

# REGULATORY IMPACT ASSESSMENT (RIA)

## EMPLOYER SUPPORTED CHILDCARE

### **Introduction**

1. The Government announced in the Pre-Budget Report in December 2003 that the tax and National Insurance contributions (NICs) treatment of employer-supported childcare would be reformed from April 2005. The new arrangements will add to the existing tax and NICs exemption on workplace nurseries, thus enabling more employers to help their staff to meet the cost of good quality childcare. Currently, when an employer contracts with childcare providers for its employees to have the use of childcare facilities or provides childcare vouchers, the employee is taxable on the benefit in kind. Employees are exempt from tax only when they are provided with a place in a nursery or crèche on the employer's premises, or one that is wholly or partially funded and managed by their employer. The cost of childcare met by an employer is tax deductible for the employer as it is considered to be part of the cost of employing staff. Employer-provided childcare vouchers are exempt from both employers' and employees' Class 1 NICs and employer-provided childcare or contracted childcare is exempt from Class 1A NICs (which applies only to employers).
2. Under the new arrangements the present exemption for workplace nurseries will continue. But, in addition, employers will be able to contract direct with a registered childcarer or approved home-childcarer (such as a nursery, childminder or after-school club) on behalf of their staff. The benefit-in-kind of this form of childcare provision will be tax and NICs free – up to £50 per employee, per week. Alternatively, employers will be able to provide childcare vouchers to employees free of tax and NICs – up to £50 a week of the face value and administration cost of providing the vouchers – which their employees will similarly be able to use for registered childcare or approved home childcare.

## **Purpose and intended effect**

### **Policy Objectives**

3. The purpose of the new exemptions is to provide a better incentive, and to make it easier, for more employers to offer support to employees with childcare and childcare costs. The new exemptions will widen the range of good quality childcare that qualifies for tax and NICs relief in order to better suit the needs of employers and employees. Specifically, the exemptions aim to:
  - advance the Government’s strategy on childcare to promote safe, good and quality childcare;
  - provide incentives and wider options to encourage more employers to support such childcare provisions for their staff;
  - put the tax and NICs treatment of employer-supported childcare on the same footing; and
  - provide clearer rules on the tax and NICs exemptions for employer-supported childcare.
4. The new exemptions will be easily accessible to employers, with minimum administration and record keeping required. They will be introduced with clear qualification criteria and guidance to ensure effectiveness as a fiscal incentive and alternative to ‘classic regulation’.

### **Risks**

5. The majority of employees in the UK do not currently receive any assistance with childcare from their employers. For many parents the cost and, or, availability of suitable childcare can be a significant barrier to returning to work or increasing working hours when they would otherwise choose to do so. By encouraging employers to support childcare these measures will help to reduce the risk that lack of good quality, affordable childcare will prevent parents from being able to

work, thus helping to increase levels of workforce participation and reduce child poverty.

## **Options**

6. The policy intention as stated above is that the new exemptions will provide an effective incentive to employers to become more involved in helping their employees to balance work and home life by better supporting staff with their childcaring responsibilities. The exemptions need to be of sufficient value to provide that incentive while being cost-effective. The consultation document published in February 2003 proposed a limit to the exemptions of £50 a week. This amount reflected the average level of support that employers who gave childcare support to staff typically offered through the provision of childcare vouchers or through subsidies for workplace nursery places. The majority of respondents to the consultation agreed that the proposed exemption would be effective in encouraging more employers to offer childcare benefits to staff.
7. Following the consultation, the Government considered a range of possible options, including whether the proposed limit of £50 a week would deliver the policy intention. The Government already offers help to low to middle income working families with the cost of childcare through the childcare element of the Working Tax Credit and took the view that a general tax relief covering all childcare costs would be prohibitively expensive and poorly targeted. The Government decided that a £50 a week financial limit to the exemption would be affordable, while still delivering a radical change to the tax and NICs treatment of employer-supported childcare.
8. Most respondents to the consultation pointed out that the proposed £50 a week limit was insufficient to cover the weekly cost of many types of registered childcare or approved childcare and that a higher limit should be offered to better reflect higher childcare costs. However, it is important to recognise that the £50 a week limit is not intended to match all childcare costs. Apart from the obvious implications for Exchequer costs, such a measure could, in effect, simply become a Government subsidy rather than stimulating genuine employer involvement.

9. But while it is acknowledged that the limit will rarely be enough to cover the cost of 5 full days of childcare per week in a nursery/crèche or with a childminder, there will be some situations where it will cover participating employees' childcare costs. For example, where childcare is needed for one or two days per week or in after-school clubs or similar after-school arrangements. The average cost of a daily session in a nursery in the UK is reported to be around £28<sup>1</sup>. The average weekly cost of childcare in after-school clubs in England is reported to be around £35<sup>2</sup>.

