

The Chartered Institute of Taxation

Application and Professional Skills

VAT and Other Indirect Taxes

November 2025

Suggested answer

REPORT FOR SANGAVEERA COURSES LTD ON PROVISION OF ONLINE LANGUAGE COURSES

1. Introduction

Sangaveera Courses Ltd (“SCL”) currently employs teachers to provide English language courses to foreign students attending its UK colleges. SCL is proposing to change its business model and make cost savings by using webinars to provide courses in English and possibly by introducing courses in other languages (“OLCs”). SCL will continue, however, to provide computing, book-keeping, and marketing etc courses in physical form at its premises. Two options for the language courses have been identified:

A) SCL would supply these courses but buy-in teaching services from self-employed teachers or their personal service companies (“PSCs”).

B) The self-employed teacher/ PSC would supply these courses to students, with SCL acting as intermediary.

This Report addresses the VAT, corporation tax (“CT”) and employment taxes issues arising. It is based on information provided by David Sangster, Finance Director of SCL, in his letter dated 28 October 2025, together with enclosures, and on material held on file. The tax law and HMRC practice considered is that currently in force. Should these change, further advice may be necessary.

This Report is solely for the benefit of SCL and should not be disclosed to any third party without our prior written agreement.

2. Executive Summary

- 1) Teaching English as a foreign language (“TEFL”) is VAT-exempt and so SCL has been charging VAT incorrectly and consequently has reduced its profit (by up to £200,000 per annum based on current figures). SCL should make a claim to HMRC to recover overpaid VAT for the last four years. Input tax recovered incorrectly as a result of the error will need to be repaid, although this is likely to be quite low. It should be noted that HMRC have a defence of “unjust enrichment” which may allow them not to make the repayment claim unless the benefit is passed onto the students, but the onus is on HMRC to prove this. Going forward, VAT should not be charged on TEFL.
- 2) As described, the webinars will be treated as supplied in the UK on the basis that SCL and the teachers are based here. This is regardless of where the students are based.
- 3) The proposed letting of surplus space is VAT-exempt, unless SCL elects to waive VAT exemption (“opts to tax”), or the letting comprises facilities only. We recommend the commercial implications of exercising the option are carefully considered, together with the CT treatment, before any contracts are exchanged.
- 4) Input VAT is only deductible on supplies to a VAT-registered business which are used, or to be used, by it in making taxable supplies. Where exempt supplies are made, deductible VAT must be calculated using a partial exemption method. The standard method is by reference to turnover; though a special method (“PESM”) can often be more advantageous.

Option A

- 5) This assumes that removing teachers from SCL’s payroll will save employment taxes. Given SCL’s wish to continue exercising significant control, and related factors, there is a significant risk of challenge by HMRC to independent contractor status, leading to assessments and penalties. Where a PSC is used, anti-avoidance rules (known as “IR35”) apply for these purposes. As SCL is currently a “Small Client” the compliance obligations fall on the PSC, though we would expect this point to feature in negotiations. Should teachers/ PSCs become VAT registered, SCL may recover VAT on teacher fees attributable to OLCs.

Option B

- 6) Option B assumes that teachers/ PSCs supply the courses as principal and SCL's role is as intermediary. The main issue here is VAT. A substantial VAT charge (£133,330 based on current assumptions) is created on the commission which would be irrecoverable by the teachers/PSCs in respect of TEFL courses. This makes Option B far less attractive than Option A from a financial perspective. In respect of OLCs, there is a fairly remote possibility of a VAT saving, depending upon numbers of teachers and values, but this brings with it the (again remote) possibility of a challenge by HMRC to the arrangements. The risk of an employment tax-based challenge is lower than under Option A.
- 7) There are no significant CT issues arising for SCL under either Option.
- 8) When supplied as an optional extra, a course manual is a separate zero-rated supply for VAT purposes.

Recommendations

- 9) Both Options involve possible challenge by HMRC regarding VAT and/ or employment taxes, risking additional costs rather than savings. Option A might be made more robust if SCL is willing to reduce the element of control, allowing teachers more autonomy. This may run counter, however, to SCL's business priorities. Option B involves a significant VAT cost on SCL's commission.
- 10) There is a further option for SCL to consider, namely: continue supplying the courses as principal, using employed teachers. This would avoid challenge by HMRC and ensure certainty of the tax treatment, while enabling savings to be made on headcount and overheads (by virtue of the webinars) and increase competitiveness of TEFL courses.

