



Registered Auditors • Chartered Accountants • Taxation Consultants

Directors • B. Gascoyne FCA, ACII • C.J. Reeve ACA

Childcare changes

Some of the rules affecting the provision by employers of childcare vouchers and employer-supported childcare are set to change from April 2011. It is important that employers are aware of these changes so that they can advise their employees of what these changes will mean. Although the changes take effect from April 2011 employers may wish to take action now to:

- maximise the benefit of the existing rules before 6 April 2011, especially given the national insurance (NIC) increases ahead; and
- make the necessary changes to their scheme before offering these types of benefits to new employees or existing employees looking to join their scheme.

Background

The workplace nurseries exemption was introduced many years ago. This exempts from tax and NIC the provision to an employee of a place in a nursery at the workplace or in a facility wholly or partly financed and managed by the employer.

Whilst these sorts of arrangements are not that common, the later introduction of a limited tax and NIC exemption for employer-contracted childcare and employer-provided childcare vouchers has been very popular with both employers and employees alike. The exempt amount is currently £55 per (tax) week.

Salary sacrifice

Many employers use these childcare exemptions as part of salary sacrifice arrangements; for example, the employee gives up pay, which is taxable and NIC-able, in return for childcare vouchers, which are not. This may save tax and NIC for the employee and NIC for the employer.

In light of the fact that all rates of NIC increase from April 2011, such arrangements can be attractive. However, as always, care needs to be taken when implementing a scheme to ensure that it is set up correctly. Also, for those on low rates of pay, such arrangements may not be appropriate.

If the employer-contracted care exceeds £55 per week the excess will be a benefit in kind and subject to Class 1A NIC. However, with vouchers, although any excess is also a benefit in kind it is subject to Class 1 NIC via the payroll. As the tax and NIC issues are complex many employers limit their employees' potential entitlement to a maximum of the exempt limit (currently £55 a week).

The exempt limit of £55 applies to the full face value, rather than the cost, of providing a childcare voucher, which would normally include an administration fee.

An employee is only entitled to one exempt amount even if care is provided for more than one child but it does not matter that another person may also be entitled to an exempt amount in respect of the same child. As always, there are various conditions to meet but these rules have led to many employers providing such care, particularly childcare vouchers, to their employees.

Changes ahead

In December 2009, the former Labour Government announced proposed changes for the future tax and NIC treatment of employer-supported childcare and the Coalition Government intend to proceed with these changes.

Although not passed as law yet, it appears the changes will apply to employer-contracted childcare and childcare voucher schemes **but will only affect individuals joining a scheme from 6 April 2011**. The existing tax and NIC exemptions for workplace nurseries will remain.

Employer-contracted or childcare voucher schemes offered through salary sacrifice arrangements will fall within the new provisions.

What are the changes?

From 6 April 2011 (2011/12), the limit on the amount of exempt income associated with childcare vouchers and employer-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.

Anyone already in a scheme before 6 April 2011 will not be affected by these changes as long as they remain within the same scheme.

What will employers have to do?

To identify the rate of tax an individual employee will pay in any one tax year, an employer will need to carry out a 'basic earnings assessment' for any employee who joins an employer-provided childcare scheme on or after 6 April 2011.

From 6 April 2011, employers who offer or provide employer childcare will be required, at the beginning of the relevant tax year, to estimate the 'employment income amount' that the employee is likely to receive during that year.

This is basically the contractual salary and benefits package (not discretionary bonuses or overtime) less the personal allowance which appears in the PAYE code for the tax year in question.

Employers must keep a record of the basic earnings assessment. These records do not need to be sent to HMRC but must be available for inspection by HMRC if required.

What is the position for the employee?

For 2011/12, the personal allowance for most employees will be £7,475 and the basic rate limit will be £35,000, a combined figure of £42,475. The higher rate limit is £150,000.

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 (generally £42,475 as explained above), 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 (generally £42,475 as above) but falls below the limit at which tax becomes payable at the 50% rate limit for the year (currently £150,000), 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 50% rate limit for the year (currently £150,000), the employee will be entitled to relief on £22 exempt income for each qualifying week.

Similar changes will be made to the NIC rules to mirror the above.

New starters

The rules are modified where employees join the scheme part way through a tax year. In that case, the earnings review has to be carried out at the point of joining. Basically, the joining employee's salary and taxable benefits need to be pro-rated upwards to estimate the notional annual earnings figure for the employee.

Gaps in payment

An employee can ask to stop receiving childcare vouchers temporarily whilst staying in the employer's scheme; for example, if an employee only works during school term time and doesn't need the vouchers during the school holidays. Basically, as long as the gap in providing the vouchers doesn't exceed 12 months the employee can still be classed as an existing member of the employer's scheme.

This also applies to employees who are on maternity leave, sick leave and those who wish to take a career break, provided that the total length of absence does not exceed 12 months.

Lots of questions?

HMRC have provided many questions and answers on their website to help both employees and employers and these can be viewed at www.hmrc.gov.uk/thelibrary/esc-qa.htm

What to do now?

If you already provide employer-contracted childcare or vouchers, then clearly there is a one-off opportunity to ensure that any employees who wish to do so join the scheme before 6 April 2011. However, for those employees joining on or after that date, or for those employers who set up a scheme after that date, then procedures will need to be put in place to meet the new rules.