Tax-free childcare: delay provides opportunity for improved guidance

Personal tax

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Delay provides opportunity for improved guidance

Tax-free childcare (TFC) was due to be implemented in October 2015 but the government announced on 1 July that implementation will be delayed until early 2017.

The government attributed the delay to a legal challenge which focused on the decision to appoint National Savings and Investments (NS&I) as the childcare account provider. Since NS&I uses Atos – a private company – to run its operations, it was argued that the government should have put out the running of the childcare accounts to open tender. The Supreme Court ruled on 1 July that the government's decision was not unlawful, and set aside an interim order which prevented implementation of the scheme.

TFC – the basic rules

TFC is a new system of support for working families who are saving to meet childcare costs for a child under 12 (or under 17 if disabled). Note that a child may cease to qualify several months before their 12th (or 17th) birthday based on the precise rules. HMRC will top up payments made into a childcare account to be used to meet the cost of 'qualifying childcare'.

Users of the scheme do not need to be the child's parents in order to qualify – eligibility depends on being responsible for the child. Those eligible will pay money into a childcare account run by NS&I on behalf of HMRC and will receive a top-up payment from the government. The payment will be £20 for every £80 paid in, subject to an annual limit of £2,000 a child (equal to tax relief at 20% on costs of £10,000) or £4,000 for a disabled child.

Complexity

The basic design of TFC is straightforward but there is much complexity in the interaction between TFC and other means of childcare support. People receiving TFC will not be able to continue receiving tax credits or universal credit. TFC will also replace the existing tax and NIC reliefs for employer-supported childcare (ESC).

Throughout the development of TFC, LITRG has highlighted concerns about these interactions and the need for detailed guidance and information so that people can make the right choice based on their circumstances and again as their circumstances change. HMRC published draft guidance for consultation in October 2014. In response, LITRG again raised concerns about the interaction between TFC and the childcare support provided through ESC, tax credits and universal credit.

Many people will need to decide whether to join the TFC scheme or stay with their existing childcare support. This can be a complex decision, not only in determining the best financial choice but also in understanding the different eligibility rules. Here are some of the factors to be considered:

- Different age limits apply to ESC, tax credits, universal credit and TFC.
- Unlike ESC, TFC will be available to self-employed parents (depending on their estimated income).
- TFC is awarded based on payments into a childcare account over a three-month period (and not on the childcare costs paid out in that same period). Tax credits are an annual award with childcare costs averaged over varying periods and UC is a monthly benefit with different childcare calculating rules.
- Tax credits are being phased out, and many claimants will be transferred to universal credit which also includes support for childcare costs but has different rules. Some potential TFC claimants will need to compare tax credits and TFC; others will need to compare universal credit and TFC. There is still uncertainty about the rollout of UC.
- The cuts and other changes to tax credits announced in the July Budget will affect any ‘better-off’ calculation.
- TFC is not available if the claimant (or their partner) does not work, except in some circumstances.

Current and likely future changes of circumstances, such as a new baby, a child exceeding an age limit, or a claimant becoming a member of a couple or separating, will need to be considered.

These issues will present a challenge for tax agents. How will unrepresented taxpayers and claimants fare? Detailed guidance will be essential. That guidance will have to be long and complex if it is to deal with the wide range of personal and financial circumstances.

Free childcare

The increased free childcare provision introduced by the Childcare Bill and set to start in September 2017 is a key factor in any ‘better-off’ calculation because some parents who might have expected to take up TFC will no longer need to do so. Others may still need TFC but to a lesser extent than anticipated.

In summary, the Childcare Bill would provide for an increase from 15 to 30 hours a week for 38 weeks of the year in the entitlement to free childcare available to ‘eligible working parents’ of three- and four-year-old children in England. Separate rules apply to free early years’ provision in Scotland, Northern Ireland and Wales.

The government has made a commitment to make good a reported underfunding of free provision, which has resulted in fee-paying parents subsidising themselves or other parents.

The Bill was amended at committee stage in the House of Lords to withdraw a regulation-making power that would have allowed the establishment of a body corporate to carry out functions set out in regulations. The report stage is expected in October. The Bill itself is short and peers have complained that nearly all the key provisions have been left to regulations.

However, the second reading on 16 June and the committee stage debates on 1 and 6 July provided some useful indications of the government’s thinking. Further guidance was provided in a Department for Education policy statement made available to peers on 25 June and in a House of Lords library note published on 10 June.

The conditions for the additional 15 hours will be set out in regulations. The stated intention is that both parents or the single parent, as the case may be, must be working the equivalent of eight hours a week at national minimum wage.

Consultation with parents, providers and employers about how they access or deliver childcare will inform the development of draft regulations and draft guidance, which will be the subject of a public consultation in 2016.

Employer-supported childcare

The delay in implementing TFC will prompt renewed interest in ESC. The government confirmed on 1 July that ESC will ‘remain open to new entrants until TFC launches’. Parents who wish to remain in ESC once TFC has begun will be able to do so while their current employer continues to offer the voucher scheme. Workplace nurseries will be unaffected by the introduction of TFC.

In a TFC impact assessment updated in November 2014, HMRC suggested that ESC was ‘neither effective nor fair’ as many working families were unable to access it. HMRC expected about 1.25 million families to have childcare costs that would qualify for TFC. About one million families would be better off as a result – most of those ‘would not qualify for any support were [TFC] not introduced’.

Guidance

LITRG has urged the government to take the opportunity presented by the delay to consider the impact of TFC as drafted and to examine the interactions. We will continue to take part in HMRC’s implementation advisory forum on the delivery of TFC.

There is an opportunity to re-examine the legislation to try to smooth some of the interactions and to make sure that detailed guidance and supporting tools are in place so that individuals can make informed decisions.