10. The Government considered possible options suggested in the course of the consultation to increase the effectiveness of the exemptions. The options considered were:

(i) *A higher financial limit, say at £75 or £100 a week.*

- The cost of increasing the financial limit to £75 or £100 a week on a per employee basis was considered at this stage to be prohibitively expensive.

(ii) *Offering the limit on a 'per child' basis.*

- Operating the exemption on a per child basis, for example where a family with one child would be entitled to an exemption of, say, £50 a week and a family with two or more children, entitled to, say, £75 a week. This option would impose a significant extra regulatory burden on employers who would have to maintain records of their employees' family circumstances to satisfy entitlement.

(iii) *Offering a higher limit – but restricting to a 'per family' basis.*

- Operating the exemption, say at £75 a week, on a one per family basis. As with the option of a 'per child' exemption limit, employers would have to keep

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<sup>1</sup> Source: Laing & Buisson's 2004 Children's Nurseries UK Market Sector Report

<sup>2</sup> Source: Daycare Trust research quoted in the Laing & Buisson report.

additional records to ensure compliance. The Government considered that an important aspect of the exemption is that it is straight-forward and easy to operate (a point made very strongly by a number of employers in their responses to the consultation document).

*(iv) Offering a flexible limit based on a percentage of the childcare costs.*

- This option would be more complex for employers to operate than a straight-forward limit and could disproportionately help higher paid employees who had more expensive childcare costs.

11. The Government concluded that an exemption limit of £50 a week provides sufficient incentive to encourage more employers who have not done so before to engage with the issue of their employees' childcare, and to consider offering contracted childcare or childcare vouchers. From this starting point more and more employers are likely to start to play a fuller role in supporting childcare, for example by making information about local childcare arrangements available and in supporting local childcare businesses.

### **Unintended consequences**

12. There may be a risk that some parents could experience difficulty in finding available good quality childcare places because of an increase in demand for such provision while the market catches up with the new exemptions. However, this risk is likely to be more than offset by the Government's ongoing strategy to increase the availability of registered and approved childcare. And where more employers contract directly with commercial childcare providers these businesses are likely to become more sustainable as contracts with employers will provide more reliable payment and more consistent booking of childcare spaces. Additionally, increased use of childcare vouchers will ensure childcare providers are paid (childcare vouchers cannot be spent on anything other than childcare).

13. There is a small risk that some employers who currently provide childcare to their employees in nurseries or crèches they wholly or partly finance and manage may

choose to withdraw that provision. That might happen if an employer considers that the new limited tax and NICs exemption available for employer-contracted commercial childcare or for childcare vouchers is a sufficient alternative. In these instances, however, the employer-run childcare provision would probably be contracted out to a nursery business, so the number of childcare places would not reduce.

**Exchequer costs**

14. The table below shows the Exchequer effect of introducing the new statutory exemption. It is estimated that it will cost the Exchequer £20 million in 2005/06 tax year rising to £60 million in 2009/10 tax year. The projected cost of £60 million in 2009/10 reflects an estimated growth in the numbers of employees using childcare vouchers for under-5s from 30,000 (current number of users) to 90,000. It also takes into account growth in other forms of employer-provided childcare from 30,000 (current number of users of workplace nurseries) to 85,000 (including holiday play schemes and out of school clubs).

£50 per week limit	2005/06	2006/07	2007/08	2008/09	2009/10
Exchequer Costs	£20 million	£25 million	£40 million	£50 million	£60 million

**Impact on Employers’ Compliance Costs**

15. Up to around 1500 employers who provide childcare vouchers up to the exemption limit of £50 a week would, under the new system, not have to report the benefit-in-kind for tax purposes as they do under the current rules. For those employers these measures would therefore lead to compliance cost savings associated with not having to provide information about the childcare vouchers given to employees on P11D or alternative returns of expenses and benefits.

Additionally, a small number of employers (around 300 a year) who currently complete P11D returns for contracted childcare benefits will no longer have to do so if the benefit provided is within the exemption limit.

16. All employers will have to ensure that to qualify for the exemption, childcare vouchers are used only to buy registered childcare or approved home-childcare. This is not likely to add any significant regulatory burden on employers as childcare voucher companies typically deal with the administration of voucher schemes and would maintain records on behalf of the employer of the childcarers used. The restriction of the use of childcare vouchers to registered and approved childcare may increase the record keeping required for employers who choose to produce and administer their own childcare vouchers, although currently these are rare.
17. We estimate that employers' recurring compliance costs will be less than £100,000 per year lower due to the new system. This is due to the relatively small numbers of employers presently offering support with childcare for employees outside the existing exemptions (and which, therefore, need to be declared to the Inland Revenue under the existing rules).

