

TAXREP 10/05

CHOICE FOR PARENTS, THE BEST START FOR CHILDREN: A TEN YEAR STRATEGY FOR CHILDCARE

*Response submitted in February 2005 to HM Treasury by the Tax Faculty of the Institute
of Chartered Accountants in England and Wales*

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CHOICE FOR PARENTS, THE BEST START FOR CHILDREN: A TEN YEAR STRATEGY FOR CHILDCARE

INTRODUCTION

1. We welcome the opportunity to comment on the paper **Choice for parents, the best start for children: a ten year strategy for childcare**, published on 2 December 2004 at www.hm-treasury.gov.uk/media/426/F1/pbr04childcare_480upd050105.pdf
2. The strategy published on 2 December 2004 has much to commend it. The ICAEW Tax Faculty supports any proposals which ensure that every child receives the best start in life. We do, however, have a number of concerns in relation to the interaction of this strategy with the tax system. In this response, we have confined our comments to this interaction.

KEY POINT SUMMARY

3. We are concerned that childcare policy is being formulated without proper consideration of the tax consequences or the impact on employers.
4. We believe that the changes suggested in the consultation paper favour employees at the expense of the self-employed. Most of the initiatives, such as vouchers for childcare and extended and flexible parental leave, are aimed at employees but will not be available to the self-employed. Tax relief should be available for self-employed women or men who need their children looked after so that they can work to support their families, in the same way as it is for employees
5. In the interests of tax simplicity and flexibility and choice for working parents, we ask the government to reconsider full tax relief for childcare costs. The paper correctly identifies that childcare costs vary by geographical location and by age of child. Tax relief for what childcare actually costs would make a link between work and support for the cost of childcare, whilst relating the amount of relief directly to cost.
6. Tax relief for training remains an area which is in need of urgent review. There are particular problems where an individual pays for his or her own training while unemployed, in order to help himself back into the workforce. There is no tax relief for such costs against income when the individual starts to get work. This is a disincentive to those showing such initiative, and the lack of tax relief often comes a surprise when they later find employment or seek to use their new skills in a new self employment.
7. We welcome the Government's review of the statutory payment mechanisms, including considering the case for transferring payment of SMP, SAP, SPP and MA from employers to HMRC. We believe that this will be widely welcomed by business, as these payments are a major burden on employers.

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8. We support the suggestion that entitlement to the working tax credit could be extended to parents who work less than 16 hours a week.
9. We disagree with the premise that Government support should also be denied where payments are made on a commercial basis to family members.

WHO WE ARE

10. The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
11. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
12. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

GENERAL COMMENTS

13. We are concerned that childcare policy is being formulated without proper consideration of the tax consequences or the impact on employers.
14. We have previously responded to consultations on childcare support, including most recently that on Employer supported childcare (submitted as TAXREP 15/03), urging that the Government should take a holistic approach to the tax treatment of childcare support. Extracts from TAXREP 15/03 are included at Annex 1.
15. The Tax Faculty has formulated ten principles (the ten tenets) that we believe should underpin all tax legislation, which are attached as Annex 2. We hope that any new proposals for childcare will be in line with these tenets, and are particularly concerned in relation to:
 - Tenet three – Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
 - Tenet four – tax should be easy to collect and to calculate.

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16. In the past we have expressed concern that consultations into support for childcare have been dealt with on a piecemeal basis rather than looking at the issue as a whole. The Government policy purpose is, we understand, to encourage people to return to work and to provide assistance with childcare to enable that to happen. This is a principle which underpins, for example, the Tax Credit regime. However, in order to achieve such an aim, what is required is a broad and practical vision of how this can be achieved. Just as the implementation of the introduction of Tax Credits has not dealt satisfactorily with the practicalities of childcare and childcare provision, there remains a danger that similar issues will arise in respect of the proposals set out in this document. The Government needs to take a step back and look at the overall aims and strategy behind childcare assistance to ensure that all aspects of the system operate from the same starting point and that no one group of individuals is disadvantaged. One important aspect of this is the use of tax reliefs and exemptions and what part they can play in this area.
17. We are concerned that there is virtually no consideration of the tax consequences of different methods of supporting parents and providing childcare. This is particularly surprising since Affordability is one of the four key aspects of childcare provision identified in the documents, and the tax and National Insurance consequences of childcare support is integral to evaluating its affordability.
18. We believe that the changes suggested in the consultation paper favour employees at the expense of the self-employed. Most of the initiatives, such as vouchers for childcare and extended and flexible parental leave, are aimed at employees but will not be available to the self-employed. Tax relief should be available for self-employed women or men who need their children looked after so that they can work to support their families, in the same way as it is for employees.
19. We have no objection in principle to initiatives such as extending the period of maternity leave, making maternity leave transferable, and introducing a right to flexible working for parents of older children. But we do have concerns about the impact of these initiatives on employers, particularly small businesses, who may be placed under considerable strain by having to provide their workers with these extra periods of parental leave. We trust that the impact of these measures on employers will be considered carefully, with full consultation, and that government funding will be available to support employers who are required to implement them.
20. Childcare provision is a long-term issue for all parents. We would welcome consideration of the many varieties of childcare required, eg after-school, term time, holidays etc in any proposals. There are also situations where the availability of types of childcare can be problematic. For example, we have some difficulties with the distinction between school fees and childcare for pre-school children. Whilst the existing exemption for childcare vouchers provided by employers is not intended to cover private education, it might be that pre-school fees would still

