Low Incomes Tax Reform Group
A voice for the unrepresented

Tax-Free Childcare: consultation on design and operation

HM Treasury and HMRC consultation document

Response from the Low Incomes Tax Reform Group ('LITRG')

1 Executive Summary

1.1 To be successful, both administratively and from a work incentive perspective, any new scheme needs to:

- operate seamlessly with universal credit so that people can easily move from one to another;
- allow people to choose whichever is best for them in financial terms;
- be simple and straightforward for parents to operate;
- ensure that it provides support at the critical times when costs are at their highest (eg during school holidays);
- strike the right balance between responsiveness and simplicity; and
- be easily explained to parents, advisers and relevant organisations.

1.2 More could be done to ensure that Tax-Free Childcare operates seamlessly with universal credit childcare. Key definitions between the two schemes should be consistent – for example, the concept of a household should be identical in both systems to bring certainty to the scheme and reduce administration. We support the rule in universal credit that if you work, you receive childcare to enable you to work; Tax-Free Childcare should follow suit, and not seek to impose a minimum hours rule or a minimum income rule. Besides, neither rule lends itself well to people who move in and out of jobs frequently with gaps in between or who work unpredictable patterns on zero hour contracts.

CHARTERED INSTITUTE OF TAXATION
1st Floor, Artillery House, 11-19 Artillery Row,
London, SW1P 1RT

REGISTERED AS A CHARITY NO 1037771

Tel: +44 (0)20 7340 0550
Fax: +44 (0)20 7340 0559
E-mail: litrg@ciot.org.uk
www.litrg.org.uk

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UK REPRESENTATIVE BODY ON THE CONFEDERATION FISCALE EUROPEENNE

1.3 We welcome the Government's intention to avoid situations where overpayments have to be repaid or where parents are subjected to intrusive compliance checks. We would recommend that parents should be able to use saved-up vouchers for future childcare under the tax-free system. If they continue to receive Tax-Free Childcare after ceasing to be eligible, they should have a choice of setting any excess support they have received for one child against Tax-Free Childcare to which they may be entitled in respect of other eligible children, or against a present or future entitlement to universal credit childcare.

1.4 The tax-free scheme needs to provide for childcare support at the times when parents need it. For example, there is no sense in imposing a limit of £100 a month throughout the year if parents incur most of their childcare costs in the school holidays, and only very modest costs at other times.

1.5 The success of the scheme will depend entirely upon how well the provisions are explained to parents; yet the complexity of the proposals as they stand will result in that challenge being extremely difficult to meet. In particular, any explanatory materials need to take full account of both Tax-Free Childcare and universal credit childcare – and, for as long as it lasts, employer-supported childcare; clearly describe when and in what circumstances parents might be eligible for each; and offer online calculators that will enable parents to decide under which alternative they will be better off. Yet we know from the experience of the tax credits childcare calculator that this will be no easy task.

1.6 It will be essential for such information to be available in paper format as well as online, and for paper claims to be possible, to ensure there is no unlawful discrimination against (in particular) people with a disability that makes it difficult or impossible for them to use computers, people who are computer illiterate due to age, and those who live in areas not well served by broadband.

1.7 We see a role for the voluntary sector in helping parents claim the childcare support that is appropriate for them. As for the role of commercially operated third parties, great care must be taken to ensure that such involvement would not add to costs for parents, and safeguards applied to reduce the scope for mis-selling of the kind we have seen operating in the childcare vouchers industry. HM Revenue & Customs (HMRC) will have a consumer protection role to play here. Any market solution must give parents the widest possible choice consistent with the maximum protection.

1.8 It is unhelpful in the extreme to conflate fraud and error as though they were one and the same, when in fact they are two entirely different concepts which demand separate and distinct remedies. While it is important to detect, prevent and deter fraudulent applications for Tax-Free Childcare, it is equally important to acknowledge genuine mistake whether by claimants or officials, and to safeguard against it by educative rather than compliance-based means.

