projects, is vital for ensuring that fundraising asks are targeted and GDPR compliant. The potential donor motivations for giving to the school are absolutely key to ensuring that their donor experience is positive and, ideally, recurring.

A fundraising plan that targets multiple fundraising streams that suit the school and the stakeholders, making use of modern technology and a varied selection of fundraising tools, including, for example, crowdfunding, charitable bonds and social media. The charitable bonds, in particular, have huge potential for the sector, delivering a method of raising cost effective capital, with potential for translating the bond to a donation during the period of the bond issue. Monitoring against the fundraising plan will be vital for success and pipeline information should be developed at the outset to monitor progress against individual targets, to celebrate successes and to move away strategically, if necessary, from under-performing revenue streams.



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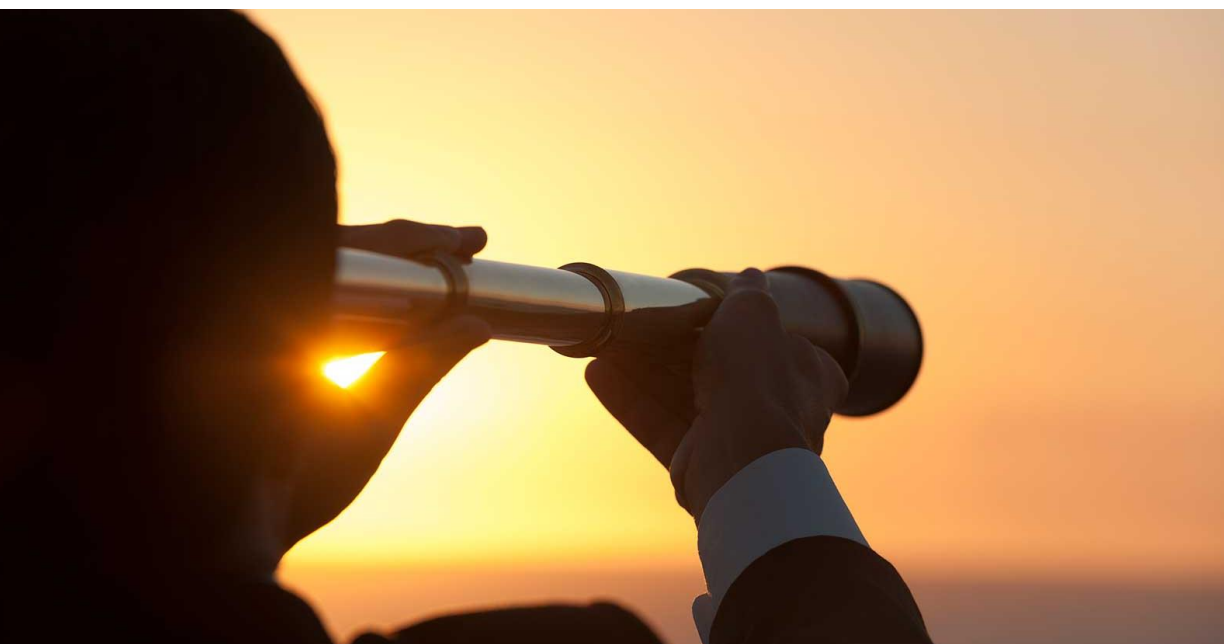
Opening a school overseas?

Tax systems differ the world over

The rush by independent schools to open sites overseas has continued, if not accelerated over the last couple of years. ISC Research has identified 30 UK independent schools with campuses in China educating around 16,000 pupils. They believe there are plans for 48 more in the next few years. With just over 500 pupils per school, it is likely that the existing schools will need to grow rapidly to be financially stable, even as the potential competitors come into the market place.

While there are a variety of models for operating a school overseas, by far the most popular approach is to get a third party to run the school, build or convert the property and take on the financial risk. The independent school licenses the name, knowledge and knowhow to the school and provides services to the campus for which it receives a license fee and raises invoices. Many governing bodies have concluded that this is an

appropriate balance between taking an acceptable commercial risk that doesn't involve committing capital and getting a good return for the time, energy and heritage that needs to be committed to the project. Returns are rarely instantaneous but with good husbandry revenues can build up over time, without the project consuming considerable amounts of management time.



