

VAT: Consideration of the case to extend the education exemption to for-profit providers of higher education

1. Introduction

million+ is a university think-tank to which a number of universities affiliate. However we also publish independent research and analysis. We welcome the opportunity to comment on this HMRC consultation.

We recognise that it is the government's general intention to create a 'level playing field' for all providers, including 'alternative' private providers. For their part private Higher Education Institutions (PHEIs) have argued that they are treated inequitably in the UK in respect of VAT exemption and have suggested that this may contribute to higher fees in their institutions.

However, these providers are not currently regulated in the same way as providers which are VAT exempt. As a result they currently enjoy some advantages in the market in spite of being in receipt of significant and greatly enhanced funding via the student support system with effect from 2012.

We would also question whether it is in the public interest to extend VAT exemption at the present time to for-profit providers, particularly since this measure will reduce VAT payments from for-profit organisations.

2. The current situation

The current VAT situation for universities, colleges and private providers is outlined below:

Eligible body status:

Universities and colleges are currently listed for VAT purposes as 'eligible bodies' - this means that VAT does not have to be charged on supplies - i.e. fees for education provided.

An 'eligible body' is defined in VAT legislation as:

1. Including schools and universities
2. Those bodies involved in 'education' as contained in Group 6 of Schedule 9 to the VAT Act 1994.
3. Does not include profit making bodies

As an 'eligible body' this qualifies the institution for exemption from charging VAT in the provision of education and closely allied goods and services.

Therefore, currently education and training provided by a university or a university trading company, is exempt. The exemption from VAT is also applicable to schools, 6th Form colleges and FE colleges etc. ***One of the primary pillars for this is the non-profit making status of the provider.***

Distribution of Profits:

Under HMRC Notice 701/30 s4.1, to qualify as an 'eligible body' an educational institution must NOT distribute the profits derived from such provision of education.¹ This means that:

1. No dividends can be distributed.
2. No payments or donations can be made to another body (even if the recipient is a charity).
3. No management charges can be paid to another body.

Each of the above are designed to stop the profits made from providing education, in VAT exempt bodies, being transferred to other group companies and other bodies - to stop the distribution of profits made under a protected regime (i.e. the umbrella for education providers) to other corporations outside the sector.

To meet the criteria for non distribution of profits evidence by the institution must be provided; typically this is contained in the Memorandum and Articles of Association of the body or some other constitutional article or rule.

Business Test

VAT legislation further defines that if 'in business' supplying goods and services, this will determine how the body is to be treated for VAT purposes (assuming that certain turnover criteria are met, the supplies are subject to VAT).

Business is defined as making supplies for any form of payment or consideration, in money or otherwise AND continues over a period of time with some degree of frequency and scale.

3. Consequences of VAT exemption for private providers:

The immediate consequence would be to undermine one of the central pillars of 'eligible body' status, the bar on distributing profits.

Private for-profit providers of higher education such as BPP University College, Kaplan, College of Law, INTO University partnerships, Study Group International, Greenwich Management, Brighton Institute of Modern Music and others, would be able to combine their for-profit status with exemption from paying VAT on fees.

This would allow them to deploy their capacity to raise private capital on the financial markets, potentially reduce their fees and undercut other universities and colleges in search of market share.

There is no direct evidence that VAT requirements contribute to higher fees in PHEIs. The latter have lower costs in a number of operational areas compared to established UK universities.

Moreover, without further primary legislation, these PHEIs cannot be regulated in the same way as established university and college providers.

¹http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pag eVAT_ShowContent&id=HMCE_CL_000117&propertyType=document#P106_8118

The proposal to provide a VAT exemption for PHEIs will place established universities at a disadvantage in the market. In contrast, shareholders will be advantaged. In addition there will also be a loss of receipts to HMRC.

4. Options 1 and 2

In view of the questions about the merits of extending VAT exemption at the present time, we consider that for-profit providers wishing to take advantage of exemption could structure their operations in ways which would be beneficial to their shareholders under both options. This is illustrated by the following case-study:

Case study: BPP

In July 2009, BPP Holdings Plc., of which the higher education provider now named BPP University College is a subsidiary company, was acquired by Apollo Global, a joint venture between Apollo Inc. and the Carlyle Group private equity fund. At the point of acquisition, the long-term aim of the acquisition was made clear in Apollo Global's press release. This suggests that this was not a charitable acquisition:

"We are delighted with the addition of the BPP organization into our portfolio of education investments. We are excited about the potential of the large and growing global education sector, and we are pleased to have an organization with the history and reputation of BPP as a platform to expand this mission into the European market."

"The Company does not expect the acquisition to have a material impact on its earnings per share in fiscal 2010 and believes BPP will create long-term shareholder value."²

BPP Holdings remains a Profit-Distributing Body, which means it must pass its profits on to its shareholders - Apollo. However, in June 2010, almost a year after the acquisition, a special resolution of the board of BPP College of Professional Studies, which is the higher education arm of BPP Holdings, changed the subsidiary company's articles of association to make it a Non-Profit Distributing Body. It can generate profits, but it now cannot pass them on to the parent company as dividends or bonuses. The companies can still lend to one another, pay fees and trade assets, but BPP University College cannot pass on any retained profits to its parent company or Apollo.

The other effect is that BPP University College is now exempt from paying VAT on its fees. In September 2011, BPP announced that its fees would be £5000 a year for three year courses and £6000 a year for two year courses.

According to its latest company accounts, BPP University College has accumulated retained profits of £23 million, which it now cannot pass on to its parent company.

Given the statements made by Apollo at the point of acquisition, it seems highly unlikely that the company is holding these profits for charitable reasons. Neither is there much evidence of the profits being ploughed back into the business.

² http://www.apolloglobal.us/index.php?option=com_content&view=article&id=162:welcome-bpp&catid=46:news&Itemid=32

It could be argued that BPP University College is exploiting its VAT exempt status in a short to medium term bid for market share while at the same time arguing for VAT exemption for commercial providers. If VAT exemption were to be agreed at a future date, they would be able to unlock the profits shut up in the University College accounts.

Alternatively if VAT exemption is not granted to commercial providers, it would very simple for BPP University College to change their articles of association back to a Profit Distributing Body at the most opportune and profitable moment and unlock the profits they have accumulated from their period enjoying a tax break.

5. Consequences for universities

VAT exemption will give profit-distributing bodies a tax break which is additional to their ability to raise capital. As a result, they will have a market advantage over established universities and colleges. A level playing field would not have been created. Instead the rules of the game would have been tilted towards PHEIs and for-profit providers which would enjoy an additional advantage.

No assessment has been undertaken of the consequences for universities and colleges which currently have VAT exemption, of extending the latter to for-profit providers. This was confirmed by the BIS Secretary of State, the Rt Hon Dr Vince Cable MP as a recent oral evidence session of the BIS Select Committee.

6. Conclusion

There is no clear rationale for HMT to forgo VAT receipts by incentivising shareholder value. Far from creating a level playing field in higher education, the proposals to extend VAT exemption to PHEIs and for-profit providers will provide the latter with an unfair advantage. Moreover this exemption is being considered in advance of primary legislation being tabled which would have provided greater regulation of these providers.

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