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EMPLOYER-SUPPORTED CHILDCARE

Text of a letter sent on 22 March 2010 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales to HM Revenue & Customs commenting on the Technical Note published on 19 February 2010

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EMPLOYER-SUPPORTED CHILDCARE

INTRODUCTION

1. In this document we reproduce the main part of the text of a letter sent by the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) commenting on the Technical Note published by HM Revenue & Customs (HMRC) on 19 February 2010 at www.hmrc.gov.uk/employers/employersupportedchildcare.pdf.
2. Information about the Tax Faculty and the ICAEW is given below. We have also set out, in the Appendix, the Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals to change the tax system.

WHO WE ARE

3. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
4. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.
5. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions 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 Institute who pay an additional subscription, and a free weekly newswire.

EMPLOYER-SUPPORTED CHILDCARE

TEXT OF LETTER TO HMRC

[We are] writing following the publication on 19 February of your technical note ('TN') at www.hmrc.gov.uk/employers/employersupportedchildcare.pdf. HMRC have not invited comments on this topic but we have concerns about the practicality of the proposals in the TN as well as the solution that the proposals are attempting to implement. We therefore recommend that an alternative and simpler solution be adopted, as explained below.

The proposals in the TN

The proposals in the TN under which employers will be expected to estimate the marginal tax band applicable to their employees' income as well as make entries in forms P11D will be burdensome, disproportionate and open to manipulation and abuse. It will also not even give the correct answer as 'the level of exempt income' will be based on income at the beginning of the year, not actual income.

We consider that childcare and childcare vouchers ('CCVs') for those who first participate in employer provided schemes after 5 April 2011 should simply be returned by employers on forms P11D, just like any other benefit-in-kind, and that employers should not be obliged to make estimates.

HMRC will then be able to make an adjustment in the employees' code numbers for the following year to collect any underpaid or overpaid tax for the previous year based on the actual income figures from all sources, just like for any other benefit-in-kind.

HMRC will also be in a position to include in the code numbers for the following year an estimated restriction for childcare/CCVs (but at HR tax only) for relevant employees, just like for any other benefit-in-kind. Although the code may be incorrect, employees are free to provide information to HMRC on an ad hoc basis so HMRC can change the code to a more accurate figure.

There will be a time lag between the benefit first being provided and tax being collected on it, but that is no different from what happens at present with newly-provided benefits-in-kind.

Alternative policy method of achieving the same objective

With regard to the policy solution of giving tax relief at basic rate only which is intended to target the relief away from the higher paid, given the practical difficulties of implementing basic rate only reliefs, we do wonder whether exempting this benefit from tax at basic rate only is the right way to proceed. There were always practical problems when the married personal allowance was given only at basic rate.

The TN says that 'around a third of the funding for ESC goes to the 6% of parents who pay tax at a higher rate'. First, how is this figure arrived at, what does 'the funding' mean and how is it split between workplace childcare, employer-contracted childcare and CCVs? Since workplace childcare is wholly tax-exempt and therefore not reported to HMRC at all, how can HMRC possibly know how much tax relief is given to higher rate taxpayers in the relevant workplaces? Similarly, could you please explain how the statistics for other tax-free childcare have been derived? We presume that HMRC knows only about those taxpayers who have something on P11D. It would be very helpful to know whether the statistics validate adequately the proposed policy change.

Secondly, assuming that the statistic is true, the fact that it indicates that there is a substantial proportion of higher rate taxpayers who benefit from this relief is not that surprising and we would question whether even this figure supports the proposed policy change. After all, given that CCVs are taken into account when calculating tax credits and most people who are aware of the

interaction between tax credits and CCVs opt to take the childcare element of tax credits rather than take tax-free CCVs and lose the tax credits, we would suggest that lower paid workers should be under-represented.

We suggest that the way better to target the benefit of ESC away from higher rate taxpayers would be to remove the tax exemption altogether for directly-contracted childcare and CCVs, ignore all ESC for tax credits (so low and middle earners can take ESC of whatever sort and tax credits), and make all ESC exempt from NIC. This should not only benefit materially only those employees who pay standard rate NICs on their marginal earnings and but also encourage employers to continue to provide ESC.

The rules for tax and NICs on ESC were harmonised for simplicity, but since harmonisation and simplification have been abandoned in the last few years (for example, different earnings thresholds for PAYE and NIC, different UEL and UAP, and a third earnings threshold coming soon when the primary and secondary NIC thresholds diverge), there seems no reason why the government should not steer behaviour by giving income tax relief only to basic rate employees, and NIC relief to them and their employers.

The outcome would also align more closely to our Ten Tenets for a Better Tax System (summarised in [the Appendix]) by which we benchmark the tax system...

... We should be happy to meet to explore these proposals in more detail. ...

PCB
22 March 2010

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APPENDIX

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/index.cfm?route=128518>).

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