3. VAT Issues

VAT Liability of Courses

The starting point is that the provision of courses is a taxable supply and this is the treatment adopted by SCL for all of its courses. There are four exemptions from this to consider:

- 1) The courses are provided by an eligible body. SCL is a private, profit-making company and is not therefore an eligible body.
- 2) The courses are of vocational training and funded by the Department for Education. This does not apply.
- 3) Tuition is provided in a personal capacity of a subject normally taught in a school or university. The exemption only applies to individuals and cannot apply to a company such as SCL.
- 4) The course is of English as a foreign language. This is relevant to SCL.

As a result of the above, most courses have been correctly treated as taxable; and the same treatment will apply to OFL courses should they go ahead, TEFL however is an exempt supply for VAT purposes, and VAT should not have charged. A claim can be made to HMRC to recover this VAT.

VAT Claim

There is a four-year time limit for the claim so VAT periods before 06/ 21 are now time-barred. Based on fees of £1m per annum, there is potentially £200,000 of VAT overpaid each year.

HMRC have a defence to repayment where SCL would be "unjustly enriched." This defence can be rebutted where charging VAT has caused loss or damage, either from reduced turnover or reduced margins, or both. The onus of proof is on HMRC who must carry out an economic analysis of the market in which SCL is operating. We note that competitors have been under-cutting SCL by as much as 15% (which could be due to competitors exempting TEFL). In such circumstances HMRC may contend that the true market price of the supply is around £1,000 per term and SCL has passed on the VAT burden to the students.

As the supply is exempt, SCL is “partially exempt”. Input tax directly relating to the TEFL supplies will not be recoverable and a proportion of any non-attributable VAT based on the ratio of exempt to taxable supplies will also not be recoverable. This will reduce the VAT recoverable. As the main expense is teachers’ salaries, which are not subject to VAT, the potential recovery should still be substantial.

We recommend SCL assembles the evidence to support a claim, though we may need to counter an unjust enrichment claim by arguing loss or damage to the business. Any VAT recovered is additional profit and subject to CT.

Place of Supply

Webinars will be supplied to students who may be resident overseas. Electronically-supplied services may be subject to special rules. However, these do not apply where, as here, pre-recorded content is supported by a live teacher. Accordingly, as SCL is UK-established (and, we understand, so are teachers/ PSCs) the webinars will be treated, for VAT purposes, as supplied in the UK.

Letting

Letting premises is VAT-exempt where exclusive occupation of a defined area is granted for a specified period in return for payment, usually in the form of rent. SCL may exercise the option to tax (“OTT”) by notifying HMRC, possibly by email in order to receive an acknowledgement. VAT must then be charged at 20%, entitling deduction of related input VAT. Where the lessee can recover VAT in full, there is no net VAT cost. However, if the lessee uses the premises for e.g., exempt supplies, they may suffer non-deductible VAT. An OTT generally binds the whole building for 20 years. This can make the property less attractive to lessees or purchasers.

Where, however, the grant involves facilities only (i.e., it falls short of exclusive occupation), it is subject to VAT at 20%.

Before any contracts are exchanged, therefore, we recommend SCL reviews the type of letting intended, likely use by the lessee, and future strategy for the premises and, only then, if appropriate, makes an OTT. We can advise further if required.

Input VAT

In principle, input VAT attributable to exempt supplies is non-deductible. To the extent SCL makes exempt supplies (e.g., on TEFL or property-letting) input VAT must be apportioned using a partial exemption method. Subject to the amounts of input tax incurred, given the complexity of its business, we recommend SCL considers a special method which must be agreed in advance with HMRC. We can assist in devising a method which achieves optimum deductibility.

If teachers/ PSCs are operating as independent businesses, it follows that SCL must take care not to deduct any VAT on supplies made by third parties to teachers/ PSCs.