1.9 The proposal to increase childcare support through universal credit to 85% for lone parents and couples who pay tax is unfair, almost certainly unworkable and will damage work incentives for some of the lowest paid. Instead we think that using the additional funding to increase everyone's childcare help to 80% would be fairer and less complex both for the Department for Work & Pensions (DWP) to administer and for claimants to understand their position.

1.10 Income tax is worked out based on a tax year, and it is not generally known until well after the year end whether a person is liable to pay tax in that year. Universal credit, on the other hand, will operate month by month. Therefore, in any month when childcare costs are paid and 85% relief claimed for universal credit purposes, it will still be uncertain whether the payer's income for the year as a whole will be greater than the income tax personal allowance. The rise of zero-hours contracts, part-time and agency working will make the situation even more unpredictable for many.

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 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.

3 General Comments

3.1 We welcome the opportunity to respond to the consultation on the design and operation of Tax-Free Childcare published by HM Treasury and HMRC.

3.2 We agree that the high costs and availability of childcare are two of the biggest challenges that parents face. We also agree that the costs of childcare can be prohibitive to parents looking to enter the workplace or increase their hours. It is clear that this issue needs to be addressed in order to improve work incentives for parents.

3.3 However, we are concerned that the proposals in the consultation document will lead to complexity and confusion for parents and those advising them and will be expensive for the Government to operate. We expand on these concerns in our answers to the consultation questions.

3.4 To be successful, both administratively and from a work incentive perspective, any new scheme needs to:

- operate seamlessly with universal credit so that people can easily move from one to another;
- allow people to choose whichever is best for them in financial terms;
- be simple and straightforward for parents to operate;
- ensure that it provides support at the critical times when costs are at their highest (eg during school holidays);
- strike the right balance between responsiveness and simplicity; and
- be easily explained to parents, advisers and relevant organisations.

3.5 We do not think the scheme, as outlined in the consultation, meets these aims. Although provision is made for moving between universal credit and Tax-Free Childcare, more could be done. The universal credit 85% support with childcare costs appears both unfair and unworkable and in our view will have a negative impact on work incentives for the lowest paid.

3.6 Overall, we think the proposals are very complex and will be difficult to understand for parents. In particular the interactions between the schemes (Employer Supported Childcare, Tax Free Childcare and Universal Credit/Tax Credits) are so complicated that it will be virtually impossible to write any simple leaflet explaining the options and ensuring people understand which scheme is best for them in financial terms. At the very least a better-off calculator will be needed, but based on our experience with the HMRC childcare indicator (which compares childcare vouchers with tax credits) we are doubtful whether this could be achieved to allow accurate results for anything but the most basic situation.

3.7 It is unclear, when it is proposed that anyone on tax credits or universal credit should not be able to benefit from Tax-Free Childcare, whether that restriction applies only to those who are receiving the childcare element of either tax credits or universal credit, or whether to anyone in receipt of any element of tax credits or universal credit. The first would make sense – clearly support should be given only once, either through tax credits/universal credit childcare element, or through Tax-Free Childcare. However, the language of the consultation document seems to indicate the latter interpretation, which would mean that anyone in receipt of even a small amount of, say, child tax credit would be ineligible for Tax-Free Childcare. That in our view would be illogical and unjustifiable.

4 Specific questions

Q1: What features will the payment system need to have to ensure that it meets the needs of parents and childcare providers?

4.1 Principally, the payment system needs to be prompt. As much information should be gathered and verified at the start of an application as possible to obviate the need for lengthy post-application compliance checks. The childcare provider needs to be paid promptly and the parent needs the money to pay them at the start of their arrangement. Any delay could mean that the child loses his/her place at the nursery, with the result that the parent (particularly if a lone parent) has to give up work to look after the child themselves.

4.2 It is important too that parents who do not have online access are able to purchase vouchers and hold voucher accounts. One way of doing so might be to open voucher accounts with their local bank or building society branch, or the Post Office.

Q2: What are the advantages and disadvantages of applying the £1,200 limit by means of a monthly cap as opposed to other options?

4.3 We see no advantage in prohibiting parents from claiming more than £100 a month in support. The main drawback of applying such a cap would be for those parents who use childcare mainly in the school holidays, who may wish to use the bulk of their annual £1,200 entitlement during the three or four months of the school holidays. Paragraph 1.12 of the document acknowledges that support before and after school and during school holidays is the most costly. Support limited to £100 a month is clearly inadequate to provide for full-time childcare, and could be unfair if it effectively limits those parents who do not use childcare at any other time to a mere £300 or £400 support for the entire year.

4.4 The consultation document identifies the main risk of not having a monthly limit as the possibility of parents paying into their account to get the maximum £1,200 support in one go, knowing they may be ineligible later in the year. Whilst we can see the potential issue, we think that it is a relatively small risk (given that parents have contribute 80% of costs to the Government's 20%) and certainly not one that warrants stopping other parents who need support at specific times of the year from accessing it.

Q3: In what situations should parents be able to spend saved-up vouchers if they become ineligible?

4.5 In short, we propose that parents should be able to use all saved-up vouchers for future childcare under the Tax-Free Childcare system. It would be unfair and harsh to stop parents spending saved-up vouchers that they received at a time they were eligible given that they will have paid their 80% contribution. It would also mean parents would be discouraged from buying vouchers and saving them up if they run the risk of losing them.

Q4: The Government is committed to giving employers the opportunity to remain involved in the provision of support for childcare in any ways that are consistent with the principles and operation of Tax-Free Childcare. How can the Government best ensure this happens?

4.6 We see no reason why employers should not be able to contribute towards an employee's tax-free voucher account if they so wish. They may require a salary sacrifice equal to the extent of their contribution but clearly, in fairness to other users of the scheme, there could be no additional tax relief and no exemption from either employee or employer National Insurance Contributions (NICs) on the amount contributed by the employer to the employee's account. Employers whose principal concern was for the welfare of the employee rather than in saving NICs would still find that option attractive even after the withdrawal of employer-supported childcare.

4.7 It is important that if the Government wants employers to advertise and promote the scheme, they are provided with suitable materials that explain the scheme fully to both employers and employees. If this is not done it could lead to employees receiving incorrect information about

the scheme. In particular, during the period where some employees may be receiving Employer Supported Childcare (tax and NI free) and others receiving contributions from their employer to their Tax-Free Childcare account (which will attract tax and NI) that employees fully understand why they may be paying a higher amount of tax under the new scheme than their counterparts.

Q5: What roles might other organisations play in helping parents access Tax-Free Childcare?

4.8 We agree there could be a useful role for the other organizations mentioned in 2.26 to provide information or advice to parents, help them to open or manage an account or to choose appropriate childcare, particularly in helping them work out which of the various options for which they might be eligible – employer-supported childcare while that lasts, Tax-Free Childcare or universal credit childcare – works best for them. The extent to which voluntary sector groups in particular were able to provide that useful service would depend on the availability of funding for the purpose.

Q6: Does the proposed definition of 'parents' ensure that all individuals who have responsibility for a child can benefit from Tax-Free Childcare?

4.9 Yes, but there may also be a need for rules to determine primary entitlement where more than one person is able to claim responsibility, as in the Child Benefit regulations. We are thinking not just of cases where two separated parents share responsibility for a child and cannot decide which of them should open the voucher account, but cases where – for example – a child goes to live with a relative (typically a grandparent) when the child's natural parent is unable to look after him or her (because of illness, imprisonment, etc). The rules will need to ensure that the grandparent (in this example) is not debarred from accessing support through the scheme. Thought will need to be given to such situations and whether the new carer of the child will have to open a new voucher account for the child (separate from the account the natural parent already has) or whether there will only continue to be one account for that particular child and the person(s) eligible to contribute and receive the financial contribution changes.

4.10 In addition, there are a number of further complexities that will need addressing in the regulations. For example, if separated parents have joint responsibility can one parent claim support through universal credit/tax credits and the other claim Tax Free Childcare? What will the situation be if one parent is working abroad for long periods of time?

Q7: Is the proposed definition of 'household' fair and workable?

4.11 The definition of who forms part of a household for Tax-Free Childcare purposes is very important. However, we feel that the consultation document does not give enough detail about the actual definition to know whether it is fair and workable.

4.12 Para 3.6 of the document refers to members of a couple who 'live together as a household'. It is not clear whether this is intended to be the full definition.

4.13 For ease, we think the definition should mirror the one set out in the universal credit regulations which defines who is a couple. This would bring certainty to those using the scheme and make it easier for the Government administratively. If that is the intention, then we do think it is fair to the extent it mirrors the definition in universal credit.

4.14 However it does sit oddly in a tax system in which liability attaches to the individual rather than the household. It is also a slightly different definition to the one used for tax credits and the High-Income Child Benefit Charge (HICBC) which could cause some unintended consequences. This disparity could make the definition unworkable depending partly on how efficiently information will flow to the voucher provider to determine the tax position of each individual in a couple, and how accurately and fairly the system deals with couples whose status is unclear.

4.15 The latter is by no means a new problem: the same difficulties occur in determining the status of a claimant, or joint claimants, for tax credits purposes. No doubt in time the problem will arise also in the context of the HICBC. New couples may spend weekends together and live apart during the week, say; separating couples may stay under the same roof, though in different households; couples may be living separately but not yet have taken steps to obtain a divorce; or they may be in a trial separation. Particular problems with implementation arise where couples have been truly separated for many years but are still linked in some way by CRA records. This often leads HMRC investigators to believe they are still together, and to end the single claim of the lone parent leaving her penniless unless she is prepared to claim jointly with a former partner with whom she parted, probably on acrimonious terms, many years ago. Needless to say, summary withdrawal of her tax credits has disastrous results for the lone parent trying to work and pay for childcare.

4.16 In summary, the definition is fair if and to the extent that it follows the universal credit definition. But for it to be workable, HMRC will have to be prepared to take a far subtler and less compliance-oriented approach to determining who is and who is not in a relationship.

Q8: What are the potential benefits and risks of a minimum income rule or hours rule in defining qualifying employment?

4.17 Having either a minimum income rule or minimum hours rule in defining qualifying employment risks those on the lowest incomes losing out on this valuable support which will negatively impact work incentives. In general, neither rule lends itself well to people who move in and out of jobs frequently with gaps in between or who work unpredictable patterns on zero hour contracts.

4.18 The potential risks of a minimum hours rule are as follows.

- One of the aspects of universal credit which mark an improvement over tax credits is the fact that it does not adhere to a minimum hours rule – if a claimant works and gets in earned income, they enjoy the benefits of the work allowances and the lower taper, in addition to freedom from conditionality requirements. The same advantages are carried through to the childcare element within universal credit, for which a claimant qualifies if they are in paid work, and take up childcare arrangements to enable them to do that work.

- More and more employees are now on zero-hours contracts. They, and agency workers who depend upon their agency calling them to work day by day, do not have the certainty in their employment arrangements to know whether they will fulfil a minimum hours each week. During any given week, they could work 40 hours, or none at all.

Imposing a minimum hours requirement will therefore exclude such workers from the scope of Tax-Free Childcare, as they will be unable to predict how many hours they will work week by week.

- The same plethora of rules would need to be developed for (eg) seasonal workers, term-time workers, paid lunch breaks, hospital visits, and so forth, as currently applies to working tax credit and adds to the general complexity and potential for both claimant and official confusion that besets that regime.

