TAXREP 25/11

FINANCE BILL 2011

CLAUSE 35 AND SCHEDULE 8: REDUCTION IN CHILDCARE RELIEF FOR HIGHER EARNERS

Parliamentary briefing submitted at Public Bill Committee stage in May 2011 by ICAEW Tax Faculty setting out concerns with these provisions

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Proposal to give relief at basic rate only should be dropped owing to misalignment with Government objectives and complexity for employers

1. Schedule 8 intends that the exemption from income tax for employer-supported childcare (ESC) will be restricted to the basic rate in the hands of employees who join a scheme on or after 6 April 2011. In order to operate the restricted relief, employers will be required to estimate at the start of the tax year the marginal tax rates applicable to their affected employees' earnings from that employment and then apply tax via the payroll in such a way that each employee receives relief only at basic rate tax for a given value of ESC.

2. The PAYE system does not enable relief to be given only at basic rate. This was demonstrated some years ago when married couple's allowance was allowed only at basic rate. That measure had to be withdrawn within a short time.

3. The concepts of giving relief at basic rate only and employers estimating the tax rate for a single benefit-in-kind (BIK) (but not others) in advance and then taxing it in isolation at a different rate from other income and BIK do not meet our Ten Tenets for a Better Tax System (Appendix 2) – particularly in terms of simplicity and ease of collection – and should be dropped. If however this provision is passed, then we should not like to see this approach applied more widely to other BIK.

4. We are concerned about these provisions:
   - they conflict with the Government's professed claims that it favours tax simplification,
   - the way in which the regime is intended to operate will not actually meet the Government's objective of equalising income tax relief on ESC across all those who first receive ESC after 5 April 2011,
   - we question the practicality for employers of making this proposal work in the real world and the impacts on employer/employee relations, and
   - we should welcome clarification about HMRC's approach to penalties if they perceive that employers have got it wrong.

5. We commented on 22 March 2010 (TAXREP 20/10) on HMRC's Technical Note dated 19 February 2010 in which the intended modus operandi was first publicised. At that time we recommended that, rather than having to make estimates, employers should simply return the excess benefit on forms P11D so that the benefit-in-kind on childcare chargeable to higher and additional rates of tax is processed by HMRC in exactly the same way as any other benefit-in-kind. We also put forward an alternative, simpler policy method of targeting the desired recipients. Having commented in February 2011 (TAXREPs 5/11 & 12/11) on the draft legislation published on 9 December 2010, we still consider that returning the BIK on form P11D would be the least burdensome approach for employers. It would also be the only practical way of achieving the desired policy objective of limiting the tax-free amount to basic rate for those subject to higher and additional rate tax on their total income.

6. Employers will have to make an estimate which will be burdensome and open to error, manipulation and abuse.

7. In addition, the number of different types of income and deductions that have to be included and excluded (see new clause 270B(1), (3) & (4)) will involve the payroll department in having to undertake a number of time-consuming and burdensome calculations. The extent to which bonuses, which may not have been fixed, should be taken into account is not clear, nor even confidential future business plans that are being considered for execution in the forthcoming

tax year, for example, to close a division, and which will impact on the affected employees' taxable pay. We should welcome confirmation that in cases such as this the previous year's income can be taken as a reasonable estimate.

8. There are a lot of different elements to the 'relevant earnings amount', ie the amount of earnings less allowances and reliefs which make up the total earnings from the employment calculated for the purposes of this new regime (see new section 270B(1), (3) & (4) in para 3). As noted above, it will be complicated for employers, and employees in particular, who are unlikely to get to grips with the complicated rules and may therefore dispute the 'appropriate amount', ie the relief (see new subsection (6ZA) in para 2(5)) that their employer allocates to them.

9. If the estimate process is to be retained, with all the inherent risks of a breakdown in employer/employee relations, then we recommend that the personal allowance applied should be the full personal allowance for the year so that employers do not have to ask their employees for the information.

10. We should also welcome clarification, preferably by way of a ministerial statement, of the steps that employers will have to take to satisfy HMRC and employees (eg who object to the estimated rate of tax arrived at by the employer) that they have done all that is necessary – ie taken reasonable care – to comply with the law in making the estimate, and whether penalties for an incorrect end of year return P35 will arise owing to an estimate that is found to be wrong.

11. We are also concerned that whilst the stated intention of the government is to limit the tax free element to basic rate for all employees, this will not turn out to be the case in practice for employees whose other income takes them into a marginal rate of tax which is higher than that applied to the earnings of the employment in which the ESC is provided. Restricting the calculation of marginal tax rates to the employment in which the ESC is provided will give an answer which is at variance with the policy objective of giving less relief to those whose marginal tax rates overall are above basic rate.

12. We would also note that there is a national insurance contributions impact. Basic rate taxpayers get 12% NIC relief. Higher rate and additional rate taxpayers get only 2%. There is now going to be a huge disparity between the relief actually enjoyed by basic rate taxpayers and others: BR taxpayers get 50% more relief than HR/AR. Reliefs have not been equalised – HR taxpayers and their employers are to be taxed much more heavily.

ICAEW recommendations

13. The clause should be deleted and an alternative, simpler method should be devised for targeting relief for childcare to the desired recipients.

14. Failing that, the requirement for employers to make estimates of employees' marginal tax rates at the start of the tax year should be dropped and replaced by a duty on employers to make entries on forms P11D for all those to whom ESC is provided for the first time after 5 April 2011, which HMRC can then process.

15. Failing the above, ie if the requirement for employers to make estimates is retained, we should welcome Ministerial confirmation as to what employers have to do to ensure that they will not be subject to HMRC penalties for having got the estimates wrong.

Further contact

16. For any further enquiries please contact:

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APPENDIX 1

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

2. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

3. 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.

4. We have set out in Appendix 3 the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

APPENDIX 2

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.com/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx).