



Home > Insights > Market views

Market View

Independent school fees and VAT

The Labour government's proposal to introduce VAT on private school fees marks a significant shift in the UK's educational and fiscal landscape. Currently, private school fees are exempt from VAT, which provides financial relief to many families opting for private education. The new proposal aims to address funding disparities between private and public education while increasing tax revenues.

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With the recent landslide election win, it is now all but a certainty that this increase will be applied at a fiscal event in the not-too-distant future.

What is the current legislation?

Private schools charge fees rather than being funded by the government. They may also raise capital via donations, investments or endowments. Under the current UK VAT law, education provided by an eligible body is deemed exempt from VAT, which extends to ancillary services linked to education, including boarding accommodation, school trips and catering services. This exemption significantly reduces the cost for those who choose to educate their children privately.

Implications of VAT exemption on schools

Currently, being VAT-exempt means that private schools cannot reclaim VAT on their expenses. For instance, if a school embarks on a capital project like constructing a new building, it must pay VAT on the related costs, thereby increasing overall expenses. Conversely, if schools lost this exemption, they would have to start charging VAT on their fees. However, they would then be able to reclaim VAT on their expenditures, which could help partly offset the increased fees.

Implications of VAT exemption on families

The knee-jerk response to this pending legislation has been for many to consider pre-paying school fees in advance. Any decision to pre-pay school fees is not without risk and families would need to consider a number of factors prior to making their decision.

Cash flow

There is a potential opportunity cost in paying the school fees upfront. The possibility to pay for a number of years school fees has to be weighed up with alternative saving or investment options for the cash.

Anti-forestalling measures

There is always a possibility that anti-forestalling rules are implemented to negate any pre-emptive payment of school fees before the new legislation takes effect.

However, these rules generally apply from the date the new legislation is announced in Parliament, rather than retrospectively.

In addition, a number of VAT tax professionals have also expressed the view that payments beyond the 2024/25 academic year may prove less effective against any new legislation

introduced. The implication being that schools may pass on increases in any case (see contract review below).

Timing

Timing is key. Whilst several schools have been proactive in offering parents the possibility to pay school fees upfront, you would expect this opportunity to be gradually closed off by some schools as the landscape becomes clearer on when the new legislation will be introduced.

Contract review

It is important to carefully review existing contracts with the school prior to making any decisions to pay fees upfront, in particular paying attention to clauses that allow for fee increases due to circumstances outside of the school's control in the future, such as a change in tax legislation. This itself should not discourage pre-payment, but it then needs to be weighed in with other factors, such as the level of discount offered for pre-payment and the aforementioned cash flow implications.

Financial stability

The financial stability of the school is also a key consideration particularly where families are pre-paying fees years in advance.

In conclusion, the decision to pre-pay school fees should be balanced against the level of discount offered, the financial stability of the school and the robustness of the contract against future fee increases.

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