

Sally is a lone parent who earns £25,000 and lives in England. Her childcare costs are £200 a week for her two children.

Sally's tax credits award, including the childcare element of working tax credit (WTC) would be £10,547 a year (made up of £4,442 WTC and £6,105 child tax credit).

Sally's salary sacrifice option for childcare vouchers under her employer childcare scheme means she could save tax and NIC on the value of the childcare vouchers, subject to a limit of £55 a week (or £243 a month).

(Note. The figures for the tax saving may be slightly different for Scottish rate taxpayers)

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's tax credits would be different:

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 £416 (£2,916-2,500 disregard) until a later year when it would fall by the full £2,916 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) £2,916 x 41% =	£1,195.56 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 (£55 a week) so she can only claim £145 a week. This leads to a decrease in tax credits of:

Decrease in childcare costs of £2,916 x 70%=	£2,041.20 decrease in tax credits
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Bringing all of this together creates gains on one side and losses on the other. This shows that if Sally used the childcare vouchers option, she would (in the longer term), be slightly better off but only by around £87 a year. Initially however Sally would be worse off by around £937 by taking the vouchers due to the disregard for falls in income.

GAINS	LOSSES
Tax and National Insurance saving £933.12	Loss of tax credits £2,041.20
Increased tax credits £1,195.56	
TOTAL £2,128.68	TOTAL: £2,041.20

However, it is important to bear in mind that, not only was the tax and NIC relief associated with childcare vouchers and directly-contracted childcare withdrawn for new joiners from 4 October 2018, but also that universal credit is gradually replacing tax credits and most people can no longer make a brand new claim for tax credits. Existing tax credit claimants will eventually be moved over to UC under a managed exercise which is expected to run between November 2020 and December 2023, unless they need or choose make a claim for UC beforehand which will end their tax credits.