Printed Course Manuals and VAT

A printed course manual (including where supplied electronically) is zero-rated. When included with the course, it forms part of a single composite supply with the same VAT liability. Accordingly, manuals included in TEFL courses are exempt. Manuals included in the other courses are standard rated (where supplied by a taxable person). Where, however, a manual is supplied as an optional extra for a separate charge, it forms a separate zero-rated supply.

We have considered whether, under Option B, there is any tax advantage in SCL supplying the manual. Anti-avoidance rules apply where connected supplies are split between two or more suppliers. However, these rules only impact where, if there were a single supplier, the transactions would be a single composite supply taxable at the standard rate. Consequently, there is not an issue for TEFL courses, although there could possibly be one for OLCs should these proceed. Provided however the hard copy manual is truly an optional extra, zero-rating should not be lost, even if SCL supplies it alongside the teacher/ PSC supplying the course.

5. Option A

VAT

SCL's contractual relationship with students would be unchanged. Accordingly, SCL will continue to act as principal in the supply of all language courses.

SCL's supply of TEFL is VAT-exempt and so these courses can be more competitively priced while preserving SCL's margin or can be priced as at present so that SCL's margin is increased. If they do remain the same, this may assist a possible HMRC defence of unjust enrichment on the VAT claim. Dr Elias did state in his email (EXHIBIT B) that the pricing differential was affecting student numbers and so making it more competitive may assist in alleviating this.

As the supply of TEFL is exempt, the teachers, or their PSCs would not be able to register in respect of their TEFL supplies.

If OLCs are provided, these supplies will in principle be taxable, though the supplies may be below the limits depending upon whether the numbers of individual teachers and values should the OLC courses proceed. There may be scope for the supply to SCL by the teachers (as individuals) to qualify for exemption as "personal tuition". HMRC state (VATEDU40200) that it is irrelevant whether the teacher contracts with an organisation that makes an onward supply of the educational services; or works under a franchise agreement that allows him or her to use the teaching methods, name or trading style of another person or organisation. They could question however whether the webinars constitute "personal tuition". Supplies of OLCs by PSCs are definitely taxable.

Employment Taxes

The key difference from the current business model is that teaching will be provided by sub-contracted teachers, or their PSCs. This aims to save SCL Class 1 Employer NICs as well as employment costs.

Just because someone does not have an employment contract doesn't mean that they aren't an employee for tax purposes.

SCL will exercise a high level of control over the contents, preparation, and delivery of courses, including quality control. There would be personal service if the appointment is specific to the teacher, without the ability to offer a substitute. We understand all equipment and infrastructure required to deliver the webinars will be provided by SCL. Payment is regular and in a similar form to wages. Overall, we consider there is a high risk that HMRC would regard the tests for employment as satisfied.

Consequently, directly engaged teachers, would be regarded as employees of SCL so that SCL would need to operate PAYE and National Insurance on payments to them. Since the teachers would be paid £50,000 rather than £40,000 under the current system as direct employees, the consequence of this recategorisation would be to substantially increase costs as compared to simply continuing to employ them.

If the teachers operate through PSCs, SCL as a "small" company will have no responsibility for PAYE or National Insurance. However, IR35 is likely to apply which will deem payments made to their PSCs to be salary on which they must account for PAYE and National Insurance. With the costs of running their PSCs, the teachers could be worse off than at present. Thus, from a commercial perspective it is unlikely to be an attractive proposition.

Corporation tax

SCL would be liable to corporation tax on its profits earned from the courses. The cost of Teacher Fees/DDPs are allowable expenses, as is non-deductible VAT, since these are wholly and necessarily incurred for SCL's business.

6. Option B

VAT

TEFL Courses

Option B assumes the teacher/ PSC supplies the course as principal. This requires a major change in the contractual framework. Students would contract directly with teachers/ PSCs for the courses in return for course fees; teachers/ PSCs would not be SCL's independent contractors as, in effect, the roles would be reversed, i.e., with SCL acting as an intermediary remunerated by a commission. Devising an appropriate contractual framework may be theoretically possible, but this would only be effective for tax purposes if it reflects economic and commercial reality having regard to all the circumstances.