- Part time working has become more prevalent in recent times, and lone parents in particular benefit from employment arrangements that enable them to fit their working hours around their children's school or nursery times. Introducing a minimum hours requirement will make it more difficult for that group of workers, whom the Government particularly wants to encourage into employment, to find and continue in work.

4.19 The risks of a minimum income rule are similar in that an employee's income generally reflects the hours they work. In addition, a self-employed worker could work hard throughout the week, many more than the 35 hours required of most universal credit claimants, and yet generate only a small amount of income – particularly in start-up periods, on taking on a new employee, at particular times of the year if the nature of the trade is seasonal (eg agricultural), or if the business is experiencing hard times for any other reason.

4.20 Having a minimum income rule would lead to a perverse situation where a person with a high hourly rate could qualify working only a few hours, whereas a person nearer the national minimum wage (NMW) would need to work more hours to get the Government support. It would also be difficult to decide where to set the minimum hours requirement in order to not penalise those who are only able to find part time work.

4.21 Finally, in order to operate a minimum income rule, income would need to be defined with certainty week by week, or month by month. But income in the tax system is defined on a yearly basis. A self-employed person may not know their annual income until many months after the end of the year. Even an employed person might not be able to predict their annual income in advance, particularly if it was dependent upon the size of a bonus, or the duration of the employment was uncertain. In short, there would be formidable practical obstacles to a minimum income rule.

Q9: What alternative ways are there to define qualifying employment, and what are the potential risks and benefits of these approaches?

4.22 Tax-Free Childcare is intended to complement the childcare element in universal credit. It therefore makes sense to use the same criteria for both purposes.

4.23 There is no minimum hours rule in universal credit – if you work, and you enter into childcare arrangements in order to 'take up paid work or continue in work', you can claim universal credit childcare. Abuse is prevented by leaving out of account "any [charges paid for relevant childcare] that the Secretary of State considers excessive having regard to the extent to which the claimant (or, if the claimant is a member of a couple, the other member) is engaged in paid work . . ." (Universal Credit Regulations 2013, reg 34(2)). It would seem sensible to use the same

formulation to ensure that Tax-Free Childcare is used only to support parents when they need to work, and not a different one.

4.24 Any definition of qualifying employment should be flexible enough to ensure that those with less predictable patterns but who want to work and are doing some form of work are able to access consistent support.

Q10: Will the proposed operation of the age cut-off rule ensure that all children who are eligible for Tax-Free Childcare in year one remain eligible until the end of the school year in which they turn 11?

4.25 Yes, provided (as is the stated intention) eligibility continues until the September following the child's birthday, following the model set by tax credits and universal credit. We welcome the retention of eligibility to 17 where a child is disabled.

Q11: How often do stakeholders expect issues around changes to eligibility to arise, and do stakeholders hold information that could help inform the Government's thinking on the scale of this issue?

4.26 When the tax credits system was introduced in 2003, the disregard for income changes from one year to the next was set at £2,500. Eventually this had to be increased to £25,000 because claimants experienced far bigger fluctuations in income that the Government envisaged. It follows that users of the scheme, particularly those on low incomes, may have regular changes of circumstances such as change of household status, change of working hours and change of wages. Depending on the criteria for this new scheme, such changes could see people move in and out of eligibility on a frequent basis. It is therefore essential that the scheme is designed with this in mind and that eligibility criteria are flexible to ensure administration does not become problematic and discourage people from accessing the support.

4.27 We do not hold specific information that could inform the Government's thinking on the scale of the issue but we suggest that consideration is given to the number and types of changes that are reported to Tax Credits Office.

Q12: What are the best ways of ensuring that all parents have the information they need to judge whether they will be eligible for Tax-Free Childcare, and to make the best choice for themselves?

4.28 As a minimum, we recommend:

- Online decision trees and better-off calculators whereby parents can work out whether they are (a) eligible for and (b) better off under Tax-Free Childcare or universal credit, to be held on GOV.UK. This would need to take into account the fact that the eligibility criteria differs between the different schemes as well as explaining the financial consequences.

- These decision trees should also invite parents to declare their status (ie couple or single parent) and number of children and whether they have access to an employer-provided scheme. To enable them to do this the definitions (principally of 'couple' or 'household')

must be consistent as between Tax-Free Childcare and universal credit. Where parents declare themselves as a working couple with one child and with access to an employer-provided scheme, the online facility should warn them that they might be better off on their employer's scheme rather than claiming Tax-Free Childcare (per condoc table 3A and following examples 3B). It should also highlight where it is more beneficial to remain in the childcare voucher scheme rather than take up the new childcare (for example because the ESC scheme covers children until 1st September following their 15th birthday rather than until the age of 12 as proposed for the new scheme).

- Any calculator or guidance would also need to make the criteria around qualifying employment particularly clear so that parents can work out whether any changes they are planning to working hours/income would affect their current participation or whether it would make them eligible for support.
- For those who do not have internet access, there should be clear printed explanations in plain English covering all childcare options available under the tax and welfare systems – employer-provided schemes, Tax-Free Childcare and universal credit childcare. They should cover eligibility for each and the amounts of support available to parents in different circumstances. To ensure that everyone who claims Tax-Free Childcare or universal credit childcare is made fully aware of their rights and responsibilities, the printed leaflet should be distributed to all claimants.

4.29 We are concerned that based on the current proposals in the consultation document, it will be extremely difficult to produce guidance that is simple and easily understandable for parents to make the right choice. Based on our experiences with the HMRC childcare indicator, we are also concerned that a better off calculator would be difficult to implement due to the complexity of proposals and the calculations needed to compare all of the options. Yet it is essential that good guidance and a reliable calculator is produced in order for parents to make the right choices.

Q13: What information should parents provide when registering for Tax-Free Childcare? Would parents be content to pass personal information to a voucher provider, the Government or other third-parties for the scheme?

4.30 Most of the information detailed in para 4.11 could easily be provided by parents by completing (with assistance if necessary) a single-page form, whether online or in paper format.

4.31 If the parent is in receipt of child benefit in respect of the child, the child benefit number should be sufficient to verify the child's identity – production of the birth certificate should only be required if the parent is not in receipt of child benefit (normally because they would be liable for the HICBC if they were) or where child benefit numbers are not easily obtainable. Alternatives to a birth certificate need to be clearly explained (for example where a child from overseas has no birth certificate or one cannot be obtained).

4.32 The parents' identity could be verified by means of a NINO where one is available, or by alternative methods if it is not. Any methods of verification need to be simple to comply with and not cause long delays in the application process.

4.33 The parents' work status could be verified by a PAYE reference if they are employed, as this would allow cross-checking with the RTI system for up-to-date details of employment income. Self-employed work status could be verified by providing a self-assessment UTR, but as it is not compulsory to register for self-assessment until the October following the tax year in which the trade started, a UTR may not always be available and in those circumstances the absence of a UTR should not be used as a reason to deny access to Tax-Free Childcare.

4.34 As stated in para 4.14, cross-checks of other Government data sets will verify whether a parent is claiming tax credits or universal credit childcare – although we do not understand why claiming PIP would exclude a parent from Tax-Free Childcare as it should be perfectly possible for a PIP claimant to undertake at least some paid work. HMRC could also check with the parents' employer where applicable whether they are in a childcare voucher scheme operated by the employer.

4.35 Some parents may already have a childcare provider in mind when applying to join the tax-free scheme, but others may prefer to wait until their eligibility is confirmed before making arrangements with a provider. Having such arrangements already in place should not be a precondition of eligibility.

4.36 We see no reason why parents should have to produce their bank statements to establish their eligibility. That would be an unwarranted invasion of privacy and an unnecessary bureaucratic burden, given that eligibility can be perfectly well established by the other means under discussion.

