

## Monitoring of the Reform of the Income Tax and National Insurance Rules for Employer-Supported Childcare

### A study of Provision and Experiences of Employers

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In April 2005, the Government introduced reforms to the Income tax and National Insurance contributions related to employer-supported childcare. The exemptions apply to three different types of employer-supported childcare: childcare vouchers, direct *payments* to childcare providers (payments made by an employer to an 'off-site' childcare provider to subsidise the cost of childcare) and direct *provision* of childcare services (sometimes called workplace nurseries). The exemptions aim to provide an incentive for employers to support childcare, in line with other measures introduced by the Government in recent years to provide real choice and flexibility to parents with childcare needs.

HM Revenue and Customs commissioned the National Centre for Social Research (NatCen) to carry out this study with employers, in order to assess the initial impacts of the employer-supported childcare measures. This report provides the findings from an initial telephone screen<sup>1</sup> and subsequent telephone survey of organisations in the UK.

Approximately 3,600 organisations were interviewed during the screen, which was conducted between November 2005 and January 2006. During the follow-up survey, conducted between February and April 2006, just over 900 organisations were interviewed (around 500 organisations offering employer-supported childcare - 'providers', and 400 organisations *not* offering support - 'non-providers')<sup>2</sup>. The screen provided early estimates of the extent of provision of employer-supported childcare amongst employers, and identified sufficient numbers of providers and non-providers for the follow up survey. The follow-up survey explored in more detail the nature of the childcare support offered and the reasons behind employers' decisions whether or not to offer employer-supported childcare.

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<sup>1</sup> A short telephone interview with organisations, where one of the main aims was to 'screen' for organisations that offered childcare support.

<sup>2</sup> At the time of fieldwork, in the case of childcare vouchers and direct payments, the tax and NICs exemptions applied to the first £50 per week – this limit was then raised to £55 a week in April 2006.

### ***Level of provision***

The key findings relating to the level of provision of employer-supported childcare (Chapter 3) were as follows:

- Approximately 2.5 per cent<sup>3</sup> of organisations in the UK offered employer-supported childcare, which equates to approximately 17,000 organisations<sup>4</sup>. This means that in the region of 36 per cent<sup>5</sup> of employees have access to an employer-supported childcare scheme.
- Larger organisations were much more likely to offer employer-supported childcare than smaller organisations.
- Organisations in London were among the most likely to offer employer-supported childcare.
- Organisations with a higher proportion of female employees were more likely to offer employer-supported childcare than those with a smaller proportion of female employees.
- Childcare vouchers were twice as likely to be provided than either direct provision or direct payments.
- Among the most common reasons cited why organisations chose not to offer direct payments was the administration required, and among the most common reasons for not offering direct provision was the reluctance to take responsibility for a childcare provider.

Organisations can choose to offer employer-supported childcare in a number of different ways, through:

- Additional salary, when childcare support is provided on top of an employee's existing salary;
- Salary sacrifice, when an employee receives childcare support alongside a legal reduction in salary;
- A flexible benefits package, where at the start of each year employees can choose how their salary is comprised i.e. they can choose whether or not to receive various benefits such as medical insurance or a company car and a relatively lower amount of cash.

Childcare vouchers were primarily offered to employees through salary sacrifice. Only a minority of organisations offered them as additional salary. However, direct provision was offered as additional salary by almost half of organisations, whilst only a quarter offered it through a salary sacrifice arrangement<sup>6</sup>. Organisations who offered childcare support through salary sacrifice or a flexible benefits package rather than in addition to existing salary tended to do so because they felt this kept the scheme cost neutral.

### ***Impact of the exemptions***

The impact of the new tax and National Insurance exemptions on organisations' decisions to offer employer-supported childcare was considered first of all through exploring employers' awareness (Chapter 4):

- Amongst all employers 30 per cent<sup>7</sup> were aware of the new tax and National Insurance exemptions.

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<sup>3</sup> Confidence intervals are provided for key estimates (rounded to the nearest per cent in most cases). The 95 per cent confidence interval for this estimate is 1.9 per cent - 3.2 per cent.

<sup>4</sup> The 95 per cent confidence interval is 12,334 - 21,083 (this is wide due to the small bases and the weighting).

<sup>5</sup> The 95 per cent confidence interval for this estimate is 33 per cent - 40 per cent.

<sup>6</sup> The base for direct payments was too small to analyse.

