



TAXREP 58/13

(ICAEW REP 162/13)

## TAX-FREE CHILDCARE

Comments submitted in November 2013 by ICAEW Tax Faculty on the consultation document *Tax-Free Childcare: consultation on design and operation* published to HM Revenue & Customs and HM Treasury on 5 August 2013.

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## INTRODUCTION

## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation document *Tax-Free Childcare: consultation on design and operation* published to HM Revenue & Customs and HM Treasury on 5 August 2013.
2. We should be happy to discuss any aspect of our comments and to take part in further consultations on this area.
3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

## WHO WE ARE

4. ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.
5. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.
6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including *TAXline*, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

## KEY POINT SUMMARY

7. We support the government's aim of introducing an effective system of tax-free childcare which is easy to access and operate. We understand the policy aims of providing work incentives and alleviating child poverty.
8. The current proposals include a number of welcome features, including the fact that the administrative burden for employers will be less than for the current schemes, and that the self-employed will be eligible.
9. However, we are concerned that features of the system as proposed will make it complicated and less flexible, and may discourage people from participating. These include:
  - Applying the £1,200 limit on a monthly basis, which removes flexibility, eg for those parents who use childcare mainly in the holidays.
  - A minimum income or minimum hours rule applied on a monthly basis, which does not take account of parents with fluctuating hours or income.
  - The difficult choices parents will have in deciding whether to opt for Tax-Free Childcare or stay in an existing Employer-Supported Childcare Scheme (if eligible), or whether to claim childcare support via Tax-Free Childcare or universal credit.

10. Many employers may wish to have a role under the new scheme but this should not be mandatory. We welcome the fact that government wants to avoid imposing additional burdens on employers and that the new scheme will not place requirements upon employers in the way the current one does.
11. The introduction of Tax-Free Childcare presents options for both employers and employees. Both categories will need good information and support from government so that they can understand the options and make good choices. Not all parents will have internet access, so the guidance should not be wholly online.
12. For initial registration and validation of parents' registration information, we favour option B (using a government portal), as it involves fewer steps and fewer intermediaries.
13. Regarding childcare support through universal credit, we do not support the proposal to provide increased (85%) support to claimants where both parents pay income tax. We think this is inequitable and will be difficult to operate and for claimants to understand.
14. The position of the self-employed in universal credit is not addressed. This group is very likely to have income which fluctuates from month to month, and on this we have the same concerns as described above.

## RESPONSES TO CONSULTATION QUESTIONS

Note: we have not attempted to answer all the questions, but have focused on those which are relevant to our members and their clients.

### Chapter 2 – Tax-Free Childcare: voucher accounts

#### ***1 What features will the payment system need to have to ensure that it meets the needs of parents and childcare providers?***

The payment system must be prompt, since cash flow is important to both parents and childcare providers. It must also be simple and easy to understand.

#### ***2 What are the advantages and disadvantages of applying the £1,200 limit by means of a monthly cap as opposed to other options?***

We do not support the option of capping the government top-up on a monthly basis. This could cause difficulties for those parents who use childcare mainly in the school holidays rather than throughout the year. The system needs to be flexible.

#### ***3 In what situations should parents be able to spend saved-up vouchers if they become ineligible?***

Parents who become ineligible for the scheme should be able to make use of saved-up vouchers acquired at a time when they were eligible. If this was not permitted, it could discourage parents from participating in the scheme and making contributions.

#### ***4 The Government is committed to giving employers the opportunity to remain involved in the provision of support for childcare in any ways that are consistent with the principles and operation of Tax-Free Childcare. How can the Government best ensure this happens?***

The introduction of Tax-Free Childcare presents options for both employers and employees. Both categories will need good information and support from government so that they can understand the options and make good choices.

Employers can choose whether to continue offering Employer-Supported Childcare. They also have the option of assisting employees with their contribution to Tax-Free Childcare. Employers will need to understand all the options in order to provide support for their employees in the most helpful but cost-effective way.

