

The CWU Equal Opportunities Department made enquiries in relation to tax relief relating to childcare. Below is a summary of information, which we hope you will find of use.

Does childcare tax relief work for you?

Since 6 April, the government has allowed parents who sign up for their employers' childcare voucher schemes to obtain both income tax and National Insurance relief on a maximum of £50 a week of their childcare bills. This is worth a maximum of £1,066 a year for a higher rate taxpayer and £858 for basic rate payers. If both parents have access to a scheme through their employer, the benefit is potentially doubled.

Under the previous regime, an employee using childcare vouchers could only obtain NI relief. This was gained by effectively exchanging part of their salary, which would attract NI, for the childcare vouchers, which did not.

But the arrangement was only attractive to employees earning up to £31,720, the upper earnings limit for National Insurance contributions, because they typically paid NI at 11 per cent, and hence made an 11 per cent saving on all their childcare bills if paid by voucher. People on incomes exceeding this level only paid NI at a rate of 1 per cent on the excess and most considered a 1 per cent saving not worth having.

Shawn Healy, tax director at accountancy firm BDO Stoy Hayward LLP, believes most people will be better off under the new arrangements, but expects employees on higher incomes to start taking a keener interest now that income tax relief has been added into the equation. Since 6 April higher-rate taxpayers (those on taxable pay above £32,400) have been able to obtain 40 per cent tax relief and 1 per cent NI relief, while the typical lower rate taxpayer can obtain 22 per cent tax relief and 11 per cent NI relief - limited to a maximum of £50 a week in both cases. Even though the benefit is calculated on a £50 weekly cap, this works out as far better value for higher rate taxpayers.

'Under the old system, a higher rate taxpayer spending about £5,000 a year on childcare would save only £50 a year, hardly worth the hassle of signing up to a voucher scheme,' Healy says. 'Under the new system they would save more than £1,000, so it will be worth it.'

He calculates that employees earning under the upper earnings limit (now at £32,760) and paying NI at the main contracted-in rate will be worse off under the new system if their childcare bills exceed £7,800 a year. This is entirely possible, considering that the average annual cost of childcare for London-based parents is up to £10,244 a year for a nursery and £7,384 a year for a child minder, according to the Daycare Trust charity. The savings for higher rate taxpayers may be enough to spark a mini boom in voucher schemes, according to benefits providers.

However, with just one in 10 employers currently offering access to a scheme, there is a long way to go. Under the changes, employers offering a scheme must make it available to all staff, not just the higher ranks.

Among the potential losers are low earners and people using certain types of childcare. Derek Hayes, business development manager of Family Matters, a voucher scheme operator, says: 'It won't benefit those on or near the minimum wage or the self-employed, and depending on joint income it may affect working tax credit and child tax credit.'

To be eligible for the tax perk, parents can only use childcare providers registered with the regulator, Ofsted, or become 'approved' through the government's childcare approval scheme.

This change will hit those parents who could use vouchers from the previous scheme to pay grandparents or other relatives who care for their children. The new rules expressly exclude relatives, unless they happen to run a registered nursery or are approved childminders who also look after other people's children. Parents who use nannies may also find they end up footing the bill for the 'approval' process, which includes the cost of a first aid course and a £96 a year fee.

However, Family Matters believes even parents on relatively modest salaries stand to gain under the new system. Hayes says: 'Someone on £21,000 paying £125 a week was saving £715 a year under the old scheme. They now save £858 a year.'

Parents may be rightly nervous about sacrificing part of their salary for vouchers as it can involve signing a new contract of employment. Another issue is tying themselves in to a set period, usually a year at a time, for receiving the vouchers in lieu of pay, which may be too inflexible if their circumstances change.

You also need to consider whether by taking a cut in salary, you risk seeing the value of certain benefits - such as statutory maternity pay and sick pay or pension entitlement - affected. In most cases employers will calculate an employee's benefits based on 'notional' salary, which includes the value of the vouchers in the salary total.

But employees should always check before signing up, because some schemes, particularly in the public sector, do not calculate benefits on 'notional' pay.

www.inlandrevenue.gov.uk

Family Matters: www.familymatters.co.uk

www.daycaretrust.org.uk

URL

<http://www.tiscali.co.uk/money/guardian/features/2005/04/17/doeschildcaretaxreliefworkforyou.html>