<sup>7</sup> The 95 per cent confidence interval for this estimate is 26 per cent - 34 per cent.

- Larger employers were substantially more likely to be aware of the exemptions than smaller employers, with almost all (89 per cent) of employers with 10,000 or more employees being aware compared with only 23 per cent of employers with one to four employees.
- The first sources of information about the exemptions for smaller organisations were generally HMRC leaflets, whilst larger organisations tended to first hear about the exemptions through the HMRC website or through a childcare voucher or benefits provider.

Another way to look at the impact that the exemptions have had on organisations is to look at *when* organisations that offered childcare schemes introduced it to their employees. The majority of organisations who offered childcare vouchers had initiated the scheme during or following April 2005. Organisations who offered direct payments and direct provision had most commonly started offering their schemes before April 2005.

Only a small number of organisations (six per cent) had changed their scheme since its inception. Of the organisations that had changed their schemes, just over half had made a change since April 2005; this proportion was largest, at 91 per cent, for organisations offering childcare vouchers. The most common change (introduced after April 2005) to childcare support schemes was to reduce the financial amount of support offered<sup>8</sup>.

Employers who had started to offer childcare vouchers following April 2005 were asked whether they would have still offered them if the reforms had not been introduced, and two-thirds said they would not have offered childcare vouchers. Smaller organisations in particular were more likely than larger organisations to say they would not have offered childcare vouchers. This suggests that the exemptions have had an important impact on the take up of childcare vouchers.

### ***Organisations not offering employer-supported childcare***

In order to consider how take up of childcare support might be improved, organisations' reasons for not offering support were explored (Chapter 5). The most common reasons given by 'non-providers' for not offering support were having too few employees who had wanted support; having too few employees within the organisation; and not seeing childcare as an employer's responsibility (cited as a reason by 82 per cent, 76 per cent and 53 per cent of employers respectively).

As might be expected, employers from smaller organisations were more likely to cite having too few employees who want support, or having too few employees within the organisation, than larger organisations.

Non-providers were also asked about their future plans. Only two per cent<sup>9</sup> of non-providers said they planned to introduce employer-supported childcare in the future, and four per cent<sup>10</sup> said they *might* do so. Predictably, the larger an organisation, the more likely it was to have future plans to offer employer-supported childcare.

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<sup>8</sup> Note that because the April 2005 changes introduced tax exemptions in addition to the earlier National Insurance exemptions (as well as a ceiling to the amount of support that could be offered per week within the exemptions), a reduction in the amount of support offered does not necessarily equate to a reduction in benefit to employees.

<sup>9</sup> The 95 per cent confidence interval for this estimate is 1 per cent - 4 per cent.

<sup>10</sup> The 95 per cent confidence interval for this estimate is 3 per cent - 6 per cent.

Of those planning to introduce employer-supported childcare in the future, 83 per cent of employers said they planned to offer vouchers as the type of support, compared to one-third (32 per cent) who said they planned to offer direct payments, and four per cent who planned to introduce direct provision<sup>11</sup>.

### ***Employee take up of childcare support***

The key findings relating to employee take up of childcare support (Chapter 6) were as follows:

- Focusing on employees likely to have children (aged under 16), the average (mean) proportion of employees in an organisation taking up childcare support was 35 per cent<sup>12</sup>.
- Looking at *all* employees, the mean proportion in an organisation taking up support was eight per cent<sup>13</sup>. This equates to approximately 175,000 employees receiving financial help through employer-supported childcare<sup>14</sup>.
- Employees taking up childcare support were more likely to be women than men, full time than part time, and basic rate tax payers than starting rate tax payers.
- Employees taking up childcare support were more likely to work in professional occupations or to be managers and senior officials than process, plant and machine operatives and drivers, or to work in skilled trades or in routine unskilled occupations.
- Childcare support was primarily received for children aged four or under and the most common type of childcare provider used by employees receiving childcare support was a day nursery (whether through childcare vouchers or direct provision).
- In almost half of organisations, employees took up on average between £216 and £217 per month (which was the limit of the exemptions at the time). Only ten per cent of organisations said that on average employees took up more than the limit.