Employees will have a choice between continuing within an existing scheme while they remain eligible or taking up Tax-Free Childcare. They are likely to approach their employers for information and advice about existing arrangements, the new scheme and the transition between the two. They may also in due course want information about the transition between Tax-Free Childcare and the support available under universal credit.

Table 2.A envisages ways in which employers could have a role under the new scheme, compared with the current one. Many employers may want to play a role under the new scheme, but this should not be mandatory. We welcome the fact that government wants to avoid imposing additional burdens on employers (para 2.22), and that the new scheme will not place requirements upon employers in the way the current one does.

It is crucial that the government supports in employers with any role they are to have under the new scheme. Government must provide employers with the tools they need, ie clear guidance on the new scheme and the transition from the current one, both for their own use and to give to employees who may ask for information and advice.

Table 2.A indicates that if an employer gives further assistance to employees who are claiming Tax-Free Childcare, there may be a taxable benefit in kind. The benefit-in-kind position is not clearly spelled out, and this requires clarification and further discussion.

### **Chapter 3 – Tax-Free Childcare: eligibility**

#### ***6 Does the proposed definition of ‘parents’ ensure that all individuals who have responsibility for a child can benefit from Tax-Free Childcare?***

We welcome the fact that eligibility includes the self-employed as well as parents who are employees.

#### ***8 What are the potential benefits and risks of a minimum income rule or hours rule in defining qualifying employment?***

A minimum income or hours rule brings the risk that those on the lowest income, or who work fluctuating hours, will not qualify for support with childcare. This will affect, among others, those employees moving in and out of jobs or whose income fluctuates in a way which is beyond their control because (for example) they are on zero-hours contracts.

It is also difficult to see how these limits could be applied fairly for the self-employed, which is acknowledged in para 3.25 but not discussed.

We assume the intention would be to apply the minimum income or hours rules on a weekly or monthly basis. This could only work for those with regular and predictable incomes or work patterns. Those with fluctuating income or hours may move in and out of eligibility, and thus be unable to plan with certainty for their childcare support.

#### ***12 What are the best ways of ensuring that all parents have the information they need to judge whether they will be eligible for Tax-Free Childcare, and to make the best choice for themselves?***

As noted above, employers will be one source of advice and should be provided with suitable support materials.

Parents will need good information about the new scheme, the options if they are in an existing scheme, and the potential interaction with universal credits and other benefits.

It will be difficult for parents to apply the information they are given to their own situation and work out what their financial position would be under the various options. We recommend that as well as leaflets etc, they will need practical help such as decision trees and online 'what if?' calculators.

Not all parents will have internet access, so the guidance should not be wholly online. Paper-based alternatives will be required. We also suggest that HMRC offers a helpline and also the option of face to face advice (which could be at Jobcentres or similar premises, given that HMRC intends to close its Enquiry Centres).

### **Transition from current schemes**

The decision for those in an existing employer childcare scheme, as to whether they should transfer to Tax-Free Childcare, will be a difficult one, particularly since eligibility for children is to be phased in with reference to age from 2015 to 2021. Those families with several children of different ages will have some difficult calculations to make. Parents will need good clear guidance on this aspect.

Table 3.A sets out comparisons between the costs of Employer-Supported Childcare and Tax-Free Childcare, followed by some examples. But these are simplistic, being based on couples with children young enough to be eligible for Tax-Free Childcare from the start – they do not address the situation where children of different ages come within the scheme at different times.

This aspect makes the scheme complicated and works against the simplicity and ease of understanding for which the government is aiming.

## **Chapter 4 – Tax-Free Childcare: information and validation**

### ***14 Considering the objectives set out in paragraph 4.3, what are the strengths and weaknesses for each of the alternative ways in which the initial registration, and validation, of parents' registration information could be undertaken? What opportunities might third parties bring to assist the Government in validating registration information?***

We favour option B (using a government portal) over options A or C, in that it involves fewer steps and fewer intermediaries. It will be crucial that parents can register quickly and easily.

With option A, where the voucher provider would collect details, confirm eligibility and then liaise with government, the parent is at the mercy of the voucher provider and has little control over the process. If the voucher provider is inefficient or makes a mistake in confirming eligibility, the parent may not get the childcare support they need at the time when they need it. We presume that with this option, HMRC would need to monitor voucher providers to ensure they carry out their role – which would introduce extra complexity.

### ***15 Considering the objectives set out in paragraph 4.3, how quickly should the Government confirm eligibility based on the registration details provided to it? What should happen in cases where a parent is deemed to be ineligible for Tax-Free Childcare? How should the parent be informed?***

The parents should be informed as quickly as possible. Government should publish time limits within which it will confirm eligibility so that parents know what to expect.

If their application is refused, parents must be told the reason. There should also be an appeal process if they wish to challenge the decision.

**16 Would annual checks be sufficient to confirm that self-employed parents continue to meet the (income) eligibility criteria for Tax-Free Childcare?**

Yes, this would be sufficient. We support the aim (para 4.19) not to introduce any new in-year reporting requirements for the self-employed.

**17 How quickly should parents be required to inform changes of circumstances that affect their eligibility, and how can they be reminded to do this? What does this mean for voucher providers' systems?**

We agree that there is a balance to be struck between imposing onerous notification requirements on parents and having a system to prevent a long time lag before the system is updated when parents lose eligibility.

A requirement to report changes within one month seems reasonable and mirrors the rules for tax credits, with which parents may already be familiar.

We do not think the reporting requirement should be linked to a monthly payments cap – which, as noted above, we do not support.

Parents must be given a clear checklist of eligibility rules and what must be reported.

**18 What processes should be used to recover payments made to ineligible parents?**

We support the aim of avoiding overpayments building up in the first place.

Where possible overpayments should be recovered by offsetting them elsewhere, rather than by direct collection. For example, overpaid vouchers for one child could be set against a current or future entitlement for another child. They might also be offset against a future entitlement to universal credit childcare support.

**Chapter 5 – Tax-Free Childcare: the market for vouchers**

We are not in a position to comment on this section in detail. However, it is important that (as noted in para 5.7) parents' personal data and funds are held securely. The government also needs to demonstrate and reassure parents that this is the case – any concerns about security may deter them from joining the scheme.

**Chapter 6 – Childcare support through universal credit**

*We do not propose to comment in detail on the universal credit proposals, but would like to make the following points.*

We do not support the proposal to provide increased (85%) support to claimants where both parents pay income tax. We understand the policy objective to encourage parents to work and thus take children out of poverty. However, this means that those on higher incomes will get more support than those on the lowest incomes – and those on the lowest incomes are likely to be those most in need of support. It does not allow for the fact that some parents may be keen to work longer hours and increase their income but be unable to do, because the employer cannot offer more hours.

We also think that the 85% support will be difficult to operate and for claimants to understand. It is based on a hypothetical 'monthly income tax allowance' (para 6.13) which will work for those people in stable jobs with a regular predictable rate of pay. For those employees moving in and out of jobs or whose income fluctuates, the system will mean that in some months they may receive 85% support, in other months 70% support. This will make it hard for them to plan for how much childcare they can afford. This is likely to affect many people, because of the increase in working

arrangements such as zero-hours contracts, part-time and agency working means that many employees' pay will fluctuate from month to month in a way which is beyond their control. Further, if the government increases the personal allowance, it may mean that claimants cease to be eligible for the 85% support even though their income has not changed. If people have little control over when they might receive the 85% extra support, it undermines the policy objective.

The position of the self-employed is not addressed. This group is very likely to have income which fluctuates from month to month, and on this we have the same concerns as described above.

E [jane.moore@icaew.com](mailto:jane.moore@icaew.com)

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## APPENDIX 1

### ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see [icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx](https://www.icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx))