haysmacintyre

Schools Briefing
ISBA Conference 2022

Contents

Welcome from the editor

Welcome to the ISBA Conference edition of our Schools Briefing where we continue to look at the challenges faced by schools in the current environment and how changes in regulations may impact the sector.

To begin, Tracey Young comments on the results from our latest Independent Schools Management Survey highlighting the impact that COVID-19 has had on schools' finances.

Continuing on from the theme of our previous Schools Briefings, I sit down with James Rea, Bursar of Chigwell School, to discuss the challenges encountered with embarking on a capital project in the current environment and Alice Palmer discusses direct tax implications of alternative income streams.

The introduction of the Health and Social Care Level remains to be a key topic of discussion with Nick Bustin sharing some further thoughts. Additionally, Vikram Sandhu shares the findings and learnings of the Charity Commission Inquiry into the collapse of Kids Company.

We are grateful to Stephen Ravenscroft, Partner and Head of Charity and Social Enterprise Team at Stone King, who explores the recently introduced Charities Act 2022 and what independent schools need to know.

Finally, our second guest author, David Sewell, takes a walk down memory lane reflecting on how the sector has evolved over the last 30 years. On that note, we would like to thank David for his 33 years' service to haysmacintyre and the significant impact he has made to our organisation during that time. We wish you a long, happy and relaxing retirement.

I hope you enjoy this edition and find these articles of interest. Do feel free to let the articles' authors, me or your regular contact know if you have any questions concerning the matters discussed.

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Independent Schools Management Survey 2022

The impact of COVID-19 over the last two years has had a significant impact on school finances. As schools look ahead to an uncertain future there is continued focus on financial operating models to maintain financial resilience. Benchmarking information can be a valuable tool to both senior management and Governors when assessing their schools' financial performance and helps to inform the decision making process. This year's survey has given us and our participants some useful data and we set out some of the key findings below.

Overall **pupil numbers** in the schools included in this year's survey increased 2% overall from 2019/20 to 2020/21, with the growth due to increased day pupils. There has been a marginal fall in boarder numbers over the period of 0.4%. Growth was experienced by all school categories apart from preparatory boarding and day and preparatory day schools which saw a decline in pupil numbers.

We continue to see some significant increases and sharp declines in pupil numbers at individual schools which suggests that although the general picture for the sector remained strong, many schools continue to experience tough market conditions. Mergers and closures have continued over the last year. The last two years have eaten into many schools expected financial reserves. The current challenges of rising costs along with the financial pressures on fee payers means the position is likely to become very difficult for many and impossible for some.

The average **fee increase** for 2021/22 for all schools responding to our survey was 3.3%. This is up from the average in 2020/21 of 0.8% – this was an exceptional year with 74% of schools responding, applying no increase to fees. The average increase in 2021/22 continues the trend of relatively modest increases – with the average increase from 2009/10 to 2019/20 ranging from 3.3% to 3.9%. Given the current pressures on costs most notable on pay awards to staff with current inflation levels, it feels unlikely that moderate increases can continue unless there is strong cost management or low surplus levels are accepted, which will impact future reinvestment.

The average inflationary **pay awards for teachers** over the period have increased from 1.5% in 2019/20 to 1.7% in 2021/22. The increase in 2020/21 was far lower at 0.8% which reflected the fact many schools held both salaries and fees as a result of COVID-19. Current high inflation levels will put pressure on pay awards, but governing bodies will have to balance this with affordability.

The average inflationary **pay awards for non-teachers** has broadly been in line with that applied for teachers over the last two years. However, many schools are seeing rising costs in lower paid roles as a result of the national minimum wage and in order to fill vacancies.

Schools in the survey provided **fee remissions** of 9.2% of gross fees on average, up from the prior year of 8.0% of gross fees. This excludes any COVID-19 discounts or rebates. This ranges from 4.1% in preparatory day schools to 14.7% in senior and junior boarding and day schools.

COVID-19 discounts/rebates varied from school to school. On average, schools responding to our survey lost income representing 2.6% of gross fees (or 7.7% of a term's gross fees), which was lower than the previous year of 6.9% of gross fees. Senior boarding schools, as expected, experienced the greatest levels of discount/rebates, averaging around 16% of a term's gross fees (or 5.2% of total gross fees). This compares to 25% of a term's gross fees in the prior year.

Means tested bursaries (including hardship awards) averaged 4.2% of gross fees in 2020/21 compared to 3.9% in 2019/20. The level of means tested remission provided varies significantly between the school categories, with preparatory day schools providing on average 1.9% of gross fees compared with 5.9% at senior day schools. **Scholarships** averaged 1.8% of gross fees and **staff fee remissions** (not means-tested) were on average 2.0% of gross fees in 2020/21, both consistent with the prior year.

It is an established practice in the sector for staff to be provided with discounted fees for their children, although the level of remission can vary from nothing up to 100% in exceptional cases (which can have benefit in kind tax implications). It is a very tax efficient benefit and is expected by many teachers and key support staff and can assist recruitment and retention. For some, it can be a key part of their decision-making when accepting a role.

Highlights of our analysis of levels of remission offered to teachers across all schools in 2020/21 are:

- 47% offered a remission of 50%
- 19% offered a remission of between 61% and 70%, including 16% providing 66.7%
- Only 4% of schools offered no remission to teachers

Although the levels offered are consistent for most schools over the period, roughly 5% of schools have reviewed this benefit and reduced the discount offered from 2019/20 to 2021/22.

Premises costs averaged 13.7% of net fees, which is marginally higher than the previous year. This is despite the lower net fees in the prior year due to COVID-19 discounts/rebates. This reflects that many schools cut back on spending in this area to control costs and have increased spending as income increased.

These costs can vary significantly between schools depending on the nature of the school estate, in particular the number and age of the buildings. As expected, boarding schools tend to have greater costs in this area. Repairs and maintenance costs form a significant proportion of this expenditure and it is important that both these costs, as well as capital projects, are costed in schools' strategic plans.

Rising inflation, as well as challenges in sourcing materials and labour is adding to the cost of projects which will be another area of pressure on school budgets in the current year. Although it is possible to delay projects, to do so can lead to inefficiencies, deteriorating infrastructure and higher costs in the longer run. Many schools commission regular condition surveys to enable them to identify and plan the required works effectively and ensures the funding is available as necessary.

Average **capital expenditure** was £1,316k in 2020/21 up 14% compared to 2019/20, but constrained capital spending has continued for many schools. The levels of capital expenditure can vary significantly from school to school and by school type. 45% of schools spent less than £250k which is higher than the 39% in 2019/20. 16% of schools spent between £250k and £500k which was in line with the prior year. 28% of schools spent over £1m, which is slightly lower than the previous year. There continues to be a small number of schools undertaking very significant projects. Just under a third of schools responding to our survey received fundraising income for capital projects, although the value can vary significantly with 13% receiving less than £100k. However, 2% of schools received over £1m for capital projects. The majority have funded projects at least in part by borrowing.

The average **net surplus*** was 9.8% of net fees for 2020/21 compared to 8.2% in the prior year. We continue to believe that schools should target a surplus on net fees before depreciation of at least 10% to provide sufficient working capital, to fund IT, capital and maintenance programmes and provide means tested bursaries. However, for some schools, strategic plans may indicate that they need to achieve surpluses in excess of this level.

In light of the current economic outlook, rising costs and potential impact on pupil numbers as a result of financial pressures on parents, it is imperative that schools continue to carefully monitor pupil numbers, debts and bursary and hardship awards for early warning signs of future impacts so prompt action can be taken. Continued cost control remains essential and ensure care is taken to consider the viability of potential capital projects.

Many schools have withstood the financial pressures of COVID-19 well, and far better than we all first feared. However, continued vigilance and good financial management will be important in the years ahead.

If you would like a copy of this year's publication, then please contact marketing@haysmacintyre.com.

** excludes investment income, fundraising income and expenditure, borrowing costs or depreciation*

Capital projects: insight in a post COVID-19 environment

In a brief interview between Lee Stokes, Partner at haysmacintyre and James Rea, Bursar at Chigwell School, we gain an insight into their capital project, the challenges encountered and top tips for undertaking capital projects in the current environment.

Can you provide a brief overview of your capital project?

Governors and the Headmaster at Chigwell School identified a strategic need to improve the indoor sports facilities back in late 2017. We are very lucky to be based on a 100-acre green belt site just outside London, with exceptional grass and artificial sports pitches but, there was scope to increase the range of indoor sporting opportunities particularly given our determination to provide a first-class education in the fullest sense. As with other capital projects, we were keen from the outset that this further expanded our work with the local community.

Shortly after I joined the School, I was asked to commission a feasibility study and engage with our local planning authority for some initial advice. By this stage the School had identified two potential sites for the new centre, the first building on top of the existing sports hall in the centre of the campus, and the alternative, at the end of the site with separate vehicle access and parking. In consultation with planners, governors agreed that the first option best served the needs of the School.

In 2019 the School embarked on a competitive tender process for a lead architect and a project manager and appointed Squires & Brown as the former and Gardiner & Theobald as the latter. At the same time, Design Engine architects were appointed to formulate a wider medium-term buildings masterplan around the planned sports centre. Discussions with the appointed consultants arrived at a preliminary design for a five court hall, with separate gym and CV studio, six lane 25 metre pool and associated changing facilities.

How did you finance the project?

Once the design was finalised a development budget of a little over £20m was established for the fixed cost of the sports hall building and all associated enabling works and hard and soft landscaping. Of this, roughly half was to be financed via development funding from HSBC and the remainder from reserves and fundraising.

Was the commencement of the project impacted by the pandemic?

We were largely unaffected by the pandemic itself with the initial enabling works, including the relocation of existing tennis and netball courts, starting on time in Summer 2021. The biggest challenge came as we undertook the second stage of the procurement process and the markets for various suppliers and subcontractors became significantly disrupted.

In this regard, the ability of Gardiner and Theobald to protect the School's position as both project manager and cost consultant and the willingness of governors to meet regularly and at short notice to address issues, allowed the School to finalise an agreement with McLaren as the main contractor shortly before Christmas 2021 with little to no impact to the agreed fixed price.

What were the key considerations at the beginning of the project?

Chigwell School is keen to extend its role as the heart of the local community and, to this end, it was always the intention to open up the new sports centre to the public outside core school hours, be that via community sports groups or individual members. However, with this desire came the need to design the centre to cater for two distinct groups with differing needs, and without ever compromising on the safeguarding of our pupils. Speaking to others operating a similar model in their schools and those with experience of running a commercial sports centre operation, it quickly became apparent that we would need two separate entrances.

Were there any key accounting treatment considerations?

As with any development in the green belt, the outcome of the planning process was highly uncertain and, to this end, the School agreed with haysmacintyre, our auditors, that it would be prudent to write-off professional fees until such a point as it became highly likely that the project would be granted permission to proceed.

Were any challenges encountered and, if so, how did you overcome them?

The local authority planning case officer was helpful throughout the process of the formal application and was reassured by the School's commitment, as with its other facilities, to offer the new sports centre for community use. The biggest challenge, ironically enough, came from Sport England, which required full pricing and community use details as part of the planning application. This in turn required the School to formulate an operating model for the Sports Centre alongside the finalisation of its design. Although this proved challenging at the time, we are hopeful that this front-loading of work will mean the final Community Use Agreement will be agreed with little further delay.

If you were to undertake the project again, would you do anything differently?

Other than starting and finishing 3 years earlier to avoid the recent market-wide issues, not really!

What would be your top tips for any schools about to embark on a capital project in a post COVID-19 environment?

Obvious though it might sound, always plan ahead: by the time it is completed in late 2023 this project will have been at least six years in the making. Also, choose your core project team carefully. In a disrupted market the School has seen clearly the benefits of having architects, a project manager and planning and cost consultants of substance.

Acknowledgement

Thank you to James for taking part in this Q&A and for providing an insight into Chigwell School's capital project.

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Direct tax implications of alternative income streams

With costs sharply on the rise, central funding restraints and pressure to keep fee increases low, schools are increasingly looking to generate extra income from a diverse range of activities outside of their core educational offering.

However, without proper planning and structuring, these activities could lead to unintended direct (corporation) tax and indirect tax (VAT) consequences.

This article focusses solely on the direct tax considerations, and with the corporation tax rate increasing from 19% to 25% in April 2023, it is more important than ever for schools to review their activities carefully and seek (early) professional advice.

The basic position

Contrary to popular belief, charitable schools do not receive a blanket corporation tax exemption on all income.

The starting position is actually that of a ‘normal’ company (or trust, depending on the constitution) with the expectation that most (or all) income will then fall within one of the charitable income exemptions, provided it is applied solely to charitable purposes.

Pure donations are normally outside the scope of corporation tax, however trading (broadly the provision of goods or services in return for payment), rental and investment income relies on these specific exemptions. The most relevant to this article are:

- **Charitable trading** – trading within your charitable objects, including school fees. The wider your objects, the wider the possibilities! Perhaps look beyond educational objects and also consider ‘recreational’ charity objects. Particularly take note if your school’s objects are narrow, such as only covering a certain age group or geographical area, as this could severely restrict the possibilities for charitable trading.

  Also don’t forget that the public benefit test must also be met for this exemption to apply.
- **Ancillary trading** – trading that is not charitable in itself but is closely connected with/ancillary to the primary charitable purposes. For example, branded uniform sales, school lunch sales or textbook sales.
- **Income from land and buildings** – passive income from land and buildings, including rental income, ground rents, payment for right of access etc.
- **Small-scale trading** – any non-charitable trading (or miscellaneous income, such as Feed-In-Tariffs) up to £80,000 turnover per year. This is an all or nothing relief, though is subject to a ‘reasonable expectation test’ if this threshold is unexpectedly breached one year.
- **Fundraising events** – fundraising events (e.g. balls, fetes, firework displays etc.) that meet the criteria for being VAT-exempt are also exempt from corporation tax. Broadly events must be clearly organised to raise money for the charity and keep within the strict limits on annual frequency.

Common examples

Though we have seen some very creative income generating activities, below are some of the more common examples. Whether these fall into one of the charitable exemptions will depend on the exact nature of the activity and also your school’s specific charitable objects, so please seek both tax and legal advice as necessary.

A very common scenario is the hosting of a **summer school or camp** (and also particularly relevant given the time of year!). To understand the tax treatment, it is necessary to consider the exact nature of the arrangements. Is the camp being run directly by the school or is there an external provider, for example? For the former, income is likely to fall within the charitable trading exemption due to the direct provision of education by the school, but for the latter it will be necessary to establish what is being provided by the school in the arrangement and whether that service can meet one of the exemptions or not. This can be a much more complex area and tax advice may need to be sought.

If your school is lucky enough to have a range of its own sporting facilities, another income stream you might explore the running of a **sports club** for the general public, such as gym membership, fitness classes or open access to a pool. This would be a trading activity, though might fall within charitable trading depending on the school’s charitable objects.

Another way of generating income from your sporting facilities is to let these to other schools, clubs or groups for their own use. Whether this is treated as trading or rental income will depend on the level of services provided (e.g. staff) and the type of equipment made available. It is, therefore, best to understand what the tax implications might be before any arrangements are concluded and contracts are signed.

Even without extensive sporting facilities, your school might still be **letting out rooms with specialist equipment** – such as an IT/conferencing suite, or fully equipped theatre with professional equipment, with or without support staff. Again, this could quite easily be viewed as trading rather than rental income by HMRC.

Less common, but on the rise, is the operation of a **café that is open to the general public** (even if only during certain hours). This would be very unlikely to fall within any of the charitable exemptions, except, perhaps, the small-scale exemption. If the café is restricted to students / staff at certain times then it is really important to be able to separately identify sales between these types of users, otherwise the whole activity would likely be viewed as non-charitable (and potentially taxable).

Land and buildings or trading income?

You might have noticed there is a bit of a theme with letting activities as to whether it would qualify under the land and buildings exemption or trading income exemption. Unfortunately, there is often not a straightforward answer to this and it could even be a bit of both!

If a charity rents out spare space on a short-term basis (e.g. hourly / daily) rather than by way of a longer term formal lease, then it is particularly important to consider exactly what is being provided to establish the correct corporation tax treatment.

If all that is being provided is the use of space (whether furnished or unfurnished), then it is very likely to be covered entirely by the **land and buildings exemption**.

As noted earlier, if the school is providing more than just access and/or the rental value is largely derived from the equipment within the space then the likelihood is that HMRC would view the **whole activity as a trade** and would need to rely on the trading exemptions instead. Services such as staffing or supervision, catering and equipment set-up are common examples.

It gets a bit more complicated as HMRC sometimes accepts there is **rental business and a trade** carried on together, though it only provides guidance in the context of residential accommodation. If any services provided are not integral to the letting, it therefore might be possible to separate these out, but this would need to be looked at carefully and might also have VAT implications.

This can be a notoriously grey area and there is no case law particularly relevant to the charity or school sector, only minimal HMRC guidance. If there is any doubt, it is normally best to assume that HMRC would view the activity as trading.

Consequences

If the small-scale trading limit has been exceeded and the 'reasonable expectation test' cannot be met, then the profits from all non-charitable trading will unfortunately be subject to corporation tax if carried out directly by the charitable school. This could be very costly, especially with corporation tax rates on the rise and can represent an unexpected cost where not factored into the business plans from the start.

All direct and indirect costs should be identified when calculating the profits, which will require a suitable 'just and reasonable' method for allocating shared overheads. We would recommend seeking professional advice to ensure any method chosen is acceptable to HMRC.

It should be noted that corporation tax consequences can also arise should the above calculation result in a loss.

Solutions

So what solutions are available where your school wishes to carry out non-charitable trading on a larger scale or you have realised that the school is already doing so? Firstly, you should take legal advice to ensure what is anticipated can be achieved within your school's constitution. Though there might not be much that can be done about historical activities, it is never too late to change things going forward. Though not exhaustive, two possible options you might wish to consider are:

1. Widening your charitable objects

Consider looking at your school's charitable objects and speak to your legal advisors. There might be scope to widen the objects and bring some of the existing trading activities within these, which as noted above could give far more flexibility to carry out trading activities directly within the school.

There is no financial cap on the amount of charitable trading a charity can carry out and no negative implications if these turn out to be loss making.

2. Use of a trading subsidiary

If the turnover from non-charitable trading exceeds the small-scale trading limit, then it may be possible to shelter any profits from such activities by routing the trading activities through a wholly owned trading subsidiary instead. Any taxable profits generated by that subsidiary can then be donated by way of corporate Gift Aid to the parent school within nine months of the year end to eliminate the corporation tax liability that otherwise would have arisen.

Careful structuring and agreements will be required between the school and the subsidiary to ensure this works correctly, otherwise it can simply create other tax issues in place of those you are trying to avoid. The subsidiary may also need funding (e.g. for working capital), which has its own set of rules for tax purposes and is worthy of an article in itself!

Conclusion

Alternative income generation for charitable schools can be a minefield and there are numerous things to consider from a corporation tax perspective. The consequences can also be costly if not structured correctly.

Therefore, if your school is thinking about any new income streams or is unsure about its existing ones, please do get in touch and we can help you get it right from the start.

The Charities Act 2022 – what Independent Schools need to know

After many years of discussion and debate, the Charities Act 2022 finally received Royal Assent on 24 February. The Act implements the majority of recommendations made by the Law Commission in its 2017 report, 'Technical Issues in Charity Law' and aims to reduce the administrative burden on charities, saving both time and money. While this isn't a root and branch review of charity law, it does address some of the issues which can often pose problems to charities in their general operations.

The indicative timetable for implementation suggests that provisions will come into force between autumn 2022 and autumn 2023.

So, what are the key changes?

1. Ability to amend governing documents

For many charities, particularly unincorporated charities, the changes in the Act dealing with changes to governing documents will be welcome, allowing charities to have greater clarity around the assorted rules for amending governing documents, providing greater flexibility to respond to changes in demand, different financial conditions and governance strains brought into sharp relief by the pandemic.

Until now, different rules have applied dependent on whether a charity was established as a company, a Charitable Incorporated Organisation, an unincorporated charity (trust or unincorporated association) or Royal Charter. This led to significant confusion and a sense that not all charities were being treated equally. Going forward, the same set of rules will, broadly, apply where changes of a non-administrative nature are required to a charity's constitution. In the case of any change to a charity's purposes, the Commission will be required to have regard to the original purposes, and the need for the charity to have purposes which are suitable and effective in the light of current social and economic circumstances.