The main issue here is VAT. The commission charge from SCL would be subject to VAT. Consequently, if the teachers were paid the same £50,000 as per Option A, the position would be as follows:

Option B	Fee £ <u>1000</u>	Students 250	Per Term £ 250000	Total Per Yr £
SCL	666.67	250	166667.50	666670
VAT on Commission	133.33	250	33332.5	133330
Teachers	200	250	50000	200000
Each				<u>£50,000</u>
	<u>£1,000</u>			<u><u>£1,000</u></u>

Consequently, SCL would face a VAT charge of £133,330, which the teachers would not be able to recover. Clearly, this would make Option B much less favourable than Option A. Obviously, the agreement could be structured such that SCL is not bearing all the VAT cost, but this would result in a reduction of income to the teachers compared with Option A.

OLC Courses

The position becomes a bit more complex for OLC fees and the outcome is very much dependent upon the VAT registration position of the teachers/PSCs, which is unknown at present as we do not have any numbers of teachers or fee structures for the courses. Assuming however a course fee of £1,000 + VAT and that everyone is required to be VAT registered, the VAT would flow through the system as follows:

	Fee £	Students	Per Term £	Per Yr £
SCL	800	250	200000	800000
Teachers	200	250	50000	200000
Each				<u>£50,000</u>
VAT Charge	200			<u><u>£1,200</u></u>

If however the teachers/PSCs were not obliged to be VAT registered, there is actually a VAT advantage arising, as follows:

	Fee £	Students	Per Term £	Per Yr £
Option B	<u>1200</u>			
SCL	800	250	200000	800000
VAT on Commission	160	250	40000	160000
Teachers -Not registered	240	250	60000	240000
	<u>£1,200</u>			<u>£1,200,000</u>
Assuming 4 teachers				<u>£60,000</u>

Obviously, if there were only 4 teachers their turnover each under Option B would be £300,000 and so they would definitely be obliged to be VAT registered. If however the teacher numbers were higher (above 13) then they would fall below the VAT threshold of £90,000, and an advantage could accrue. Technically, HMRC could argue that Option B amounts to a major change in SCL's business, and seek to challenge the arrangements as constituting VAT avoidance, claiming effectively that the supplies continue to be made by SCL. The fact that SCL continues to operate a good part of the rest of its business as principal and its degree of control over course content, delivery, and pricing would be relevant factors.

At this stage we think the likelihood of such a challenge to be very remote as this is:

- i. Still a proposal, based on unknown numbers;
- ii. May never arise as the teachers may well be required to register for VAT in any case; and
- iii. Part of a commercial restructuring that is not being undertaken for VAT purposes

Employment taxes

As for Option A, HMRC could challenge the employment status of the teachers although in this case the risk may be lower as a result of the change to a model where the teachers act as principals.

Corporation tax

Under Option B, SCL would be liable to corporation tax on commissions less allowable deductions.

4. The Options for the Teachers

Currently, SCL employs 8 teachers for its TEFL course with salary costs of 8 x £40,000 = £320,000. In addition to this, it would have to pay Class 1 National Insurance on the salaries (13.8%) as well as make pension contributions and deal with other legal matters arising from their employment. Although each Option appears to be much more expensive with fees of £50,000 per teacher, by the time that the other costs of employment are taken into account, the difference is likely to be fairly small.

Irrespective of which option for engaging the teachers is picked, or indeed if the teachers continue to be employed by SCL, there will be a material saving in costs for teachers because only 4 teachers will be required rather than 8 as at present.

Whilst there is a hope that any changes to the current salaried teacher situation can be made voluntarily, we recommend to be on the safe side, that you consult an employment solicitor before proceeding.

Continue to Employ Teachers

As can be seen from the above, both Options carry risks. Accordingly, rather than go with either Option A or Option B, SCL could simply continue to employ the teachers. The key benefits from this approach would be:

- 1) The employment law risks around termination of employment would be reduced in that only four employees would be affected, though we appreciate the four identified may leave on a voluntary basis.
- 2) Whilst the overall costs of engagement under Option A and as a teacher may be similar, the risks of challenge by HMRC under Option A are substantial and interest and penalties from incorrect treatment could be significant. Commercially, teachers operating through their own PSCs is unlikely to be attractive, due to the risks of IR35 applying.
- 3) The VAT issues identified in Option B would be avoided.

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