



**Reform of the Tax Treatment of Employer-Supported
Childcare**

Technical Note

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Introduction

On 3 December 2009, the Government announced changes to the tax and NICs exemptions for employer-supported childcare. This note provides further detail of these changes.

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Chapter 1

Background

When an employer provides a benefit to an employee, there is normally a tax charge for the employee, and National Insurance Contributions (NICs) liability on the value of the benefit. From 6 April 2005, a new tax exemption and revision to the existing NICs disregards were introduced for two forms of employer-supported childcare. These covered:

- Directly contracted or employer contracted childcare where an employer arranges for the provision of qualifying childcare (i.e. childcare providers registered with Ofsted in England, or the appropriate bodies regulated by the devolved authorities) for the benefit of their employees, on the first £55 a week (£50 a week in the tax year 2005-06); and
- Childcare vouchers provided by the employer for qualifying childcare, covering the first £55 a week (£50 a week in the tax year 2005-06).

The changes supplemented the existing tax and NICs exemption for workplace nurseries, the main difference being that there is no monetary limit on the value of workplace nurseries provision which is exempt. The new rules were intended to encourage employers to choose from a range of childcare options to help employees with the costs of childcare.

On 3rd December 2009, the Government announced changes for the future tax and NICs treatment of employer-supported childcare. These changes will apply to directly contracted childcare and childcare voucher schemes. These changes will apply to directly contracted childcare and childcare vouchers. They will only affect individuals joining a scheme from April 2011.

The existing tax and NICs exemptions for workplace nurseries will remain. These exemptions were introduced in 1990 to prevent employers having to estimate how much benefit-in-kind each employee receives when they use a workplace nursery; and to encourage the direct provision of nurseries by employers, boosting overall childcare supply.

Many employers offer directly contracted or childcare voucher schemes through salary sacrifice arrangements. These and salary plus schemes will fall within the new provisions.

Chapter 2

How the changes will be introduced

From 6 April 2011, the limit on the amount of exempt income associated with childcare vouchers and directly contracted childcare for employees joining an employer's scheme will be restricted in cases where an employee's earnings and taxable benefits are liable to tax at the higher or additional rate. This is to ensure that the income tax savings for higher paid employees are limited to that available for employees whose earnings and taxable benefits are liable to income tax at the basic rate.

Anyone already in a scheme by 5 April 2011 will not be affected by these changes as long as they remain within the scheme.

From 6 April 2011, employers who provide employer-supported childcare (ESC) will be required at the beginning of the relevant tax year to estimate the level of basic employment earnings that their employee is likely to receive during that year, ignoring potential bonus and overtime payments, but including other known taxable benefits.

If the level of estimated earnings and taxable benefits is equal to or below the equivalent of the sum of personal allowances and the basic rate limit for the year, the employee will be entitled to relief on £55 exempt income for each qualifying week.

If the level of estimated earnings and taxable benefits exceed the equivalent of the sum of personal allowances and the basic rate limit for the year, but falls below the limit at which tax becomes payable at the additional (50%) rate limit for the year, the employee will be entitled to relief on £28 exempt income for each qualifying week.

If the level of estimated earnings and taxable benefits exceed the equivalent of the additional (50%) rate limit for the year, the employee will be entitled to relief on £22 exempt income for each qualifying week.

The figures of £28 for higher rate taxpayers and £22 for additional rate taxpayers have been set to ensure that they receive approximately the same level of income tax relief as basic rate taxpayers, that is £11 per week.

There are no changes in respect of workplace nurseries.

Chapter 3

Frequently Asked Questions

Q: Why is the Government introducing these changes?

A: At present, higher rate taxpayers benefit from double the amount of income tax relief that basic rate taxpayers receive - and individuals who will pay the new 50% tax rate from April 2010 will benefit even more. Around a third of the funding for ESC goes to the 6% of parents who pay tax at a higher rate. This is a poorly targeted use of resources, and it is only fair that those on higher incomes should get the same level of income tax relief as the majority of parents. These reforms are being introduced so that all recipients of directly supported childcare and childcare vouchers receive approximately the same level of income tax exemption, that is £11 per week.

Q. Who is affected by the changes?

The changes will only affect people joining an employer's scheme on or after 6 April 2011.

Q: I am a higher rate taxpayer and I already participate in my employer's childcare voucher scheme – how will I be affected?

A: You will not be affected. You will retain the current level of tax savings until you leave your employer's scheme or are no longer eligible to participate – for example if your children no longer receive qualifying childcare. The changes will only affect people joining an employer's scheme on or after 6 April 2011.

Q: Employers will need to assess employment earnings for employees joining an employer-supported scheme after 6 April 2011. What does basic employment earnings mean?

