Treasury Committee – Childcare policy and its influence on the economy inquiry
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 We welcome this opportunity to provide evidence to the Treasury Committee inquiry into childcare policy.

1.2 Finding reliable, high quality, affordable childcare is a major concern for working families. The high costs and availability of childcare are two of the biggest challenges that parents face. The high costs of childcare can be prohibitive to parents looking to enter the workplace or increase their hours.

1.3 Whilst we are wholly supportive of the childcare help provided by Government through the Tax-Free Childcare (TFC) scheme, when set alongside existing childcare offerings, including the extended 30 hour free childcare in England, the childcare landscape that results is incredibly complex.

1.4 As a result, it is crucial that people are given complete guidance that not only explains the rules of each childcare scheme but also provides information that enables them to choose between the schemes and understand how they interact. We do not think that there is enough guidance and support at present to help people do this which means that people are at risk of making decisions that could be financially detrimental and in some cases irreversible.

1.5 There are many organisations who are better placed than us to comment on some of the specific questions the Committee are interested in around childcare availability and affordability. We have therefore limited our response to the issues relating to interactions between the various schemes, the need for guidance and support and consideration of some of the issues faced by the TFC scheme as it has rolled out.

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2 About Us

2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

2.4 We have a long history of involvement with HMRC on the interactions between childcare vouchers and tax credits and since the idea of TFC was first mooted we have provided many written responses and briefings on the potential issues and complexities that may arise. As noted in the executive summary, our evidence to this inquiry is limited to those areas where we have most experience and knowledge.

3 Main response

3.1 *Interactions between childcare schemes*

3.1.1 Since the introduction of TFC and the extended 30-hour free childcare support (in England) the childcare landscape has become far more complex. In addition to these two new offerings, some form of childcare support can also be found via Employer Supported Childcare[1] (such as childcare vouchers), the childcare element of Working Tax Credit (WTC) and the childcare element of universal credit. In addition, there are many other forms of childcare support available in specific circumstances such as for students. For some people, it is virtually impossible to know which childcare support to choose without advice.

[1] Employer Supported Childcare includes childcare vouchers, directly-contracted childcare and workplace nurseries. TFC is only replacing childcare vouchers and directly-contracted childcare.

3.1.2 This complexity results from three factors – the differing qualifying conditions for each scheme, the potential financial support offered by each scheme and the interactions between the schemes.

Qualifying conditions

3.1.3 Each scheme has a different set of qualifying conditions, with some subtle but important differences between them. There are many examples of the different conditions between the various schemes and we mention only a few here to illustrate the complexity it creates for people trying to navigate the system:

- The TFC scheme supports children until the last day of the week in which the 1 September falls following their 11th Birthday (or 16th Birthday if the child is disabled) whereas childcare vouchers (ESC) support children until the last day of the week in which falls the 1st September following the child's 15th Birthday (or 16th Birthday if the child is disabled).
- TFC offers support of up to £2,000 per year per child whereas the £55 a week of childcare vouchers are available per parent/carer no matter the number of children.
- Government top-ups received through the TFC scheme can only be spent on qualifying childcare which means that it must be registered or approved childcare and '*the main reason, or one of the main reasons, for incurring the costs of the childcare is (i) to enable the person to work, or (ii) where the person has a partner, to enable both the person and the person's partner to work'* whereas support through the childcare element of WTC can be used to pay for any registered or approved childcare with no requirement that the childcare is directly linked to the claimant's work.
- Under the TFC scheme there is a requirement that the claimant (and their partner if they have one) are in 'paid work'. There is an exception where the claimant is on ordinary or additional maternity leave and they are treated as meeting the paid work requirement for up to 52 weeks. For the childcare element of WTC a similar rule exists that the claimant must be in 'qualifying remunerative work'. Again, this can be met during a period of maternity leave but only for 39 weeks rather than 52 weeks.
- Under the TFC scheme 'self-employed' means '*engaged in carrying on a trade, profession or vocation on a commercial basis and with a view to profit, either on one's own account or as a member of a business partnership'.* For universal credit there is no commerciality requirement so the definition is slightly different.

Potential financial support available from each scheme

3.1.4 Once the relevant qualifying conditions have been met, the next step is to understand how much financial support can be obtained from each scheme to enable a 'better-off' comparison to be made and for many, the 'better-off' comparison will not just be a one-off snapshot but will need to be considered over a longer period. Once again, this section illustrates some of the complexities claimants face, but this is not an exhaustive list.

3.1.5 On the surface, the TFC scheme appears to be fairly straightforward in terms of calculating the amount of help a claimant will receive. According to the childcare choices website '*For every £8 you pay in, the government will add an extra £2, up to £2,000 per child per year – that's up to £500 every three months*'[1]. Although this sounds straightforward, it can be complex where someone has variable childcare costs.

3.1.6 The first point to note is that the top-up is given at the point that the parent pays money into their childcare account – not at the point at which childcare is paid for. The other point to note is that although up to £2,000 per child per year is available, this is capped at £500 every 3 months[2]. For someone with variable childcare costs, complex calculations are needed to find the most advantageous timing of making payments into the account. For example, if a parent knows their costs will be very high in the summer holidays and low at other times in the year, they may need to spread the payments into their account across the year to attract the full amount of the top-up.

3.1.7 Support through the tax credits scheme is via the childcare element of WTC. However, this is not a stand-alone element and in order to work out what childcare support you will receive you need to be able to calculate a whole tax credits award. Rather confusingly, due to how elements in an award are tapered as income rises, it is possible for someone to claim help with their childcare costs and receive £0 working tax credit childcare element but see an increase in their child tax credit instead.

3.1.8 Other factors also complicate working out the financial gains of each scheme. For example, in tax credits there is a disregard for rises and falls in income. In Appendix 1 we have included an example from our website which shows a lone parent who is offered childcare vouchers from her employer. The example shows how complex it is to work out whether she should accept the childcare vouchers or continue to claim support through the childcare element of WTC. The result being that in the longer term she would be better off by a small amount taking the vouchers but that in the short term she would be significantly worse off due to the disregard for income falls that exists in tax credits. This highlights that working out the financial implications can require more than one calculation and an understanding of both the short term and long term position.

3.1.9 The most complicated part of these financial calculations is the potential impact of changes of circumstances. Very few people who we come into contact with have static lives. There are regular changes of working hours, income and childcare costs that can affect which scheme is financially the most beneficial and secure for them. It may also be the case that even if one scheme gives more financial support in the short term, it may be better to accept a lower level of support for longer term gains if circumstances are going to change.

[1] https://www.childcarechoices.gov.uk/

[2] This is increased to £4,000 per year for each disabled child, capped at £1,000 every 3 months.

3.1.10 Of course, most people cannot predict when or how their circumstances are going to change and that means they must constantly review which childcare support is the best option for them as their circumstances change.

Interactions between schemes

3.1.11 As if the situation described were not complicated enough, further complexity is created by the interactions between the different schemes. We have explained in the preceding paragraphs that parents/carers must carry out financial better-off calculations in order to ascertain which scheme gives the greatest financial support. However, following that, how the schemes fit together must be considered.

3.1.12 Currently there are a number of different possible outcomes in terms of interactions:

- In some cases it is perfectly possible to claim help from more than one scheme at the same time. For example, you can claim support through TFC and 30 hours of free childcare at the same time.
- In some cases claiming from one scheme stops you from being able to claim support from another. For example, it is not possible to claim TFC and tax credits together.
- In other cases the answer sits someone in the middle – you can claim support from more than one scheme but the amount of support may be affected. For example, you can technically claim the childcare element of WTC and childcare vouchers from your employer at the same time however you must deduct the value of the childcare vouchers from the childcare amount claimed in tax credits.

3.1.13 The majority of people who pay childcare costs are unlikely to understand this range of interactions and yet the consequences of failing to understand can be very serious. For example, take the interaction between TFC and tax credits. Most people might see the logic in a rule that prevents you from claiming help with the same childcare costs from two schemes, and so it would seem logical that you cannot claim TFC for the same childcare costs that you are claiming the childcare element of WTC for. However, the TFC goes one step further and says that if an existing tax credit claimant, whether claiming the childcare element of WTC or not, makes a claim for TFC their whole tax credit award (both working tax credit and child tax credit) is automatically terminated. Similar rules exist between TFC and universal credit, although according to the GOV.UK website, the claimant is responsible for cancelling any universal credit claim. It is not clear whether there are punitive consequences if the claimant fails to do that.

3.1.14 A further layer of complexity is added because once the tax credit award is terminated, if the claimant lives in a full service universal credit area then technically[1] they may not able to return to tax credits if they realise they have made a mistake. Instead they would need to

[1] Our understanding is that HMRC may be willing to reinstate the old tax credit claim where this has happened but this is not publicised as far as we can find and relies on the person contacting the childcare helpline and the correct process being followed.

claim universal credit which could mean they receive less overall help than through their previous tax credit award.

3.2 ***The need for adequate guidance and support***

3.2.1 Section 3.1 above outlines the complexities created by the different childcare schemes and demonstrates a clear need for anyone who pays for childcare to have access to adequate guidance and support in order to:

- Understand the qualifying conditions of each scheme and the differences between them
- Calculate how much support they will receive from each scheme (if they meet the relevant conditions) and whether that will differ in the longer term.
- Understand how changes in their circumstances will impact on the support they receive and whether they need to consider a different childcare scheme
- Understand how the schemes interact and the potential consequences of making a claim for a scheme in terms of their existing benefits

3.2.2 At the present time we do not think that parents/carers are adequately supported through guidance and advice to understand the issues listed in paragraph 3.2.1. The main problem is that there is no single source of advice or guidance that covers all of the schemes. The tax credits helpline cannot answer questions about childcare vouchers or help parents carry out better-off calculations and similarly the TFC childcare helpline cannot answer questions about tax credits or universal credit.

3.2.3 We understand that HMRC are working on further guidance in relation to the TFC scheme, but at present across all of the schemes the guidance is limited and inadequate.

3.2.4 In paragraph 3.1.3 we outlined some of the differences in qualifying conditions between the schemes. However, much of this information is not available to claimants online. For example, one of the rules for TFC is that you can only use the government top-up payments to pay for qualifying childcare – this means that the main reason, or one of the main reasons, for incurring the costs must be to enable the person to work. However, we cannot find that important rule mentioned on GOV.UK or the childcare choices website – the former saying merely that 'you can use it to pay for approved childcare'.

3.2.5 As well as the absence of much guidance, some of the guidance on GOV.UK has been simplified to such an extent that it can be misleading. One feature of the TFC scheme is that claimants must be in paid work to access support. Broadly speaking this means that they must expect their income over the specified period (3 months) to be above the relevant threshold. For most people that will be £1,560 for the entitlement period.[1]

[1] The National Living Wage £7.50, at 16 hours per week, for 13 weeks (3 months).

3.2.6 GOV.UK currently states you must be 'each earning at least the National Minimum Wage or Living Wage for 16 hours a week – this is £120 if you're over 25'. This suggests that the threshold is weekly rather than set over a longer entitlement period and refers to being 'over 25' rather than correctly '25 and over'. Similar misleading information is found on the TFC – 10 things parents should know guidance[1]. It also fails to mention that the test is based on an expectation of your earnings. It offers no guidance to those who have fluctuating incomes on how to work out their expected earnings nor is there any information on what happens if your 'expectation' turns out to be wrong and you do not earn above the threshold.

3.2.7 There is a childcare calculator that has been launched on GOV.UK that allows people to find out how much they can get towards childcare[2]. However, we are concerned about the accuracy of the calculator for the following reasons:

- It includes free 15/30 hour childcare, tax credits and TFC but does not include universal credit. Given that in many areas you can no longer claim tax credits this is a significant oversight.
- When asking about childcare costs it simply says 'how much do you think you'll spend monthly' with no guidance on what figure to use if you have variable costs. Tax credits have very specific rules about how to calculate childcare and how to deal with changes in childcare costs that are assessed on an annual basis which is very different to TFC. Changing the figure you put in that box can significantly alter the answer given by the calculator and we are not convinced that those with variable costs should be encouraged to use this calculator, instead they should get tailored advice.
- The calculator incorrectly tells people to only include pension contributions 'if paid through your payroll'.
- It does not cover deductions that are allowable from income – for example employment expenses
- On the results page it says 'your weekly earnings (or profit if you're self-employed) must be 16 times the National Minimum Wage for your age' which is incorrect (As noted above the threshold is based on a 3 month entitlement period).

3.3 ***The roll-out of Tax-Free Childcare***

3.3.1 The Committee have asked for views on why the take-up of the TFC scheme is lower than HMRC had forecast. We think this is likely due to a combination of factors including a lack of advertising by HMRC (and a reliance on childcare providers to encourage applications) mixed with the lack of guidance and available information.

