

“VAT on private schools isn’t a ‘public subsidy’. It’s an outlier policy.”

May 20, 2024

Maxwell Marlow

Director of research at the Adam Smith Institute.

Criticism is welcome, especially from opposing viewpoints. It is, however, important not to be misrepresented, which is why I regret Professor Rebecca Boden’s [article in the PEPF](#) about my research into the proposed policy of taxing private school fees

Here I will clear up the difference between tax expenditure and subsidy, and also respond to the arguments that Boden presents. I leave Boden’s ad hominem assertions that my submission is “ideological and polemical” for readers to judge.

They may equally wonder whether it is “ideological and polemical” to assume the only way to help crumbling state schools is to tax families using private schools, as though the latter are directly responsible for the former.

As I explain in my original paper there are less complicated, more equitable, and lower risk ways to raise money, which should be bread-and-butter for economists of any persuasion.

Boden argues that the tax treatment of private schools (and almost everything in education) is a subsidy, manifesting itself as tax expenditure. On this basis, any tax you could think of becomes a cost to the Exchequer. This analysis is problematic.

When families pay for VAT-exempt childcare (except the part provided by taxpayers) we do not imagine a “subsidy”. This is simply our tax system at work.

We do not tax education for two principal reasons identified by the IFS and expanded in my paper: education (regardless of who pays) is an investment in human capital which is taxed, like all capital, when it generates future returns; and private education relieves the state from its obligation.

There are, of course, further social benefits from private education specifically, covered in Part 1 of my paper.

More formally, the Subsidy Control Act 2022 explains that “the forgoing of revenue that is **otherwise due**” is a form of financial assistance, and thus subsidy.

Private schools do not forego payments to the Exchequer, as no tax is due – as per VAT Notice 701/30. This is an open-and-close definition.

To say that “it’s as if the government was collecting all the taxes due and then handing out the money as a grant”, as Boden does, is wrong – a basic rate taxpayer does not receive a proverbial ‘grant’ of 80 per cent of their taxed income, nor does a person receive a VAT “grant” when they buy ISAs, newspapers, books, or even large marshmallows.

As there is no tax collected or grant given, the VAT exemption on educational services is not a subsidy.

Boden also argues that there is “no new evidence or analysis” in my paper. This seems confusing, as I built a new dynamic model to measure potential outcomes of changes to the fiscal treatment of school fees.

This model uses the IFS’ credible static model as a baseline and builds upon it (contrary to Boden’s assertion that I am trying to undermine the IFS).

Viewing tax and fiscal policy statically is concerning for many reasons as the ASI has outlined before [here](#), but for this case, I argue that unintended consequences such as the displacement of teachers and support staff, plus labour supply effects for families, are additional risks arising from the policy.

These are new contributions to the debate, and they require discussion. Further, as readers of my paper will know, I do not make any assertion or forecast of pupil migration, I simply provide estimates for fiscal impact between 0 per cent and 30 per cent migration, contrary to Boden’s incorrect assertion that I “insist” upon it.

I raise several concerns about the optimism of the IFS’ three to seven per cent forecast, which they acknowledge rests on evidence that is “thin, old and sparse”, and which pre-dates (for example) the cost-of-living crisis, as though private school families are immune to it... But otherwise I insist on nothing except for modesty in the face of uncertainty.

Returning to the economics, it makes no sense even to discuss the fiscal impact or “fairness” of the VAT exemption without also considering the fiscal impact of the provision of state education.

State schools do not grow on trees, and both my paper and the IFS acknowledge that every child at private school is a place the taxpayer does not need to pay for.

Now to address Boden’s specific concerns in my paper:

1. “Parents paying for private schools are saving the state money so they deserve the tax breaks”

I do not make this argument. Instead, I argue:

“Every decision to earn money and pay school fees contributes £28,000 to public finances. To the extent the £2.7k tax exemptions are pivotal to that decision, they generate a return for the taxpayer of 1040 per cent. Even if they are not pivotal (the family would nonetheless be willing and able to pay, and would nonetheless provide their taxable labour) it is not obviously “unfair”.”

I do not argue in the paper that paying for public services unused merits special treatment in form of actual tax breaks or subsidies, although the IFS paper makes a favourable reference to schemes in place globally that deliver exactly that.

I do maintain uncontroversially (like the IFS) that private schools save the state money, and that is something to consider both statically, in terms of the “unfairness” of the status quo and dynamically, in terms of the effect of the policy when the private sector contracts.

As somebody without children, Boden rightly points out that she contributes to the tax system that pays for state education despite not using it. Private school families contribute to the tax system too.

This is because education has social benefits. Both Boden and private school families (and everyone else) benefit when all children are educated. Unlike Boden, private school families are in a position to demand their taxpayer-funded place, and the relevant factor is their freedom and choice not to do so.

