J H GREENWOOD & COMPANY

CHARTERED ACCOUNTANTS

Employer Supported Childcare

FACTSHEET

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Employer Supported Childcare (ESC), commonly by way of childcare voucher, is for many employers and employees a tax and national insurance efficient perk. We consider the implications of this type of benefit on the employer and employee.

ESC, which allows a limited tax and NIC exemption for employer-contracted childcare and employer-provided childcare vouchers, has been very popular with both employers and employees alike. However ESC closed to new members from 4 October 2018. The government introduced Tax-Free Childcare which is available to employees and the self employed.

Salary sacrifice

Many employers use ESC as part of salary sacrifice arrangements; for example, the employee gives up pay, which is taxable and NIC-able, in return for childcare vouchers, which are not. This may save tax and NIC for the employee and NIC for the employer. Such arrangements have proved to be attractive for many but for those on low rates of pay, such arrangements may not be appropriate.

How much childcare can be provided tax and NIC free?

The limit on the amount of exempt income associated with childcare vouchers and employer-contracted childcare for employees is determined by reviewing the estimated earnings and taxable benefits of the employee. Where the level of estimated earnings and taxable benefits:

- is equal to or below the equivalent of the sum of personal allowances and the basic rate limit for the year, the employee will be entitled to relief on £55 exempt income for each qualifying week
- exceeds the equivalent of the sum of personal allowances and the basic rate limit for the year as above, but falls below the limit at which tax becomes payable at the 45% rate limit for the year, the employee is entitled to relief on £28 exempt income for each qualifying week.
- exceeds the equivalent of the additional tax rate limit for the year, the employee is entitled to relief on £25 exempt income for each qualifying week.

For those who joined the employer's scheme prior to 6 April 2011 the weekly limit is £55 a week regardless of earnings and benefits.

Similar rules apply for NIC purposes.

Further details

The employer has to estimate the employee's tax position each year as the amount of exempt income they can receive may change throughout their period of employment.

If the ESC exceeds the amount of exempt income per week the excess will be a benefit in kind and subject to Class 1A NICs. However, with vouchers, although any excess is also a benefit in kind it is subject to Class 1 NICs via the payroll. As the tax and NIC issues are complex many employers limit their employees' entitlement to a maximum of the exempt limit.

The exempt limit applies to the full face value, rather than the cost, of providing a childcare voucher, which would normally include an administration fee.

An employee is only entitled to one exempt amount even if care is provided for more than one child but it does not matter that another person may also be entitled to an exempt amount in respect of the same child.

Determining basic earnings

To identify the rate of tax an individual employee pays in any one tax year, an employer needs to carry out a 'basic earnings assessment' for any employees. Employers who offer or provide employer childcare are required, at the beginning of the relevant tax year, to estimate the 'employment income amount' that the employee is likely to receive during that year.

This is basically the contractual salary and benefits package (not discretionary bonuses or overtime) less the personal allowance if appropriate.

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Employers must keep a record of the basic earnings assessment. These records do not need to be sent to HMRC but must be available for inspection by HMRC if required.

The employer must re-estimate the 'employment income amount' for each tax year.

Closure of ESC to new entrants

HMRC has confirmed that employees must have joined an ESC scheme and had the necessary changes made to their salary on or before 4 October 2018. Applying to the scheme before the deadline is not sufficient as an applicant needs to have had the necessary changes made to their salary by the deadline in order to benefit from the income tax and NICs exemption.

Employers who continue to offer ESC to new entrants after 4 October need to deduct income tax and NICs on any vouchers given and pay employer NICs after this date.

Gaps in payment

An employee can ask to stop receiving childcare vouchers temporarily whilst staying in the employer's scheme; for example, if an employee only works during school term time and doesn't need the vouchers during the school holidays. Basically, as long as the gap in providing the vouchers doesn't exceed 12 months the employee can still be classed as an existing member of the employer's scheme.

This also applies to employees who are on maternity leave, sick leave and those who wish to take a career break, provided that the total length of absence does not exceed 12 months.

Further information

HMRC has provided many questions and answers on their website to help both employees and employers and these can be viewed at https://www.gov.uk/government/publications/employer-supported-childcare

Tax-Free Childcare scheme

The government introduced Tax-Free Childcare (TFC), a tax incentive for childcare.

The relief is 20% of the costs of childcare up to total childcare costs of £10,000 per child per year. The scheme will therefore be worth a maximum of £2,000 per child (£4,000 for a disabled child). All children under 12 (up to 17 for children with disabilities) are eligible.

To qualify for Tax-Free Childcare all parents in the household must generally meet a minimum income level, based on working 16 hours a week at National Minimum Wage or Living Wages rates as appropriate and each earn less than £100,000 a year and not already be receiving support through Tax Credits or Universal Credit.

How does this relate to ESC?

ESC closed to new entrants on 4 October 2018. ESC continues to be available for current members if they wish to remain in it or they can switch to the new scheme but parents cannot be in both the ESC scheme and the TFC scheme at the same time.

Employees need to advise their employer in writing (for example, by email) within 90 days if they start receiving TFC, so their employer can stop giving them vouchers and directly contracted childcare with income tax and NICs reliefs. Employees are not able to return to an employer's ESC scheme once they have left.

How we can help

If you would like to discuss childcare in further detail, please do not hesitate to contact us.

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