

Independent Schools
Tax Newsletter

The School Year Starts

Welcome to Johnston Carmichael's VAT and Employment Taxes newsletter for Independent Schools. In this edition, we provide guidance on HMRC's current tax policy on job related accommodation, offer tips for minimising costs related to compliance reviews, highlight the benefits of salary sacrifice schemes and discuss the top 10 VAT and related issues for Independent Schools.

Job-related accommodation – Are you reporting all benefits in kind?

The starting point for all employers is that all living accommodation provided by an employer is taxable. However, a tax exemption may apply in relation to 'job-related accommodation'.

Exemptions from tax

HMRC acknowledge that in the case of boarding schools where staff are provided with accommodation on or near the school premises, the accommodation falls within the exemptions. This is because the property provided enables staff to better perform their duties, and the employment is such that it is customary for the employers to provide living quarters for employees.

Valuing the benefit when exemptions do not apply

The calculation of the taxable value of the benefit depends on whether the accommodation cost more or less than £75,000 and whether the school owns or rents the property in question.

For properties that cost less than £75,000, the value of the benefit is the greater of the rent paid or the annual value of the premises less any contribution made by the employee to offset the cost of providing the benefit. NB – A proportionate reduction is available where part of the premises is occupied for business purposes.

Annual value is normally taken to be the gross rateable value or, if greater, the rent paid by the school. In practice, the old rateable value has been used even though this was replaced by Council Tax some years ago for UK-based property. However, if the school rents the property from a third party, the rateable value cannot be used if the rent payable is more than the gross rateable value – which is likely to be the case.

Where the cost of the property concerned exceeds £75,000 the above benefit charge is levied together with an additional charge. The additional charge is calculated in respect of the excess of the cost over £75,000, at the official rate of interest (3.25% for 2014/15) (less any contribution made by the employee).

Where a property is occupied for only part of a year the chargeable amount is proportionately reduced. Similarly, if the property is occupied by more than one employee the charge will be apportioned and cannot exceed the maximum amount that would have been chargeable if the property had only been occupied by one person.

Expenses and other assets – additional taxable benefits

It is sometimes the case that expenditure for running costs (e.g. heating, lighting, cleaning) is either paid for by the school or reimbursed to the employee occupying the company's property. The taxable benefit of such items falls within the normal P11D reporting system and the usual benefits rules must therefore be followed. This has been of particular interest to HMRC recently when paying schools a compliance visit.

If assets in the accommodation are placed at the employee's disposal, they are subject to a special annual value tax charge computed at 20% of the market value of the asset when it was first provided. This could apply to something like a television or indeed a whole house of furniture provided by the school.

If the living accommodation is not taxable, there is a restriction on other taxable benefits relating to the accommodation. Very broadly, the benefit arising may be restricted to 10% of the employee's earnings.

Employer Compliance Reviews – HMRC on the Attack

Employment related taxation is the most significant annual contributor to the Treasury. With HMRC under pressure to deliver higher tax receipts, it is an area that attracts much of their focus and resource.

HMRC compliance crackdown

Latest figures indicate HMRC are conducting in excess of 30,000 Employer Compliance Reviews each year. On average, each review leads to a financial settlement of approximately £10,000 (notwithstanding additional time and professional fees). More Employer Compliance Reviews are carried out by HMRC than any other form of direct tax enquiry – as a result, there is a real risk to all schools and businesses if not compliant with HMRC requirements.

Settlements typically go back 4 years although, contingent upon HMRC interpretation of behavioural actions, may go back to 6 years.

PAYE compliance - how to avoid additional charges

In order to minimise/remove the risk of HMRC imposing additional charges during a PAYE compliance visit we recommend you:-

- Ensure you have an expenses policy in place, expenses claim forms are always signed off and receipts are held. A review of existing systems and procedures is always a good idea
- Apply for a Dispensation for business entertaining etc to reduce reporting requirements

- Ensure mobile phones are in the name of the school and only one per employee is provided to ensure no benefits in kind arise
- Ensure home telephone contracts are in the name of the school and the employee has signed up to only use the phone for minimal private use
- If meals or subsidised meals are provided, make sure they are available to all staff, i.e. not just teachers, and that the dining room is not open to the public
- Make sure that relocation expenses are kept within the £8000 tax free limit per relocation
- Review contracts where individuals are self employed
- Keep within current HMRC limits for Long Service Awards and other gifts, consider a PAYE Settlement Agreement
- Review property values, utility and other costs in relation to the provision of accommodation

Please note, if HMRC do issue a notice of their intention to undertake an Employer Compliance Review, an employment taxes specialist at Johnston Carmichael may be in attendance to provide support. Furthermore, all associated work may be covered by investigation insurance if this has been taken out.

If you have any questions concerning investigations, please contact a member of the Johnston Carmichael Employment Taxes Team.

Employed or Self Employed?

The question of whether a person is an employee or is self employed has often been of great interest to HMRC in recent years. In the independent school sector, music instructors, coaches and exam invigilators have come under the spotlight of HMRC and therefore care must be exercised to ensure that such arrangements do not fail the scrutiny of HMRC.

Differing National Insurance contributions

Where an individual is classed as self employed, the rate of National Insurance contributions is much lower. This is compared with the position of an employee, where employee and employer both pay National Insurance contributions. At the same time, the self employed are able to claim a tax deduction for a wider range of expenses than employees.

New rules from the Treasury

In order to be treated as self employed, it is necessary to consider a number of factors such as who provides equipment, who bears responsibility for remedial work, who is obliged to carry out the work, what are the arrangements for holiday and sick pay? At the same time and with effect from 6 April 2014, HM

Treasury has tightened the rules under the legislation for onshore employment intermediaries, seeking to reduce the scope for particular arrangements to be treated as self employment.

Under the new rules, a worker engaged by or through an intermediary will be deemed to be employed for tax purposes if they are:-

- subject to control, supervision or direction as to the manner in which the duties are carried out
- provide their services personally
- remunerated as a consequence of providing their services
- receive remuneration not already taxed as employment income

Given this new additional legislation, HMRC will be monitoring the position of self employed workers with new vigour and reviews will no doubt feature more heavily during PAYE compliance visits in future. If you would like any advice in relation to your existing arrangements or have plans to engage people on a self employed basis, please contact a member of the Employment Taxes Team.

Salary sacrifice

In the modern workplace, employers often look at ways of incentivising their employees by providing more flexible remuneration packages. Salary sacrifice schemes, when structured correctly, often lead to both the employee and the employer saving PAYE and National Insurance.

Salary sacrifice is when an employee elects to receive a lower gross salary in return for a non cash benefit which may not be subject to Income Tax or National Insurance. To be effective for tax purposes, it is necessary for the contract of employment to be altered to reflect the reduction in gross salary in exchange for the non cash benefit and for the employee to waive their right to receive salary before they are entitled to receive it.

Salary sacrifice is widely used for paying increased pension contributions and for the provision of childcare vouchers (up to the relevant limits); however, it is also possible to provide in-house benefits which, in the case of independent schools, opens up the opportunity to use a salary sacrifice arrangement in relation to discounted school fees.

Under the tax legislation, the taxable benefit in kind that arises on the provision of in-house benefits is based on the marginal cost. In other words, this is the additional cost to the school of providing the additional school place. Whilst subject to negotiation with HMRC, in our experience HMRC will accept a discount of up to 85%.

Case study - an example of how a salary sacrifice works

Elaine has a child attending the school where she works as a teacher. Based on the level of her earnings, Elaine is a 40% taxpayer and pays Class 1 Employee's National Insurance at 2% (Tax year 2014/15).

The normal annual school fee is £12,000, but all employees receive a 40% discount which means that Elaine pays school fees of £7,200 out of her taxed salary.

Elaine opts to join a salary sacrifice scheme to waive £5,400 of her gross salary in return for a 85% discount on school fees. She will continue to pay the £1,800 out of her taxed salary.

Elaine benefits from a total annual PAYE and Class 1 National Insurance saving of £2,268 and her employer's Class 1 National Insurance liability reduces by £745.20.

Reducing gross pay may present some potential employment law issues for schools, particularly in terms of compliance with National Minimum Wage legislation in the case of lower earners, and it can affect pension entitlements and eligibility for statutory benefits. However, in many cases these are outweighed by salary sacrifice providing many employees with the option to save on PAYE and National Insurance costs.

If you would like to explore how salary sacrifice works in more detail, please contact a member of the Employment Taxes team.

Top 10 VAT and related issues for Independent Schools

Independent schools are faced with some very complex areas of VAT and other taxes but with proper planning, the effects can be mitigated whilst at the same time allowing the school to remain compliant with HMRC.

Below are 10 of the main issues which independent schools should be aware of and at Johnston Carmichael we have a proven track record in providing advice in order to reduce the tax and compliance burden.

- Schools with charitable status undertaking trading activities which go beyond their charitable objectives can create tax issues and problems with charity regulators
- An incorrectly set up trading company which is indirectly subsidised by the school may lead to the school's tax exemption position being adversely affected
- Whilst many of the school's activities qualify for VAT exemption, the same supply by a trading company may be taxable
- Many schools engage overseas agents and due to the VAT rules this can force an unregistered school to register for VAT. Not only does this create a compliance cost but also a potential VAT liability
- Different treatment of fund raising events undertaken by the school or its trading company
- Certain VAT reliefs are available to schools but many fail to take advantage of these through a lack of awareness
- Being unaware that the provision of sports facilities to the local community through a connected trading company can create opportunities to recover VAT on capital expenditure
- Incorrect VAT treatment by the trading company when letting sports facilities to third parties
- There is a conflict between VAT and direct taxes where the school or its trading company provides boarding accommodation to other educational providers
- Providing accommodation and related expenses to staff can create a possible tax liability

Contact us

If you would like further clarification on any of the tax related issues raised in this newsletter, then please feel free to contact one of our Employment Taxes or VAT experts listed below.

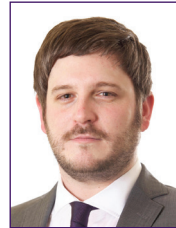
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