Whatever the approach, it is worth remembering that tax systems differ the world over. There are local taxes, national taxes, withholding taxes, sales taxes, value added taxes, short term business visitor issues, social security taxes, taxable presence or nexus issues – all of which must be navigated carefully. Withholding taxes in particular can have a significant impact on cash flows if not identified up front and managed carefully.

Withholding taxes arise when certain types of payments earned by a business in a country are subject to tax even if the business doesn't have a taxable presence there. These are typically royalties, interest and dividends, but can also include technical fees, payments for personal services provided by non-residents and a variety of other situations. The payer is required to deduct an amount from the agreed payment and pay it across to the tax authority with the net amount going to the supplier. While credit can be obtained in the UK for taxes suffered, if the recipient is not a tax payer this represents an absolute cost to the business. Relief may be available under the relevant double tax treaty, but often this can involve a considerable paper chase and requires careful organisation to

get the relevant documents in advance of any payment. This is often important when an upfront commitment fee is negotiated at the start of a project to cover the initial costs of independent school – as many territories require a withholding from this amount.

One solution is to negotiate a 'gross up' clause where by the full amount required in the contract is required to be paid over. If there are any withholding taxes these must be paid over by the payer in addition to the initial payment. Whether a business partner is willing to accept these commercial terms is, of course, a matter for negotiation, but it provides an element of protection if the necessary paperwork cannot be generated in time.



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VAT on school fees

Over-estimation of potential benefit to HMRC?

The Independent Schools Council rebuttal of the Labour Party's position in relation to schools' charitable status and the charging of VAT on school fees has recently made the front page of the Times by stating how the sector saves the taxpayer more than £20 billion a year. However, the possibility of this drastic change still looms over the sector given the current unstable political environment, many schools are starting to quantify the effect that the imposition of VAT would have on their financial positions.

In our opinion the Labour Party's estimations of the benefit of applying VAT to the Treasury have been over-estimated. The primary reason for arriving at this conclusion is that the current figures have merely added VAT at 20% to the total fee income currently received by schools. This vastly oversimplifies the economics of the situation for the following reasons.

Reason 1 – Full VAT Cost will not be paid by Families

Most (if not all) schools will not be able to add 20% VAT to their current fee income as the majority of families paying for the

education will simply not be willing or, in a position to pay the extra cost. Therefore, Schools will need to pass on a proportion of the increased VAT cost to parents but this will be a sensitive issue, consequently the proportion of that can be passed on will differ from school to school depending on specific circumstances.

In our experience most schools would only be able to pass a small proportion of the VAT on to the families and, therefore, the current figures have overstated the impact of the VAT yield on the fee income.

Reason 2 – VAT Rules will enable Schools to Increase VAT Recovery on Costs

Currently most schools benefit from very few VAT reliefs on costs as a result of charging exempt fees for the education that they provide. This is because whilst most independent schools are charities they are 'in-business' from a VAT perspective which means many VAT reliefs available to other charities cannot be accessed by schools. So, usually VAT relief is only available on building new accommodation, some works to enable disabled access to buildings and certain supplies of advertising. Furthermore, as Schools' services are currently VAT exempt, the VAT charged to them cannot be recovered to any great extent with most schools only being in a position to recover 2-4% of the VAT that they incur. If VAT was applied to school fees, schools would be in a position to recover the majority of VAT incurred on costs which again has not been factored into Labour's calculations.

Reason 3 – Boarding may be unaffected by the change

It should be noted that VAT exemption currently applies to state regulated welfare services as well as to education. In the VAT legislation welfare services specifically covers care and protection of children and we would not expect the welfare exemption to be amended as this would potentially have an adverse effect on the care sector which is already struggling to make ends meet. Consequently, if the exemption covering

independent school education was removed, this would not affect the ability for services of welfare to continue to be treated as VAT exempt. This means that whilst a day school fee would most likely have to be treated as being subject to VAT at the standard rate as being a supply of education, fees for boarding students could potentially be split between that of taxable education and welfare services with the welfare (the boarding element) retaining the VAT exemption. Of course, this approach would potentially only assist boarding schools in retaining the exemption on some of their income.