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[1] https://www.gov.uk/government/news/tax-free-childcare-10-things-parents-should-know

[2] https://www.gov.uk/childcare-calculator

3.3.2 For some people, who currently don't receive any childcare support, TFC will obviously be of benefit to them and it should be easy for them to identify this. However, those who use existing childcare support schemes or who begin to pay childcare costs and need to decide what to claim need guidance and advice. Without this, we do not think it is surprising that people might be hesitant to leave an existing scheme to claim TFC.

3.3.3 TFC is digital by default and claims need to be made online. We are aware of the IT problems that have affected the system this year and we trust that HMRC have now resolved those issues and that the platform is stable.

3.3.4 One area that concerns us as the TFC system has been developed is the lack of information available to advice organisations and professional advisers who support TFC claimants (and potential claimants). We would like to see the development of an advisers toolkit that shows the questions that claimants will be asked when claiming, information about the process, screen shots of key messages and what the account looks like. Without any of this information it is incredibly difficult for advisers to support claimants through the application process or indeed deal with any problems.

3.3.5 One particular example of this is when we were writing material for our own website about TFC and wanted to explain how to appeal a TFC decision. That information is not available anywhere online (that we have been able to find) and we were told that claimants will receive a notification through their online account detailing any appeal rights. This seems wholly unsatisfactory – having a digital system does not remove the need for adequate information and guidance for the wider population, especially those who are supporting HMRC's most vulnerable claimants. There is also a wider point that in order for the system to be fair, there needs to be full transparency – people need to be know what the process should be in order to ensure that it is working properly.

3.4 *Future changes*

3.4.1 We think that at present the childcare support landscape is too complex to be properly understood by those who need to access that support. Some of this complexity could be reduced through legislative changes – for example by allowing TFC to be claimed alongside tax credits and universal credit. However, in the absence of any major changes to the current offering, it is crucial that more support is offered to parents/carers in the form of adequate guidance and advice.

3.4.2 The GOV.UK childcare calculator should be expanded to include universal credit and improved so that it is accurate in more straightforward cases. It should be clear at the start of the calculator who should not use it. Online guidance should be supported by a specialist childcare support helpline that covers all of the major childcare schemes with advisers who can help individuals with more complex circumstances by carrying out more tailored individual better-off calculations.

LITRG
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APPENDIX 1[1]

Sally is a lone parent who earns £25,000. Her childcare costs are £200 a week for her two children. Sally's employer has just set up a childcare scheme and offers her childcare vouchers under a salary sacrifice arrangement. This means that Sally will give up some of her salary to get the childcare vouchers and by doing that she will save some tax and NI.

Sally currently claims tax credits including the childcare element of WTC – her award is £10,547 a year (made up of £4442 WTC and £6105 CTC).

If Sally takes the childcare vouchers she will save tax and national insurance on the value of the childcare vouchers, subject to a limit of £55 a week.

Tax saving 20% x £2,916	£583.20
National insurance savings 12% x £2,916	£349.92
Total tax and NI saving	£933.12

By taking childcare vouchers, Sally would see changes to her tax credits:

- The income used to calculate Sally's award would be lower as she has given up some of her salary to buy the vouchers. However due to the £2,500 disregard for falls in income initially Sally's income would only fall by £360 until a later year when it would fall by the full £2,860 that she has sacrificed. This fall in income leads to an increase in tax credits

Fall in income (initial) £416 x 41% =	170.56 increase in annual tax credits
Fall in income (longer term) £2916 x 41% =	£1195.56 increase in annual tax credits

- At the same time, if Sally takes the vouchers, she can no longer claim £200 a week as her childcare costs for tax credit purposes. She must reduce that by the value of the vouchers so she can only claim £145 a week. This leads to a decrease in tax credits of:

Decrease in childcare costs of £2860 x 70%=	£2002 decrease in tax credits

Bring all of this together creates gains on one side and losses on the other. This shows that if Sally took the childcare vouchers she would overall (in the longer term) be slightly better off taking the vouchers but only by around £126 a year. Initially however Sally would be worse off by around £900 by taking the vouchers due to the disregard for falls in income.

GAINS	LOSSES
Tax and NI saving £933.12	Loss of tax credits £2002
Increased tax credits £1195.56	
TOTAL £2128.68	TOTAL: 2002

[1] https://www.litrg.org.uk/sites/default/files/files/Sally%20example.pdf