This represents a significant simplification and harmonisation of the rules – although it must be noted that, in the case of charitable companies, the changes could make it more difficult for incorporated charities to amend their purposes in future since the Commission now has a formal framework to follow – previously, charities could simply rely on a rational argument for the change.

2. Dealings with charity land

The Act introduces various provisions which are designed to provide additional flexibility with regard to the disposal of charity land and to introduce a sense of proportionality to some dealings with land. In particular, charities have been required for many years to seek a qualified surveyor's report (QSR) when disposing of charity land. Going forward, reports can be provided by 'designated advisers' which expands the range of those who can provide advice from the current members of RICS to include fellows from the National Association of Estate Agents and fellows of the Central Association of Agricultural Valuers, while a new section enables trustees, employees and officers who are qualified to provide a report or advice, including where they do so in the course of their employment. The Act also removes the requirement for land to be advertised in the manner advised in the report.

The provisions for dealings with connected persons have also been changed, enabling the grant of tenancies for a short, fixed term or periodic tenancies to employees without being required to seek the specific consent of the Charity Commission. In these cases, going forward it will be possible simply to rely on a report from a designated adviser.

The rules have also been changed for charity to charity disposals of land – going forward, for the exemption on compliance with the land disposal provisions to apply, the Act provides that it only applies to disposals to another charity that are solely intended to further the transferor charity's purposes. This means that the exception will not apply to a commercial transaction (a transaction intended to achieve the best price that can reasonably be obtained for the disposing charity); or a social investment.

3. Charity trustees

There are various provisions in the Act which relate to charity trustees. The Commission already has a useful power under the 2011 Act to determine who the members of a charity are, where it is not clear or is disputed. The Commission does not have an equivalent power to determine trusteeship, which can be problematic where members are not involved. Additionally, all charities have some restrictions in their governing documents around benefits to trustees – they can be absolute but many charities will have powers to make some payments to trustees where it is in the best interests of the charity. The 2011 Act already includes a power for charities to remunerate trustees for services (which can give charities access to services at advantageous rates) but there is no equivalent for goods.

Accordingly, the Act sees an extension of the rules to allow trustees or connected persons to be remunerated for the provision of goods, services or goods and services to their charity. There will no longer be a requirement to supply goods in connection with services. There are examples provided in the explanatory notes to the Act - a charity can now pay a charity trustee (or their business) to decorate the charity's premises, supply paint to decorate the premises or do both.

There is a new section which gives the Commission power to order a charity to remunerate a trustee for work carried out for, or on behalf of, the charity (or to authorise them to keep any unauthorised benefit already received), where the Commission considers it would otherwise be inequitable for them not to be paid or to retain the benefit. There are various factors included in the Act to which the Commission must have regard when making such an order. This means that charities will no longer need to apply to Court to authorise these payments or benefits in these circumstances.

4. Permanent endowment

The regime governing permanent endowment has also changed, and, going forward, it will be possible to borrow up to 25% of a charity's permanently endowed funds (that is, borrow from capital) without the consent of the Charity Commission. Any such borrowing must be repaid within 20 years. There is another welcome new power enabling trustees (of charities who already opt in to invest on a total return basis) to make social investments that they could otherwise not make (because it is expected that, although the social investment would further the charity's purposes, the return would be negative or uncertain).

There are further changes which will deal with issues such as making ex gratia payments and dealing with funds which have been raised for a particular purpose where those funds can no longer be used and applied for that purpose. There are also some useful provisions to enable charity mergers – the Charities Act 2011 introduced some provisions which were intended to enable mergers to take place without being concerned about losing the benefit of any legacies intended to the transferor charity, but those provisions never quite worked. The changes now will make this effective and will enable charities to be wound up without fear of losing the benefit of any legacies.

So, as we can see, not exactly earth-shattering changes, but a range of smaller changes which should make elements of charity legal administration more straightforward. If you would like to discuss any aspects of the above or any legal issues more broadly, then please do not hesitate to contact Stephen Ravenscroft using the contact details below.

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Health and Social Care Levy – some further thoughts

After much public debate, the Government has introduced the Health and Social Care Levy (the levy), with effect from April 2023, with a temporary increase in National insurance of 1.25% for both the employer and the employee effective from 6 April 2022 until the new levy takes effect in April 2023.

The intention, as advised in our previous Schools Briefing, is that a new levy will from 6 April 2023 apply to both the employer and employee at a rate of 1.25%, a combined levy of 2.5% with the Class 1/1A and 1B National Insurance rates returning to their normal levels.

However, the following questions have been asked over recent months:

Q. Are independent schools, as charities, exempt from the levy?
A. No, there are no exemptions available to charities.

Q. What will the impact be from 6 April 2023?
A. For employers the levy will be a standalone charge of 1.25% and, as previously mentioned, the increases in various categories of National Insurance will revert to their pre-April 2022 rates. Similarly, for employees, who are not in receipt of the state retirement pension, there will be no change in the combined level of National Insurance and Levy they are due to pay. However, for employees who are in receipt of their state pension and not due to pay employee's National Insurance, unless there is a change to the draft legislation, they will be liable to the 1.25% levy.