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apply in areas where Early Years funding is not available. A clear definition of school fees would help.

21. The cliff edge effect of a person on fast taper tax credits who is offered the choice of childcare vouchers following the Finance Act 2004 changes remains. So too do the potential problems of overstated parental income which result in Child Trust Fund higher payments and Education Maintenance Allowances being repayable by children.
22. We would welcome a general broadening of the scope of the current consultation to encompass these other relevant matters.

SPECIFIC COMMENTS

23. In the paragraphs which follow, headings in italics indicate references to the consultation document.

Challenges remaining (1.8)

- *'Parents would like flexible working arrangements to enable them to spend more time with their children.'*
24. Flexible working arrangements do not always sit easily with tax credit and employment laws which in certain instances stipulate that a minimum number of hours per week, or days per year, must be worked. Detailed record keeping and averaging calculations are already needed for many purposes, for example entitlement to tax credits.
 25. Even where flexibility already exists, the practical aspects of notification are often overlooked. For example, the Tax Credits Helpline computer system can only record one advice concerning a change in working hours at a time. Most parents will wish to notify the beginning and end of a change in childcare hours (and costs) due to school holidays at the same time. This contributes to unnecessary additional telephone calls.

Regional variations in price (2.46) and Affordability of high quality childcare (2.62)

26. In the interests of tax simplicity and flexibility and choice for working parents, we ask the government to reconsider full tax relief for childcare costs. The paper correctly identifies that childcare costs vary by geographical location and by age of child. Tax relief for what childcare actually costs would make a link between work and support for the cost of childcare, whilst relating the amount of relief directly to cost.
- 27.

Right to request flexible working (3.9)

28. Many employers now offer flexible working arrangements which may include working from home. For an employee who works from home, tax relief for expenses under s 336(1)(b), ITEPA 2003 will not normally allow a deduction for costs incurred because they are not normally 'incurred wholly, exclusively and necessarily in the performance of the duties of the employment'. This rule is far

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more restrictive than the similar rule for self employed persons who may also chose to work from home and should be relaxed accordingly. S 137, FA 2003 affords relief to payments which an employer makes on account of additional expenses incurred by a homeworker, but there is no relief where the employee incurs them without reimbursement.

Childcare workforce (3.35)

29. Paragraph 3.35 refers to concerns over qualifications and continuous professional development of the childcare workforce. Tax relief for training remains an area which is in need of urgent review. There are particular problems where an individual pays for his or her own training while unemployed, in order to help himself back into the workforce. There is no tax relief for such costs against income when the individual starts to get work. This is a disincentive to those showing such initiative, and the lack of tax relief often comes a surprise when they later find employment or seek to use their new skills in a new self employment.

Employers (4.9 and 4.10)

30. We welcome the Government's review of the statutory payment mechanisms, including considering the case for transferring payment of SMP, SAP, SPP and MA from employers to HMRC. We believe that this will be widely welcomed by business, as these payments are a major burden on employers.
31. We also support the suggestion that entitlement to the working tax credit could be extended to parents who work less than 16 hours a week.
32. However, having said that, we can see that introducing such a change may introduce additional complexities into the tax credits regime. At present entitlement to Working Tax Credit, and thus to the childcare element of WTC, depends on working at least 16 hours. Is the government proposing that the hours requirement would be relaxed for the childcare element but not for any other element of WTC? This would require a fundamental change to the WTC rules.
33. We would welcome the opportunity to be involved in any discussion on this proposal.

