

# Bulletin

## Childcare..all change

*For many families in this country, establishing the appropriate work-life balance often involves financial cost in the form of childcare. Some are lucky enough to be able to call on family and friends and thereby minimise this. For others, going out to work inevitably involves a nursery, childminder or out-of-school club and the associated financial costs. One thing is for certain, good childcare is not cheap.*

The tax system in this country has not been overly helpful where childcare is concerned. The government has sought to improve the regime and make it more attractive for employers to provide tax-efficient financial assistance for childcare to their employees. In this bulletin we describe the changes in the rules for you and give some practical thoughts on their operation.

### The old rules: a brief summary

Until 5 April 2005 the tax rules applying to employer-supported childcare were pretty restrictive. The general rule was that where an employer helped employees financially with childcare costs there was a taxable benefit and national insurance (NI) charge based on the cost to the employer, with very limited exceptions. The exceptions are detailed below to help set the scene and allow you to understand more easily what has changed.

#### Workplace nurseries

Since 1990, there has been no taxable benefit or NI charge where either:

- childcare is provided on the employer's premises or
- on premises where the care is provided jointly with others and where the employer is wholly or partly responsible for managing and financing the care facilities.

#### Comment

These stringent requirements ruled out the provision of tax-free childcare by many smaller businesses. The new rules (explained later in this bulletin) aim to allow greater flexibility and make employer-supported childcare a realistic option for many more employers.

#### National insurance

Although the tax-free benefit was limited to workplace nurseries, the NI exemption (for both employers and employees) was wider and also included:

- employers contracting for places in commercial nurseries or for the services of a registered childminder and
- childcare vouchers.

#### Comments

- The NI exemption did not extend to the reimbursement of costs incurred by employees.
- The exemptions did not have any financial limits.
- Clearly the tax and NI exemptions were out of step.

### The new rules summarised

From 6 April 2005 changes have been made which can be neatly summarised under three main headings:

1. Workplace nurseries
2. Childcare vouchers
3. Other childcare support.

#### 1 Workplace nurseries

The old tax and NI exemptions already described continue and indeed, generally speaking, are widened. Now employees of other organisations may also benefit from the exemptions if they work at the same location as the employer's staff. As before there is no financial limit on the relief and, indirectly therefore, no limit on the number of children per employee for whom such care can be provided.

#### 2 Childcare vouchers

The main changes are that the exemption is extended to cover tax as well as Class 1 NI (both employers' and employees') but a financial limit of £50 per week has been introduced. Any excess is liable to both tax via the P11D, and Class 1 NI (employer and employee) via payroll deductions.

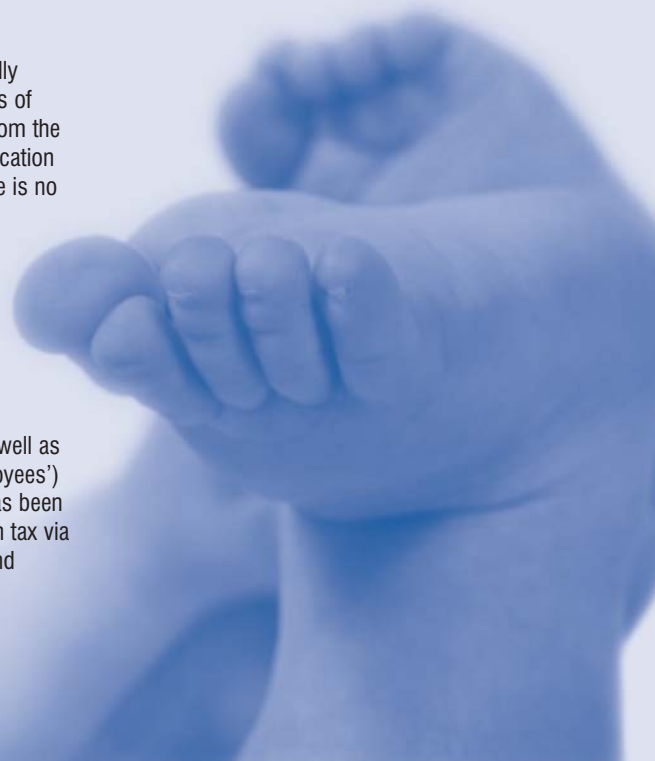
The £50 is measured by reference to the face value of the voucher. Voucher provider companies charge an administration fee for the service but this is not included in the £50.

The exemption is per employee not per child although there is nothing to stop more than one person (typically both parents or others with parental responsibility) qualifying in respect of the same child.

#### 3 Other childcare support

If the employer makes other direct arrangements for childcare then, so long as certain conditions are met, the first £50 of expenditure per week is exempt from tax and NI. Any amount over £50 is taxable, reported on form P11D and liable to Class 1A NI.