Finally, we have devised a free calculator to assist schools to estimate the impact of VAT being applicable to school fees, taking into account some of the factors covered above along with others such as the impact of the Capital Goods Scheme increasing VAT recoverable. Please contact us if you would like a copy of the calculator.



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The perennial challenge to charitable status

Whilst time passes quickly the continuing challenge to independent schools regarding their status as charities seems to remain a constant. Even with the back drop of Brexit the thought that independent schools remain only for the most privileged in society is never far away.

It is less than 10 years ago that it was proven that independent schools were charitable in law as defined by their objects and that it was for governors to decide how schools operated and the level of public benefit they provide. However, with the continuing coverage in the press we can reflect on the reality of the challenge for the sector.

The provision of education is one of the 12 principle purposes outlined as being charitable in the Charities Act 2006. This is irrespective of whether fees are being charged. A charity may charge fees for its services as long as those who cannot afford the fees can still benefit from its activities. Whilst Independent schools make up a small percentage of those charities charging fees they seem to have a disproportionate amount of press coverage related to this topic.

Whilst it can never be said that it is impossible for charitable status to be taken away from independent schools, on the face of it, to do so would be difficult. If it was suggested that education was no longer a charitable purpose the unintended consequences on other organisations would be enormous. That would suggest organisations such as professional membership bodies, for example the Royal Medical Colleges, which many would easily recognise as delivering a vast amount of public benefit, would also not be regarded as charitable. Far more possible perhaps is the removal of specific charitable tax reliefs for independent schools or that the bar may be raised “higher” for access to such reliefs.

Independent schools currently enjoy exemption from Corporation Tax, Capital Gains Tax and Stamp Duty Land Tax. If these exemptions were no longer available this would add a princely sum onto the cost base of every school making the way schools currently operate impossible. Ultimately there would be no option but to pass on these costs through fee increases to parents. This would of course make fee affordability even more challenging and even more likely to be only within the reach of the most affluent of parents. However, a more likely possibility will be for higher demands to be made on charities to demonstrate a greater amount of public benefit delivered if they wish to continue to benefit from charitable tax reliefs.

A great deal has been written about adding VAT to school fees following the Labour manifesto in 2016. This would require a change in VAT legislation which would only be possible after the UK has left the EU and most likely a change in Government too. For the majority of schools very little VAT could be recovered due to the nature of their expenditure although the larger more affluent schools would fare better as they would be able to recover VAT on their capital projects where a significant amount of money is spent.

Many governing bodies remain very concerned by these endless threats to their future position, however there are very few things that can be done to protect the school from any potential impact. Those which have looked at restructuring the business to separate the charitable assets from the trade have come to the conclusion that it is impossible to put a more robust structure in place without knowing where the “goal posts” in the future may sit. One thing for certain is that it remains imperative that schools continue to demonstrate clearly the public benefit they deliver both directly to their students and other stakeholders but also to society at large through their partnerships with the local schools and other community driven organisations.