Informal care (5.14)

34. We agree that it is not the role of Government to pay for care which is freely given within families. However, we disagree with the premise that Government support should also be denied where payments are made on a commercial basis to family members. We are surprised that the paper suggests that it would be intrusive to make appropriate checks for such payments and that this is a reason to deny relief. There are many instances where similar checks are made into a household's financial affairs beyond those normally required for tax purposes. For example, many small businesses employ relatives and normal PAYE procedures apply.

Local authority VAT exemption (5.36)

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35. We recommend that in addition to reviewing the extent of the current VAT recovery rate applicable to local authorities, further consideration should also be given to other bodies which provide VAT exempt education and which are also hampered by the cost of irrecoverable VAT.

Help with short periods out of work (7.16)

36. Continuity of childcare is extremely important for children's well being. Furthermore, the administrative burden of stopping tax credits where a person is out of work for a relatively short time should not be underestimated. We welcome the consideration which is to be given to extending the continuation of childcare payments while a parent is out of work beyond the current period of seven days.

Employer supported childcare (7.20)

37. Our original representations submitted in May 2003 in response to the consultation on employer supported childcare made a number of important points which have still not been addressed. For convenience we have repeated the most crucial of these in Annex 2 below.

AM

24.2.05

EXTRACT FROM TAXREP 15/03

The self employed

1. We are particularly concerned that these proposals have not been broadened to consider the issue of the self employed. We can see no logic as to why some form of tax advantaged childcare assistance should not be equally available to an employee as to a self employed individual. This may be an area the Revenue is intending to look at separately but we believe this is a good opportunity to consider tax reliefs for the employed and self employed in tandem.
2. There has been a great drive by the Government towards encouraging incorporation (e.g. a nil rate of corporation tax on the first £10,000 of profit) and potentially these proposals are a further force driving the self-employed to form themselves into limited companies in order to obtain the benefit of this proposed relief. Considering the situation of the self employed as part of a broader consultation would send a positive message that incorporation should only be for sound commercial business reasons rather than for tax advantages.

School fees

3. Child care provision is a long-term issue for all parents. We would welcome consideration of the many varieties of childcare required, eg after-school, term time, holidays etc in any proposals. There are also situations where the availability of types of childcare can be problematic. For example, in the Consultation Document we have some difficulties with the distinction between school fees and childcare for pre-school children. Whilst the suggested exemption is not intended to cover private education, it might be that pre-school fees would still apply in areas where Early Years funding is not available. A clear definition of school fees would help.

Quality of childcare

4. One of the stated policy objectives of these proposals is to increase the availability of good quality childcare places. Whilst these proposals may increase the amount of childcare which is needed, this will not be a guarantee of improved quality. Furthermore, we are concerned that imposing bureaucracy will also not necessarily improve the quality of childcare. Targeting the exemptions on registered and approved childcare will bring with it associated paperwork for a sector of the economy which is traditionally less able to cope with it. A considerable amount of support will be needed. For example, what of a new child minder who has recently registered but who has yet to receive their documentation? The weekly childcare costs would need to be paid, but the employer could not operate the PAYE exemption.'
5. A further extract relates to our concerns over the practicality of the new childcare voucher scheme:

‘The consultation document also does not mention part-time employees or those with irregular working patterns. There are many employees who only work during

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school term time. Many parents will work different hours during the school holidays. These same parents will also incur different childcare costs during school holidays. Those with school age children may only incur costs during the holidays. The new arrangements need to be flexible to deal with such requirements. We have recently identified significant problems with the new system of Tax Credits, which initially failed to take account of such changing circumstances.'

6. We continue:

'We believe that employers will support childcare provision when it is in their interests to do so. It is also, however, important that the rules should be clear and unambiguous. We are concerned that the fact that the impact of employer support for formal childcare provision, on a person's entitlement to the childcare element of the Working Tax Credit, will not easily be understood. In our opinion it does not make much sense to allow a tax-free benefit (a positive impact on family income) on the one hand, whilst reducing a tax credit (a negative impact on family income) on the other. The practical interaction of these needs careful thought, particularly where penalties for failing to report a change in childcare costs are in point.

7. It will be important to allow time for these incentives to bed down before any changes are considered.'

THE 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 http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160.