### ***Adherence to the exemption rules and running costs***

It is important to bear in mind the extent to which childcare schemes qualified for the exemption rules:

- Almost all organisations said their childcare schemes involved the HMRC exemptions in the case of childcare vouchers and direct payments, but only half of organisations (47 per cent) offering direct provision said their direct provision scheme involved exemptions.
- Of the organisations who said their scheme involved exemptions, virtually all offered the support to all employees, which is one of the exemption criteria.
- Awareness of the exemption rules in relation to the age of children and the registration requirements of childcare providers was patchy.
- Organisations offering a scheme which involved exemptions showed more confidence that they were meeting the exemption rules in the case of childcare vouchers than those offering direct provision: 72 per cent of those offering vouchers were very confident, and 28 per cent fairly confident, while only seven per cent of those offering direct provision were very confident, and 82 per cent fairly confident.

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<sup>11</sup> Respondents could indicate more than one type of employer-supported childcare scheme, hence percentages add up to more than 100.

<sup>12</sup> The 95 per cent confidence interval for this estimate is 23 per cent - 48 per cent (this is wide due to the small base and the weighting). The number of employees with children within each organisation was estimated through using 1) survey data on the number of employees in four age categories and 2) the proportion of employees in each age category that have children (as measured by the British Social Attitudes Survey 2006). These were multiplied and summed to estimate the number of employees with children in each organisation. The number of employees taking up childcare support was then divided by the estimated number of employees with children in each organisation.

<sup>13</sup> The 95 per cent confidence interval for this estimate is 4 per cent - 11 per cent.

<sup>14</sup> The 95 per cent confidence interval is 142,419 to 204,661 (this is wide due to the small bases and the weighting).

Organisations were also asked about the ease and cost of implementing their childcare support schemes:

- Most employers had found the process of setting up their childcare voucher scheme easy: 16 per cent very easy, and 54 per cent fairly easy.
- The majority of organisations (79 per cent for childcare vouchers, and 88 per cent for direct provision) spent one day a month administering their scheme.
- The scheme was cost neutral for the majority of organisations offering support, although 13 per cent of those offering childcare vouchers were making a profit from offering the scheme (in comparison to just one per cent in the case of direct provision).

### ***Reasons and benefits***

The changes to the exemption rules seem to have influenced a number of employers to start offering support, but what most motivated them? The most common reasons for offering employer-supported childcare included the tax and National Insurance savings for employees, requests from employees, and the employer's wish to improve relations with their employees. There were clear differences in organisations' reasons for providing support by organisation size: requests from employees were more likely to be mentioned by smaller organisations, while the following factors were more likely to be mentioned by the larger organisations (with 175 or more employees): the wish to increase employees' motivation or commitment, improving their work-life balance, reducing staff turnover, increasing productivity and marketing by organisations providing vouchers.

Employers' views on the extent to which their organisation or their employees have benefited from the introduction of childcare support were also explored:

- The majority of employers indicated that offering employer-supported childcare had had a positive effect on relations with employees (60 per cent) or on employees' work-life balance (57 per cent).
- Employers who had started offering schemes before April 2005 were more likely to identify positive effects of offering support: 66 per cent identified a positive effect on staff turnover, compared to 16 per cent of recent support providers; 47 per cent of those with older schemes identified a positive effect on productivity (compared to 16 per cent); and 30 per cent of those with older schemes identified a positive effect on absenteeism (compared to ten per cent).

### ***Summing up***

The exemption rules have had a positive impact on organisations' provision of employer-supported childcare, and there were signs that take up might increase with time. Some employers, particularly large organisations, had a future plans for introducing a childcare scheme. However, very few small to medium-sized organisations were providing any support.

There is evidence that the provision of employer-supported childcare was beneficial to organisations and their employees, and there were high levels of awareness amongst larger employers about the schemes. However, only around half of medium-sized employers and a minority of smaller employers knew about the new exemption rules.

Awareness is only part of the picture. Many employers were aware of the exemptions and were not offering employer-supported childcare. The main barriers raised by respondents to providing a scheme related to the perception that they had too few employees who wanted a childcare scheme and having too few employees in the organisation in general.

Overall, the evidence indicates that employer-supported childcare schemes are being successfully implemented by larger organisations. The research has highlighted that the level of awareness of employers could be raised, particularly among smaller organisations. The evidence on the perceived benefits of offering a scheme may help increase the provision of support by smaller organisations as well as larger employers who currently don't offer a scheme to their employees. The findings suggest that the provision of employer supported childcare is an area of potential growth in the future, and that the changes to the exemption rules have made a positive difference to employers' decisions to offer an employer-supported childcare scheme in a relatively short space of time.

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