Q. Is there anything an independent school can do to help mitigate the impact of the levy?
A. Yes. For employees who are participating in a defined contribution pension scheme, then the use of a pension salary exchange (also known as pension salary sacrifice) can help to mitigate the impact of the levy.

A pension salary exchange is a legitimate method of reducing not only employer and employee National Insurance liabilities, but also the salary upon which the levy charge will be calculated. The pension salary exchange works by agreeing with the employee to reduce their salary in exchange for the school paying the equivalent amount in pension contributions on behalf of the employee.

Both the employer and employee will pay less Class 1 National Insurance and the Levy too! This is due to the fact that the liabilities are calculated by reference to the post pension salary exchange earnings.

Benefits of the pension salary exchange
The following provides a summary of the benefits which can be obtained by both the school and any participating employees:

- As well as the National Insurance savings, the employee receives tax relief immediately at their marginal tax rate
- This is particularly beneficial for a higher rate taxpayer who then does not have to claim the additional tax relief via their Self-Assessment Tax Return
- The school can share all or part of its National Insurance savings with the employees in the form of additional pension contributions; or
- Use the employer National Insurance savings to help fund part of the Health and Social Care Levy costs; or
- Provide additional funds to provide new staff benefits such as additional life cover or other minor benefits
- Can be used as both a recruitment and retention tool
- Enhanced duty of care-helping employees better prepare for their retirement with such income planning and consequently make a real difference to their employee's future.

Whilst the use of pension salary exchange should not be used for staff who are members of the Teachers' Pension Scheme (TPS), it should certainly be considered for non-teaching staff or where any school is in the process of closing its use of TPS and replacing it with a defined contribution scheme.

Whilst many schools will be familiar with salary exchange arrangements it is important to ensure all aspects of the scheme are fully considered. HMRC places considerable emphasis on the employer making its employees fully aware of what it means, which will typically include:

- Providing illustrative models
- Staff communications
- Guidance for employees
- How details of the salary exchange are reported on an employee's payslip.

The use of salary exchange can also be used in conjunction with cycle to work schemes too!

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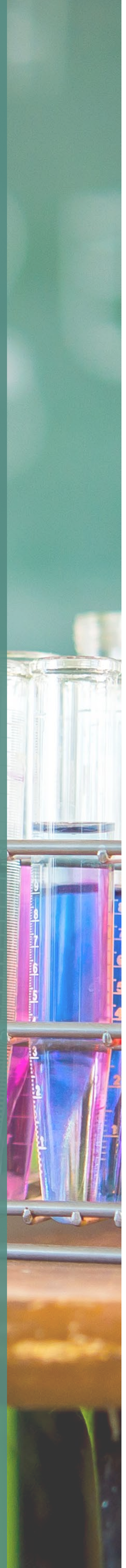
Charity Commission Inquiry into the collapse of Kids Company

The Charity Commission has concluded its Inquiry into the circumstances surrounding the August 2015 collapse of Kids Company and its report was published in February 2022. The Inquiry was opened in August 2015 but was paused while the charity went through an involuntary insolvency process and to avoid prejudicing the outcome of a High Court trial to determine whether the then trustees should be disqualified from acting as company directors. The High Court issued its judgment on 12 February 2021, with the determination that the trustees should not be disqualified from acting as company directors.



The scope of the Charity Commission's Inquiry was considerably wider than the matter decided by the High Court and can be read in full here: https://www.gov.uk/government/publications/charity-inquiry-keeping-kids-company/charity-inquiry-keeping-kids-company

The Commission's key findings were that:

1. Kids Company was operating a high-risk, demand-led model which prioritised growth and delivery of services to beneficiaries in the short term over building reserves and resilience for the longer term. As a result, when there was a shock which had a negative impact on the charity's fundraising, in this case unfounded allegations of abuse of beneficiaries, the charity's reserves were insufficient to allow the charity to avoid an insolvent winding-up. Had the charity maintained a higher level of reserves, it may have had sufficient resources to continue after the allegations were determined to be unfounded, or at least to have allowed for a more orderly winding-up and potential transfer of services to another provider, thus avoiding any detriment to its beneficiaries.
2. There was a lack of documentation relating to funding decisions made by the Board. This may, in part, have been due to the inappropriate destruction of records which followed the charity's closure, but the Commission notes that it is not clear whether certain records were destroyed or never existed in the first place. The maintenance of proper records is essential to support accountability and to ensure that the trustees can demonstrate that they have made decisions appropriately. It should be noted that at no point has it been alleged that the trustees were involved in the destruction of records.
3. The charity had repeatedly failed to make payments to creditors on time, in particular, amounts due to HMRC and to self-employed workers. The Commission found that this alone represented mismanagement on the part of the trustees.
4. There were some skill gaps on the Board and the Commission particularly noted that the presence of a trustee who had experience of running a large and complex charitable organisation, as Kids Company had grown to be, would have been invaluable.
5. Many of the trustees had been in place for a long period of time, and greater rotation of the Trustee body and specific roles within it, would have meant that it would be more likely to constructively challenge management's established working practices and the charity's operating model.