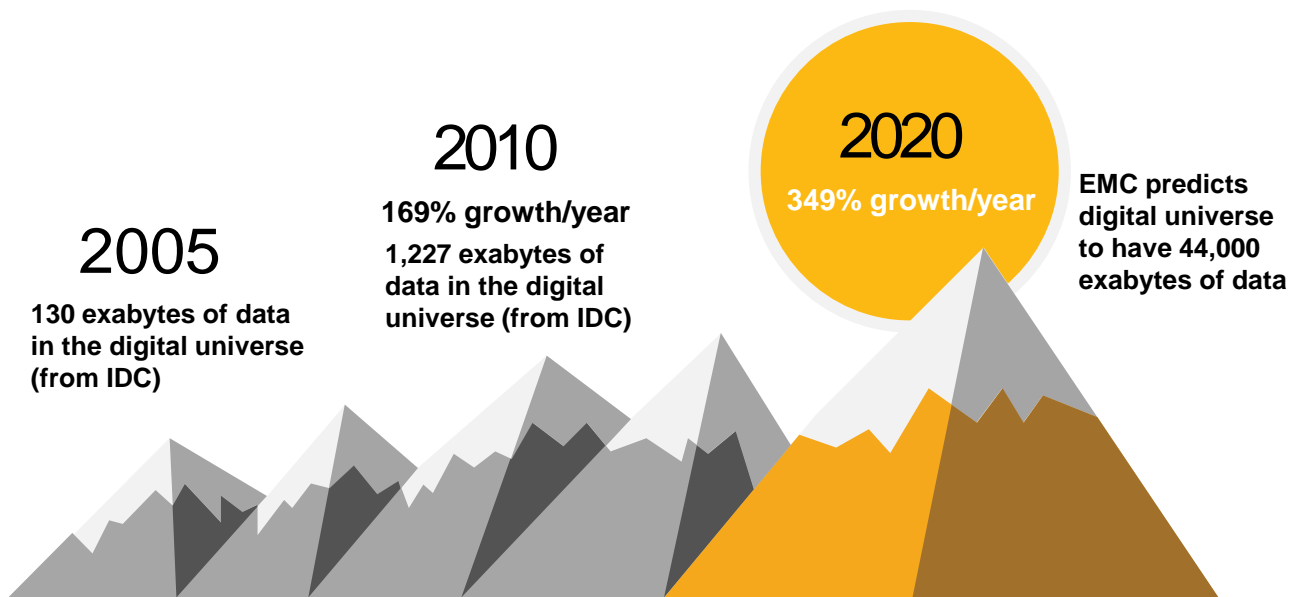
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Realising value through data

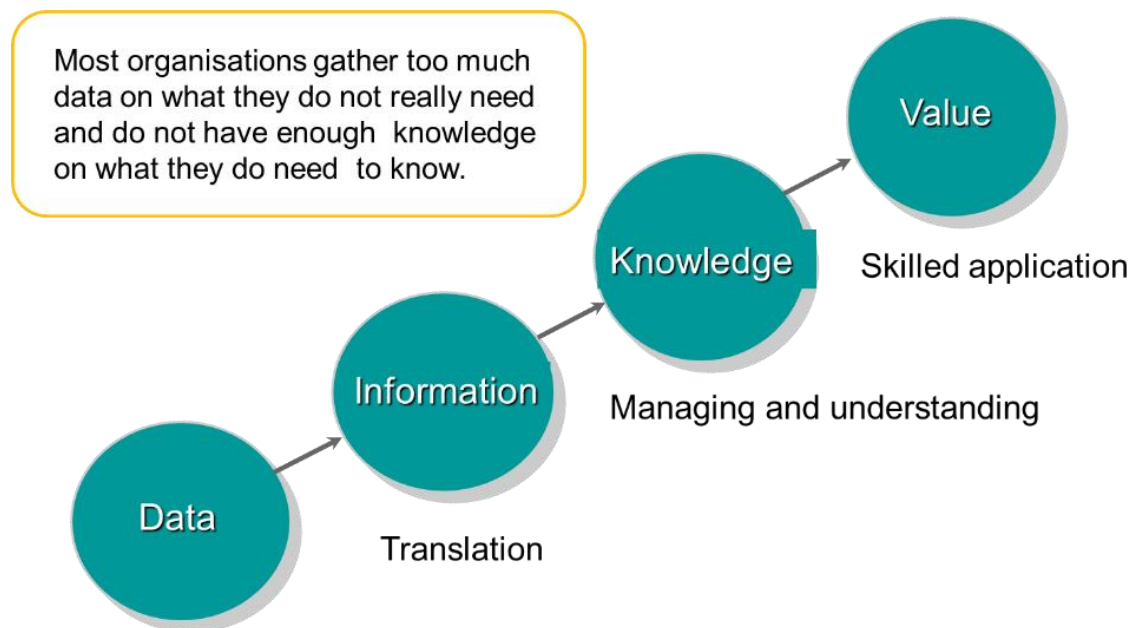
As depicted in the graphic below, there has never been more data in circulation, with this exponential increase in volume set to continue. However, in our experience, the Independent School sector, in common with the majority of organisations, is not maximising the opportunity from the data which is available, both internally and that which is publicly accessible (open source).