Examples of the types of childcare covered under headings 2 and 3 would include the employer paying for a place at a local nursery, out-of-school club or registered childminder.



## Not covered

The following are not covered by the exemptions and are liable to tax and NI in full:

- cash payments to an employee to help with their childcare costs
- paying an employee's childcare bills on their behalf
- payment of school fees
- the provision of childcare or childcare vouchers if the qualifying conditions are not met.

### New conditions

The following new conditions relate to all childcare support provided by an employer.

#### Eligibility

The childcare support should be offered in a scheme to which all employees are eligible to apply.

#### Qualifying age of the child

A child qualifies up to 1 September following their 15th birthday, or 1 September following their 16th birthday if they are disabled.

#### Registered or approved childcare only

To qualify for the new exemption any childcare provided by an employer or for which childcare vouchers are used must be registered or approved.

Registered or approved childcare can include registered childminders, nurseries and play schemes as well as out-of-hours clubs on school premises. Childcare provided by the employee's partner or other close relative in the child's home will not qualify. Neither will a nanny working in the child's home unless formally registered.

To find out if a specific child carer is registered or approved contact:

England: OFSTED - 0845 601 4771

Scotland: The Care Commission - 01382 207200

Wales: The Care Standards Inspectorate - 01443 848450

Northern Ireland: [www.dhsspsni.gov.uk/links.asp](http://www.dhsspsni.gov.uk/links.asp)

## Some practical thoughts

### Savings

The introduction of the £50 per week tax exemption for vouchers and other childcare is designed to encourage more employers to provide financial assistance for childcare costs to their employees.

An employer taking advantage of the full £50 per week could save over £300 in NI per employee per year. An employee could save up to £850 a year if they are a basic rate taxpayer rising to over £1,000 for a higher rate taxpayer.

### Who can benefit?

There is no restriction on the nature of the employers and employees who can benefit. Director/shareholders of family companies and owner managed businesses are free to participate and enjoy the benefits. In a husband and wife company where both are higher rate taxpayers the total annual savings could amount to over £2,500.

Note that the regime is restricted to employees (including directors) so that the self employed are not able to take advantage of the benefits.

## Vouchers

Employees already receiving vouchers substantially in excess of the new £50 limit may find they are worse off under the new rules because although there is now a tax exemption, albeit capped at £50 per week, the NI exemption is also capped at £50.

A number of organisations provide childcare vouchers. Employers need to be sure that their chosen provider is able to meet the new conditions. The exemptions will only apply if the vouchers are used to meet the cost of approved childcare.

Vouchers may be a more effective mechanism than the employer paying for childcare directly. This may be particularly so where an employee only needs to use childcare at certain times of the year for example during the school holidays.

### Example

Harriet needs childcare for 15 weeks of the year. The weekly cost is £170. If her employer pays for this directly, only £50 per week – ie £750 in total will be exempt and the balance (£1,800) liable to tax and NI. If on the other hand Harriet receives a £50 childcare voucher each week, there is nothing to stop her 'saving these up' for use when she needs them in the school holidays. The exemption is not compromised and the benefit of the £50 exemption is effectively averaged.

## Salary sacrifice

Some employers may decide to operate a childcare 'salary sacrifice' scheme whereby the employee formally agrees to give up part of their salary in exchange for childcare vouchers or other employer-provided childcare. The possible savings for both the employer and the employee have already been identified above.

Employers should be aware that salary sacrifice schemes should only be put in place after obtaining professional advice. It is all too easy to get it wrong and end up with a scheme that doesn't work as intended. In addition, establishing a scheme represents a variation of the employees' terms and conditions and therefore requires consultation and agreement. Please talk to us if a salary sacrifice scheme is of interest to you.

Employees should be aware that they will not have an automatic right to 'change their mind' and opt back out of the scheme or at least not immediately. Employees should also consider if they enter into a scheme what their pay will be for the purposes of pay rises, bonuses, pension provision etc.

Salary sacrifice would probably not be appropriate for employees in receipt of Working Tax Credit (including the childcare element) because part of the entitlement to these credits is based on childcare costs paid personally rather than by the employer.

## Summary

There is no doubt that the changes to the rules on employer-provided childcare are generally good news. However it is true that aligning the tax and NI rules has come at the cost of a restriction in the exemption (other than for workplace nurseries) to £50 per week. There are still a whole host of conditions to be satisfied and the danger therefore that many employers will view the regime as too complex. **We are here to help. If you would like further information on any aspect of the new childcare rules or wish to talk to us about setting up an effective scheme in your organisation please give us a call.**