Whilst the circumstances of Kids Company's operating model and eventual collapse were unique, the Commission has identified a number of learning points which are of potential relevance to all charities including independent schools. Most notably:

1. Charity boards should ensure checks and balances, and the right blend of skills and knowledge, are in place to avoid power imbalances. Boards should consider setting formal terms of office for trustees and have a diversity policy to ensure a broad range of experience in the trustees. Both are key recommendations of the Charity Governance Code.
2. Charities should identify and balance the risks associated with their operating model with the benefits of that model, and the benefits should be evidenced.
3. Charities should undertake financial planning and maintain a reserves policy and ensure that decisions are properly and transparently documented. Where charities are earning income from service provision, they should be giving due consideration to covering an element of core costs as well as the direct costs of provision. The Commission emphasises that the building of reserves would have been in the interests of Kids Company's beneficiaries because it would have allowed for a more orderly transition of services to a new provider in the event of the charity's closure.
4. Charities should ensure that their infrastructure, governance and resources keep pace with their growth. Kids Company had grown rapidly in the ten years prior to its collapse but it was not clear that the Trustee board or the charity's governance arrangements had changed to reflect the changing scale and complexity of the charity's activities.

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Independent Insight – Look Back in Wonder

I'm writing this a week after my retirement and after auditing and advising independent schools and many of their associations over the past 33 years. For much of that time, I was a governor of a predominately boarding school and I'm currently chair of the audit and risk committee of a city academy. Now seems a good time to reminisce on how much the sector has evolved over those years.

My first phone call on joining the firm in 1988 was from the deputy chairman of Barclays, as our benchmarking survey had been used in evidence in the Malvern case ("Pepper v Hart"), which established the principle of marginal costing and enabled staff to receive fee discounts up to 85% free of tax. Airlines and the coal industry were amongst other beneficiaries.

Back in the late 80s/early 90s, I used to attend the governors' meetings of prep schools each term as I had to explain their management accounts and financial forecasts which we prepared. I note that current auditing standards do not permit such a high level of involvement. As bursary departments became better resourced, my attendance sometimes declined to only once a year.

Our next event was accompanying the ISC to a meeting with HMRC which established that most staff accommodation in boarding schools would be tax-exempt – including the bursar's. The rules are now less generous. In those days, Heads' conferences were held in Oxbridge colleges and far-flung university halls of residence. One year, an IAPS chairman had the bright idea of selling some space for trade stands. The bursars were the first to hold their conferences in smart hotels and then they had more people manning trade stands than attending as delegates.

Soon after the turn of the century, two Winchester College pupils leaked to The Times an email to 49 other school bursars containing the phrase "confidential please, so we aren't accused of being a cartel." This "fee-fixing" scandal was investigated by the OFT, although it was never proved that fees had been increased as a consequence. The schools claimed that they were unaware that the law had changed; previously they were exempt from anti-cartel laws.

The first Charities SORP had been issued in 1988. An official from the Charity Commission presented the original SORP at our conference and seemed to be unaware that over half of the larger charities were independent schools – many being in the room! It wasn't the last we heard from the Commission as ten years later they published their public benefit guidance, including guidance on public benefit and fee charging, which suggested that discounts had to be given to those who couldn't afford high fees. Following the ISC's judicial review, revised guidance was published in 2013 which stated that trustees could decide what fee assistance or other benefits were appropriate.

It is reported that over the last ten years bursary fee assistance has increased from approximately £250m to £450m. Additionally, there are many examples of partnerships between independent and state schools involving the sharing of facilities and resources, supported by the ISC's joint understanding with the Department for Education.

The political threat hasn't gone away. The 2019 Labour conference voted that the party should commit to "integrate all private schools into the state sector" in its next election manifesto. This would include the withdrawal of charitable status, subsidies and tax privileges, including the business rates exemption.

Schools are now faced with a plethora of regulations meaning that many now employ a compliance officer to manage them all. Health and Safety initially led the way, but has been overtaken by safeguarding and of most significance currently is the recent report of IICSA regarding child sexual abuse at residential schools. Schools have had to become more professional and many now have separately managed departments for admissions, marketing, recruitment, fundraising and alumni, as well as separate trading subsidiaries and foundations. Some have overseas satellites and franchises. Boards of governors are also more professional with more sub-committees, training and regular rotation and with the expectation that they spend more time witnessing the schools in action.

Affordability for parents is critical for pupil recruitment. Counter-intuitively, some schools do better in recessions due to the 'flight to quality': parents selecting the best school, at the expense of its rivals, in order to ensure that their expectations can be met – for example, by having enough pupils in the year group to fill the rugby teams. This has led to an 'arms race' with the wealthiest building ever better sports centres, theatres and other facilities, with the assistance of low borrowing costs – until recently.

Cost control is of increasing importance, the largest element being the payroll. Recently, the threat of future increases to the employers' cost of the teachers' pensions scheme has led to an ever-increasing number of schools exiting, or with plans for a phased withdrawal.

Schools have had to restructure to maintain or increase their pupil roll, in order not to lose the advantages of economies of scale. Hence the moves by single-sex schools to go co-ed and for prep schools to open nursery departments and extend their year groups up to GCSE. There has also been an increasing number of mergers and acquisitions, often by corporate groups, private equity and international investors.

As boarding has waned, from full to weekly to flexi/hotel, so there has been recruitment from overseas meaning that it's often only those pupils who are onsite at weekends. London and urban day schools have benefited at the expense of country boarding schools.