In general Independent Schools hold considerable volumes of data, which in part, was put into focus by the introduction of the General Data Protection Regulation (GDPR) in May 2018. In a number of cases this led to a rationalisation of the data sets held and a challenge as to why the data was

being collected, what it was used for and how long it was retained for.

However, whilst the volumes of data held have tended to increase this has rarely been part of a wider strategy for data itself, reflected in the chart below:



In general, an approach of “more is better” with data and reporting has developed, with additional management information produced as a result of a specific request at a point in time, with the reports continuing to be produced, irrespective of whether the need is still there. Indeed it is uncommon, if not extremely rare for a Committee or management team to request that a report or paper is no longer produced as it is no longer required or the resources to produce outweigh the associated benefits.

Given the complexities of the operations of Independent Schools there is a real need to generate value from the data held. The move to internationalisation of schools, completion of new capital projects, consideration of boarding provision and strategies and the need to address the costs of the Teachers Pension Scheme places an increased focus on financial and performance data being accurate, complete and timely.

In terms of utilising data, there is often the challenge that “rubbish in, rubbish out” and that in many cases, there is a complete mistrust in the data being presented. We see this often in the Independent School sector, with no single version of the truth in use and different sections of the School maintaining their own off system records. Not only is this inefficient in resource use, but multiple versions of the data also increases the risk of errors and of decisions being made based on the incorrect or incomplete information.

In the majority of instances technology is the medium through which the data is collected, retained and delivered. However, underpinning issues in data is often an adhoc technology strategy – systems are not sourced and implemented in an integrated manner, with resultant issues with the integration of data between the systems.

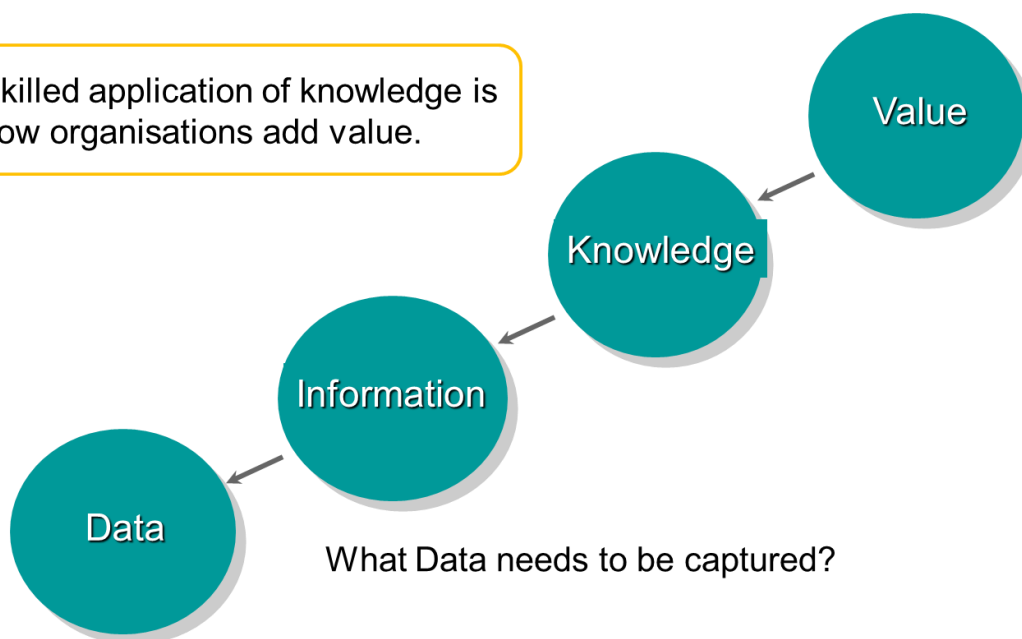
Making best use of data

At the outset it is to reverse the information cycle set out in the previous chart – instead begin with what will support value

for the school – for example, what are the key financial metrics that will help determine performance, and what do your stakeholders need? For example, when considering houses and the boarding provision – what do the House masters or equivalent need to know to manage their budget effectively – is it a simple monthly report or purely reporting on exceptions?