A: This means contractual wages or salary, including taxable benefits in kind, but does not include overtime earnings or bonuses. If the employer's scheme is offered on a salary sacrifice basis then it is the post salary sacrifice wage or salary that is used for the assessment of basic earnings. There is no need to make an assessment for any employees who already participate in an employer's scheme on or before 5 April 2011.

Q: What happens if my basic employment earnings change during the year?

A: The employer should assess the employee's pay at the beginning of the tax year or when the employee first applies to join the scheme. This will fix what level of exempt income you are entitled to receive for that tax year. If your pay changes during the course of the year this may mean that the amount of exempt income you will be entitled to receive in relation to employer-supported childcare will be reduced from the start of the following tax year.

Q: I was assessed as a higher rate taxpayer and received the lower value of tax relief on childcare vouchers. I am no longer employed and over the relevant tax year I would have been a basic rate taxpayer – can I recover the additional tax relief from HMRC?

A: No – childcare vouchers are an employer provided benefit. Your former employer provided vouchers in accordance with the assessment of your basic employment earnings at the relevant time. In the same way, if during the course of a tax year you had moved from being a basic rate taxpayer to a higher rate taxpayer, your employer would not be required to apply a lower tax relief. The tax relief you are entitled to will always be set by the level of your basic employment earnings at the beginning of the year or when you first join an employer-provided childcare scheme in that year. If you join an employer’s scheme in the future, the employer will make an assessment of your basic employment earnings in your new job.

Q: What happens if the employer gets the assessment wrong?

A: If your pay changes during the course of the year this may mean that the amount of tax relief you will be entitled to receive in relation to your employer-supported childcare will be reduced only from the start of the following tax year. However, if the employer gets the initial assessment incorrect and the employee has received a level of relief they were not entitled to, then the employer should notify HMRC of the taxable benefit using the normal procedure – a P11D.

Q: What happens if the employee receives more than the exempt amount of vouchers from their employer (based on the assessment of salary at the beginning of the year)?

A: The employer will have to notify HMRC of the taxable benefit represented by the additional vouchers using the normal procedure - a P11D

Q: What happens if I receive vouchers now, but change jobs during the year and move to a new employer who also offers a childcare voucher scheme – do I continue getting the same exempt amount of vouchers?

A: You will be treated by your new employer as a new joiner, so your entitlement will depend on the level of your basic employment earnings in your new job.

Q: How will these changes affect the relief from National Insurance Contributions?

A: As at present, relief from NICs will be determined by the amount of contracted childcare and childcare vouchers that an individual can disregard for tax purposes, and the rate of NICs that they pay.

Q: My child attends a nursery where I work. Will I be affected?

A: The changes don’t affect workplace nursery provision at all.

Q: I would like to join my employer’s childcare voucher scheme before April 2011, but my child is not expected to be born until after that date. Can I join the scheme before my child is born?

A: No – you must be a parent or have parental responsibility for a child at the time you join an employer’s scheme.

Q: My employer doesn’t offer help with childcare costs – do they have to provide it?

A: Employer-supported childcare schemes are voluntary arrangements. The Government supports these initiatives with the tax and NICs reliefs that are available, but it is up to the employer to decide whether or not to offer support with childcare to its employees.

Q: Why don't self-employed people get help with childcare costs through vouchers?

A: Employer-supported childcare is not available for the self-employed. However, people who are self-employed can benefit from other forms of Government support with childcare costs. These include free part-time nursery places for three and four year olds, and this provision is being extended to more two year olds. The childcare element of the Working Tax Credit also offers help for working families on low and moderate incomes, including those who are self-employed.

Further guidance is available on the HMRC website here:

<http://www.hmrc.gov.uk/taxcredits/start/who-qualifies/children/childcare-costs.htm>

Q: How do childcare vouchers affect my tax credits?

A: If you get employer-supported childcare, your childcare costs for the purposes of the childcare element of Working Tax Credit are reduced by the value of childcare support you get. This applies even if you receive childcare support in return for a reduction in your pay.

Your entitlement to tax credits may also be affected if your salary has been reduced under salary sacrifice.

If you are unsure if you will benefit from childcare vouchers, because of the effect it might have on your tax credits, you should discuss this with your employer or voucher provider before you join their voucher scheme. Further guidance (including an on-line calculator) on how childcare vouchers can affect your tax credits entitlement is available on the HMRC website: <http://www.hmrc.gov.uk/calcs/ccin.htm>

Q: What are 'salary sacrifice' and 'salary plus' arrangements?

A: Salary sacrifice is where you agree to forego some of your salary in exchange for an employer-provided benefit. This is a change to the conditions of your contract of employment. A salary plus arrangement is where your employer provides a benefit in addition to your normal salary.