Competition from the state sector has been limited, except in those counties with grammar schools and other pockets of excellence. There is no evidence yet of educational improvements arising from the conversion to academies of schools once controlled by local authorities. The Government's current desire is that all state schools should join multi-academy trusts. I know several independent schools which gained pupils from the state sector because they responded more quickly during the first COVID-19 lockdown to provide effective remote teaching and learning.

Schools have always been exposed to frauds, such as the faking of an invoice based on the building firm's sign at the school entrance. Cyber fraud has increased this risk and the hacking of emails has led to some criminals diverting fees and other payments. Schools had previously been identified as being soft targets for money launderers to channel monies earned from drug-trafficking towards donations and advance fee payments. Attention is now paid to Politically Exposed Persons, holders of prominent positions who are regarded as posing a higher risk. Russian kleptocrats are "reputation laundering" by sending their children to independent schools.

A school's own reputation management is now more onerous following the growth in social media, such as 'Everyone's Invited'. Schools are also having to create new diversity and inclusion policies in connection with their staff and pupils.

Fortunately, this article is about my memories of the past, rather than my predictions for the future. Threats continue to include the adverse impacts on affordability of higher personal taxation and limited economic growth; inflationary pressures on employment and other costs; borrowing costs increasing; and ever more onerous regulations.

On the plus side, independent schools are better equipped than ever before with strong and active governing bodies, professional management covering all aspects of the organisation, as well as being supported by their well-resourced associations and professional advisers.

I wish the sector continued success.

David Sewell
Guest Author

Upcoming events programme

We have one of the largest charity and not for profit teams in the country: we act for over 800 clients, accounting for over 40% of our annual turnover. Our team of specialists host topical seminar updates and speak at other organisations' events presenting the latest developments within the not for profit sector.

ISBA Conference
Tuesday 17 - Wednesday 18 May 2022
09:00 - 17:30
ICC Birmingham

Quarterly Charities Update
Tuesday 7 June 2022
15:30 - 17:30
Online

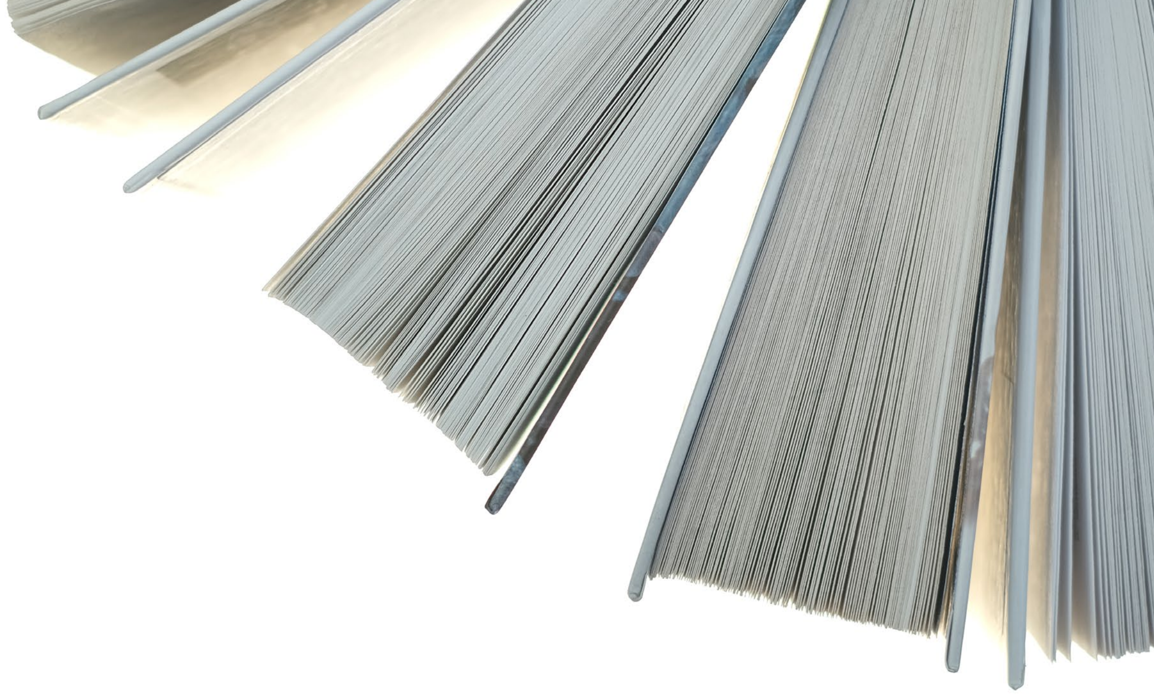
Quarterly Charities Update
Wednesday 14 September 2022
15:30 - 17:30
Online

Bi-annual Schools Update
September 2022
Online

NFP VAT and Tax Exchange
October 2022
Online

Trustee Training: What Every Trustee Should Know
October 2022
Online

To book your place at any of our events, please visit haysmacintyre.com/events



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Winner of the Bronze Award for 2018 and 2017

Top adviser to the top 5,000 charities, Charity Financials' league table 2021

Top ten by audit fees in the 2020 Charity Finance Audit Survey