2. “State schools will be swamped by private school children”

I do not argue that state schools will be swamped. I wrote that if children move the state system cannot simply be assumed, at the local level, to accommodate them.

The IFS and I agree that aggregate effects cannot be assumed to average-out locally; the “flaw of averages” which Boden commits when she refers to 4.85 children per state school at the 20 per cent migration level.

I also argue that migrating private school families can be expected to seek places at oversubscribed preferred state schools and this has consequences for those schools and for other families, referring to industry practitioners who confirm this is already happening.

Follow-up research we conducted at the ASI found that 28 of 111 councils do not have capacity for any migration across several year groups, whilst 95 per cent stated that they did not have any contingency plans for if VAT was levied on private school fees ([read here](#)). Even if we accepted the IFS’ estimates, there would likely still be children without school places to go to.

3. “The cost of the VAT will be passed on to parents”

Seventy-six per cent of sampled schools from evidence presented by 350 independent schools through a poll conducted by *the Telegraph* ([read here](#)) confirm their intention to pass on VAT-driven increases of at least 10 per cent. Ninety-five per cent say they will make an increase. One prominent school has [rowed back](#) on an earlier indication of absorbing the cost in full.

As I explain in my paper, even if schools do absorb VAT in full or in part, it has consequences. An industry where 71 per cent of expenditure goes on payroll cannot possibly make a 15-20 per cent cut without significantly affecting employment and the £5.1 billion direct and indirect tax contributions it makes, and that leaves a risk against fixed cost coverage and remaining open.

Boden is in company with other advocates of the policy in asserting that schools can absorb the tax without accounting for the consequences.

4. “Private schools will stop giving bursaries and scholarships”

It is a fact that some smaller schools will reduce the amount of bursary and scholarship support given, with some industry insiders arguing that this would disproportionately affect those SEND plans ([see here](#)). Seventy-eight per cent of schools told *the Telegraph* they would be reducing bursaries, and 64 per cent said they would have to reduce partnership work.

Whether or not these students who lose out from fees are all disadvantaged is not known, but the fact remains that there would be a reduction in support.

5. “Charging VAT is a bad thing because it might disrupt children, affect their human right to education, and taxing schooling is wrong”

I certainly view the disruption of education to be a bad thing. If we are disrupting children and families (a cost), the burden of proof for benefits is extraordinarily high.

I think it is irresponsible for policy makers to pursue a policy without recognising the cost. Further, although not covered in the paper, I worry about a blanket “equality agenda” that seeks to obscure other “things” that we value in education: quality, diversity, choice, innovation, and, for those so inclined, the freedom not to be educated by the state.

I also worry that implementing this policy will be extremely complicated and has significant opportunity cost in terms of more constructive ways to improve the UK’s education.

As I wrote “It is not clear that government-induced migration followed by provision of a place at local authorities’ discretion outside of application windows meets the requirement for choice”. There is a [human right to choice of education](#) as well to education itself, and one reason it exists is to prevent the state claiming a monopoly on education.

Taxing schooling would place the UK as an outlier in the west. EU law prohibits taxing education and also prohibits taxing the private sector for what the state offers “for free”. Greece’s foray into taxing education caused, according to *The Economist* “general mayhem” and I see no reason to repeat that experiment.

I do not believe that taxing a service which we all eventually benefit from, whether it’s privately educated doctors, film directors, entrepreneurs, or civil servants, is a wise policy choice.

To the extent private education merits Pigouvian treatment of any kind, it should be the opposite of what Boden suggests.

My research evaluates the policy in light of its stated objective: to raise taxes of around £1.5 billion.

We need to assess all the costs and all the benefits, we need to be honest about what we cannot predict, and then we need to consider whether other ways of raising £1.5 billion might be preferable to a hypothecated education tax.

I cannot disagree with Boden that my paper is quite long – this reflects the many gaps in the debate which I have sought to fill, and which Boden appears content to ignore.

For those thinking that imposing a potentially life-changing tax on hundreds of thousands of children does not merit reading 30 pages, I offer this paragraph from my conclusion:

“Wishing to raise money, few economists would instinctively recommend

- (1) a new tax offering
- (2) highly uncertain net revenue potential
- (3) on a positive externality, that
- (4) distorts competition and
- (5) disrupts the education of (in the IFS’ optimistic scenario) some tens of thousands of children,
- (6) shifting their demand onto a state-obligated supplier; that
- (7) poses hard-to-quantify risks to the labour supply, value creation and taxes of higher earners, and that

(8) requires new legislation, presenting many avoidance opportunities and enforcement challenges and

(9) has only one international precedent, said to have caused “general mayhem”.

This is not a good tax.”

This article was co-published with Private Education Policy Forum: <https://www.pepf.co.uk/>

Maxwell Marlow is ***Director of research at the Adam Smith Institute.***