### **Small Business impacts**

18. The Government believes that all businesses, including small and medium enterprises can get business benefits from helping employees with childcare. Businesses that support childcare can make savings through reduced recruitment costs and training costs (where employees are able to return to work after having children), and reduced absenteeism (where reliable childcare is used). Where employers support childcare they can find improved retention of good, experienced staff and improved staff morale leading to enhanced organisational productivity and ability to adapt to changing market conditions, with the overall impact of improving macroeconomic growth.
19. The only tax exemption currently available to employees is through the "workplace nurseries" exemption. The conditions of this exemption are that the

childcare place made available to an employee is provided on the employer's premises, or in a facility that is wholly or partly financed and managed by the employer. Many smaller businesses have not been able to provide this kind of support to their staff due to lack of available premises, lack of demand (where maybe only small numbers of employees have children) and lack of resources (money, time and expertise). In the consultation exercise, many respondents agreed that a tax and NICs exemption should be available that did not require such a degree of employer involvement.

20. During the consultation process small businesses were particularly concerned about the exclusion of unregistered childcare from the proposals. The Small Business Service in particular was concerned about the exclusion of childcare provision by nannies from the scope of the exemption. The Government does not consider that it would be appropriate to support informal childcare as this would not be in line with its strategy to encourage and support the growth of quality assured childcare. However, the Government announced in Budget 2004 that to build on the existing home-childcare approval scheme, a new light-touch voluntary scheme that will enable accreditation for financial support purposes (eligibility for childcare element of the Working Tax Credit and the employer-supported childcare tax and NICs exemptions). The new scheme aims to extend financial support to a wider range of providers of good quality childcare, including home-childcarers and those caring for children over the age of 7. This will widen access to the tax and NICs exemptions to more working parents. The Department for Education and Skills will consult on proposals for the scheme in the summer of 2004 with the aim of implementing the scheme from April 2005.
21. Small businesses who provide childcare services (e.g. nursery businesses) are likely to see an increase in demand for places by employers (contracting for places for employees) or employees provided with childcare vouchers that can only be used to pay for formal childcare. This may result in reduced administration costs per place if employers increasingly contract for blocks of places for set periods rather than holding individual contracts with parents for each place due to the introduction of the new system.

22. The Small Business Service (SBS) has been consulted on this Regulatory Impact Assessment.

### **Benefits**

23. Introducing the new tax and NICs exemption for employer-contracted formal childcare is likely to help businesses, in particular small or medium sized businesses, that may not find workplace nurseries a practical option. It will enable them to offer real support to staff by contracting for individual nursery places or with a childminding network. And the new equal value tax and NICs exemption on childcare vouchers will particularly help small and medium enterprises for whom providing or contracting for childcare is unlikely to be a viable option due to lack of resources or expertise to administer childcare schemes. It will also help all businesses to help employees with school-age children where childcare at or near the workplace is often not practical.

24. Small childcare businesses are likely to benefit through increased demand for available childcare places. Where employers contract direct with the childcare business for places for their employees' use rather than individual parents contracting, there is less risk of running with vacant places at any time as employers are less likely to change or terminate contracts early. Additionally fees due to childcare businesses from employers are more likely to be paid on time than from individuals and the risk of bad debts will reduce.

25. This will also be the case where employer-provided childcare vouchers are used to pay for childcare. As these cannot be used for any other purpose than to pay the childcarer, parents are less likely to fall behind or fail to pay for their childcare than when they pay with cash payments (which can be used to buy anything. Where money is tight, paying the mortgage or the gas bill is likely to be a higher priority than paying outstanding childcare fees). The measure is therefore likely to help with the success and sustainability of small childcare businesses, with the longer term effect of growth in these businesses to meet demand.

## **Impact on Individuals**

26. Women are still more likely to be responsible for the care of children, even when both parents are working. The new system should encourage employers to offer greater support and to support a wider range of good quality childcare. This should help all parents, and in particular women with children, to return to work or work longer hours where they choose to do so. It would also help parents who benefit to have a greater range of job opportunities open to them, which would help them to make better use of their skills and experience and improve their career prospects.
27. Some people benefiting from the current unlimited NICs exemption on childcare vouchers will lose their entitlement to the exemption. These will be those who are using employer-provided childcare vouchers to buy childcare that is unregistered and does not become registered before 6 April 2005. An employee receiving £30 of vouchers per week to pay for informal care could lose up to £3.30 per week (11%) if the childcare remains unregistered. Also some employees whose highest rate of income tax is the basic rate (22%) who are currently benefiting from the NICs exemption on vouchers over £50 per week will lose, as the value of the limited tax and NICs exemption may be less than what they save on NICs at the moment. We estimate the total number of employees who could lose out is likely to be less than 10,000.