In the case of groups of schools – are the costs fully understood and opportunities for synergies in working together fully realised? This may involve an initial exercise to move the schools to a consistent chart of accounts and way of working, but there are short, medium and longer term benefits to this type of exercise. Consistency of structure of stat facilitates comparison exercises and presents opportunities for schools to learn from each other. It is also gives rise to opportunities. For example, can certain services be procured at a group or regional level?

Skilled application of knowledge is how organisations add value.



Technology as an enabler

At the outset, there is a tendency to blame the technology infrastructure in place – either the implementation of the Finance system wasn't seen as effective, or the Finance system doesn't link to the CRM/ Fundraising etc. One aspect of this, referenced earlier, is the need to ensure the IT function is involved in all key project decisions, rather than being brought in post implementation to try and make things work. In particular, there should be a wider IT Strategy and Roadmap in place, with full consideration of the costs of implementation. We would also recommend that consultation with existing customers is essential for any change in system, to understand any particular challenges and to see the reports which are produced operating in practice.

As a further add on to this – the existing systems do not need to be a barrier to change. There are a number of business reporting tools which are widely available which can extract all the data from different systems to produce reports which are accessible and more crucially, available in real time. This then prevents the issue of significant costs being incurred and a more immediate impact upon reporting.

Open Source Data

There is a considerable volume of data which can be sourced to inform decision making when combined with the existing data held by the School, both from across the UK and EU. The key to this is in determining what data would be of benefit and then identifying whether this is

available. One such consideration may be in the consideration of impact in the delivery of charitable purposes or in seeking to understand potential targets for internationalisation or alternate sites.

Where to start?

Often there are barriers – either real or perceived, in commencing with a wider strategy to address the challenges in data and starting to realise the benefits. In these instances the starting point should be to set out the key questions which need to be addressed, then to prioritise accordingly.

The work in respect of data can start with addressing the key question itself, and as the benefits are then seen, the work extended further to wider data validation and actively challenging the approaches in place. We would recommend a short and focussed exercise in the form of a “20 day sprint” in order to make some real progress – with real gains made in the short term it is possible to demonstrate the wider opportunities to the School.



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Reforms to off-payroll working in the private sector

The impact on schools

Since 6 April 2017 maintained schools, academies and certain other educational institutions have been subject to changes to the rules on off-payroll working (known as IR35). The changes to rules have meant that the responsibility for operating IR35 moved from individuals providing their services through an intermediary e.g. a personal service company (PSC) to a public sector body engaging the worker when, if it were not for the PSC, the individual should have been on the payroll. The engager must then operate PAYE and NIC on payments made.

HMRC believes the existing IR35 legislation in the private sector "is not working effectively, and non-compliance is widespread". Therefore, Autumn Budget 2018 announced a reform of IR35 in the private sector.

Broadly speaking, the reforms will require medium and large organisations impacted to identify and review the employment status of all workers engaged through PSCs, including those workers provided via an agency or third party, and potentially treat them as a deemed employee for tax and NIC purposes from 6 April 2020. This may include visiting lecturers, cleaning and maintenance staff etc.

The new rules should not affect the smallest 1.5 million organisations and although it is not yet confirmed, it is expected that the following tests will determine if a company is small.

This is the case if two or more of the following conditions are met:

1. turnover =< £10.2 million,
2. balance sheet total =< £5.1 million and/or
3. =< 50 employees.

For unincorporated bodies the test is likely to involve 1 and 2 above.

HMRC issued a consultation on 5 March 2019 to inform the draft legislation expected in Summer 2019: you have until 28 May 2019 to contribute. This consultation sets out how organisations can prepare for reform; HMRC's plans to provide education and support; and addresses some of the teething problems previously encountered such as the former lack of a right to appeal.

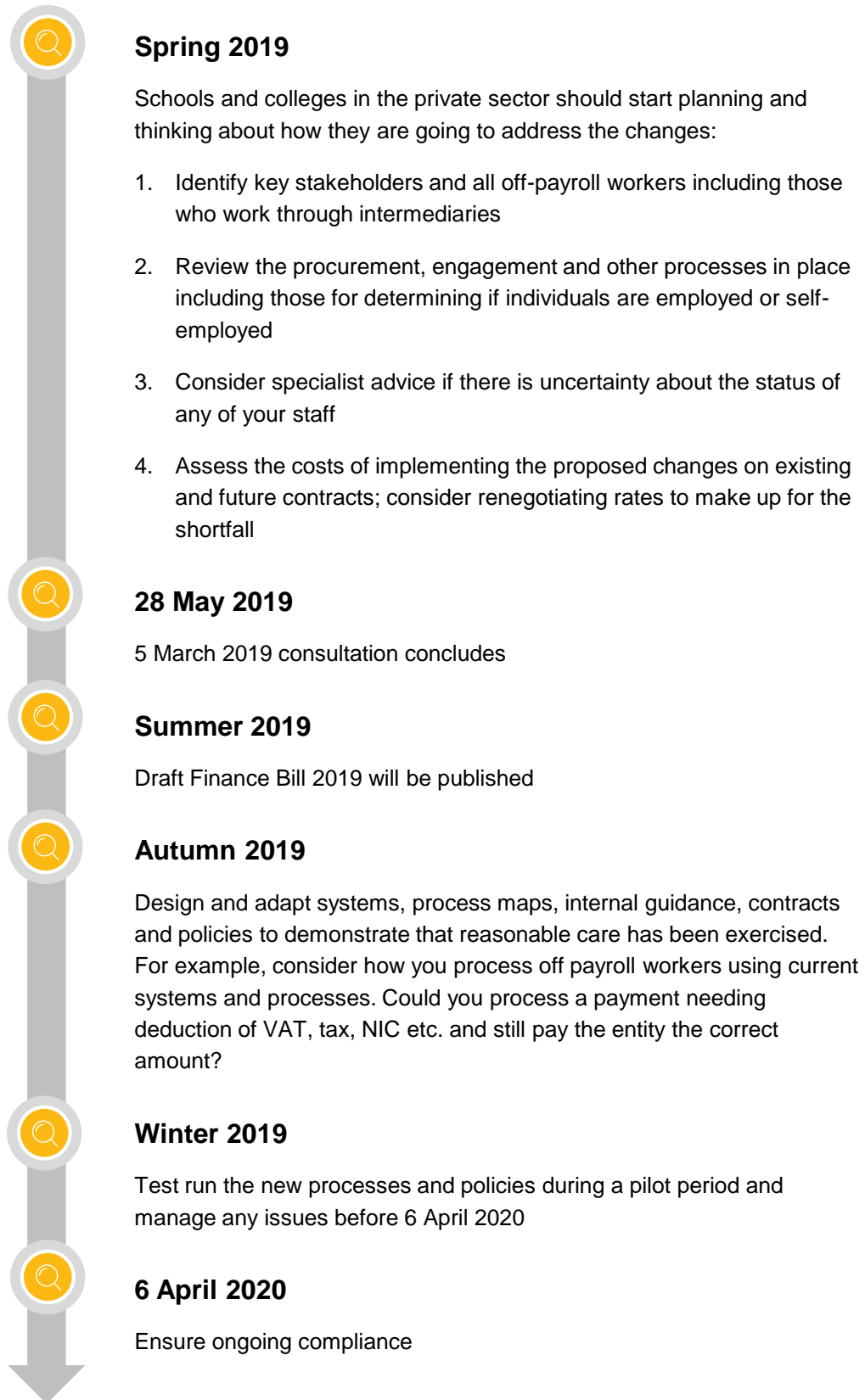


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What's next? A timeline of what you should aim to do

Based on our experience, there are practical steps that you can take now



However and above all else the message is clear – schools and colleges not already caught by the new rules should start planning and taking actions as outlined above as soon as possible. Those in the public sector who are already operating the reformed IR35 should review the changes outlined in the new legislation and ensure that they comply going forwards.



Start the conversation

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