## **Impact on public sector**

28. The departmental impact of administering the new system is negligible. In introducing the new exemptions we intend to inform staff and employers of the new system with guidance (both paper and Internet based). There will be no changes required to the Inland Revenue computer system or current compliance procedures.

## **Other impacts**

## **Devolution**

29. This measure extends to England, Wales, Scotland and Northern Ireland.

## **Human Rights**

30. Inland Revenue Solicitors have advised that the provisions of this policy comply with the European Convention on Human Rights.

## **E-policy**

31. Information on employer supported childcare is published on the Inland Revenue website and further guidance on employer supported childcare will be developed before April 2005. It is envisaged that information on the new system will be updated regularly. We are also currently producing further guidance on salary sacrifice and will be placing this information on our website.

## **Environmental impacts**

32. There are no significant environmental impacts of this policy.

## **Rural proofing**

33. Rural communities are likely to benefit from this measure as employers will be able to support a wider range of registered and approved childcare, helping areas where sustainability of childcare businesses is more problematic than for more densely populated areas.

## **Competition Assessment**

34. We have undertaken a competition assessment and this indicated that the proposed changes should not have any adverse effects on the competitive process in the market place. Rather, these changes will increase demand for childcare and hence

the numbers of childcare providers are expected to increase in some areas to help meet the extra demand.

35. Although the number of providers should increase, the extent to which competition between them intensifies or slackens will depend on the extent to which the increase in supply of childcare services compares to the increase in demand for them. Arguably, the greater the extent to which the supply increases relative to demand the greater the extent to which competition will intensify.

### **Securing compliance**

36. The reform will take effect from April 2005 and will be subject to the following rules:

- to qualify for the exemption, the childcare used must be either registered childcare or approved home-childcare in line with the Government's commitment to only support safe, good quality childcare;
- the exemptions for tax and NICs will be set at £50 a week per employee. This will simplify the administration and ensure that the relief is both available to all and affordable; and
- to qualify for exemption, employers will have to ensure that where childcare schemes operate, they are generally available to all staff.

The Inland Revenue will monitor the operation of the exemption through its existing employer compliance activities.

### **Consultation**

37. We consulted formally on proposals to improve the tax and NICs exemptions on employer-supported childcare from February – May 2003. The consultation document can be found at [www.inlandrevenue.gov.uk/consult\\_new/esc.pdf](http://www.inlandrevenue.gov.uk/consult_new/esc.pdf) Over 100 responses were received and a summary of the responses was published on our website in September 2003. The document can be found at [www.inlandrevenue.gov.uk/consult\\_new/esc\\_responses.pdf](http://www.inlandrevenue.gov.uk/consult_new/esc_responses.pdf)

38. The responses to the consultation document have informed and shaped the development of the key features of the new system. A summary of the general analysis of the consultation responses is presented in the paragraphs which follow.
39. All of the respondents agreed that childcare vouchers should receive equal treatment for tax and NICs as other employer-supported formal childcare provisions. Many felt that this would lead to greater choice for employees.
40. An overwhelming majority of respondents supported the proposal to extend the existing exemption (for workplace nurseries only) to cover all forms of employer-contracted registered and approved childcare. Some commented that it would make it easier for employers to support childcare, others felt that it would widen access to childcare and some felt that it would help with recruitment and retention.
41. On the proposed financial limit to the exemptions, the majority of respondents would prefer to see it set at a higher rate. Some suggested alternatives, varying from £75 to £150 per week. Others thought that it should be a variable limit, related to a percentage of childcare costs or that it should be related to the actual cost of childcare. Some suggested that it should mirror the childcare element of the working tax credit.
42. On the issue of better guidance, a substantial majority of respondents agreed that it would encourage employers to increase support for childcare, particularly by bringing out the business case for doing so. A number commented that it was needed to help employers and employees make informed choices. However, some did express reservations about how much effect it would have in encouraging employers to increase real support for childcare other than simply facilitating childcare voucher schemes through salary sacrifice arrangements.

### **Monitoring and Evaluation**

43. The Inland Revenue plans to monitor and evaluate the new tax and NICs exemptions for employer-supported childcare. We will assess the impact of the new arrangements over time compared against the predicted costs. We also intend to conduct informal review through the Inland Revenue network as well as established channels of communication between the Revenue and employers' representatives.

### **Contacts**

44. Please address any communication regarding this Regulatory Impact Assessment to:

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## **REGULATORY IMPACT ASSESSMENT**

### **EMPLOYER SUPPORTED CHILDCARE**

#### **Statement of Ministerial Approval**

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

Dawn Primarolo

Paymaster General

Date 26 March 2004