4.37 We see no reason why parents should not be prepared to pass information to Government or Government-appointed agents in order to gain admission to the Tax-Free Childcare scheme, provided the information is proportionate and necessary for the purpose. It will also be necessary to ensure that any third party bodies involved are regulated. Thus, there should be no objection to disclosing details such as child benefit number, NINO, UTR, PAYE number, marital status etc, but we suspect that few would be prepared to submit to producing bank statements and if such a requirement were introduced it would damage take-up.

Q14: What are the strengths and weaknesses for each of the alternative ways in which the initial registration, and validation, of parents' registration information could be undertaken? What opportunities might third parties bring to assist the Government in validating registration information?

4.38 The scheme is likely to be simpler and cheaper to operate with fewer steps and fewer intermediaries. On that basis we would favour Option A or Option B.

4.39 We do not see a need for third parties to assist the Government in validating registration information, and interposing a third party is likely only to increase costs for the parents. There may however be a role for voluntary sector organisations to facilitate claims, whom parents could approach or not as they wished.

Q15: How quickly should the Government confirm eligibility based on the registration details provided to it? What should happen in cases where a parent is deemed to be ineligible for Tax-Free Childcare? How should the parent be informed?

4.40 Assuming the necessary links are set up before the scheme is launched, there is no reason why the Government should not confirm eligibility without any delay. It is important for the success of the scheme that they do, given that parents on being offered work need to confirm arrangements with a childcare provider promptly and, equally, the provider needs to be paid promptly.

4.41 It is particularly important that a parent who is deemed to be ineligible should be informed well before they need to make arrangements for childcare (unless the reason for their ineligibility is that they are claiming assistance with childcare through tax credits or universal credit). There is no reason in our view why the parents should not be informed within (say) 48 hours of applying, if information flows are working properly.

4.42 How should they be informed? They should be told the result of their application (preferably by phone, followed up with a letter, or by email) and, if rejected, the reasons why – at least sufficient information should be given to enable them to appeal. A clear and fast appeal system will be necessary.

Q16: Would annual checks be sufficient to confirm that self-employed parents continue to meet the (income) eligibility criteria for Tax-Free Childcare?

4.43 Yes provided that information given to claimants about other eligibility criteria is sufficient so that they know when they should report a change of circumstances. In addition, checks can be made with the DWP in respect of self-employed parents who have moved across from universal credit childcare.

Q.17: How quickly should parents be required to inform changes of circumstances that affect their eligibility and how can they be reminded to do this? What does this mean for voucher providers' systems?

4.44 We agree that the current requirement in tax credits should be replicated – parents should be required to notify HMRC within one month of the change occurring, or of their becoming aware of it. The latter is an important qualification, as some changes – such as household formation or breakdown – happen over a period of time rather than all at once. It would be unfair to require parents to report an event that takes time to unfold, and of which they may themselves be unaware until the situation is irretrievable.

4.45 Similar issues may arise with identifying when changes in relation to income or hours occur. Depending on whether minimum income or hours rules are implemented, clear guidance will be needed to ensure parents know what actually constitutes a change so that it can be reported. For example, what if they have a gap between agency work of 10 days – would that count as a change or not?

4.46 As is the current practice in tax credits, parents should be given a clear and concise checklist of events that they must report within one month, and told to keep it and refer to it from time to time. The checklist could be re-issued annually, with the annual re-issue coinciding with the annual eligibility check on the self-employed.

4.47 The extent to which parents comply with reporting requirements depends upon how well they are kept informed of their obligations.

Q18: What processes should be used to recover payments made to ineligible parents?

4.48 We welcome the Government's determination to avoid the situation where overpayments have to be repaid or where parents are subjected to intrusive compliance checks (condoc, para 3.40). We recommend that if someone claiming Tax-Free Childcare continues to receive it after ceasing to be eligible, they should have a choice of setting what they have received in respect of one child against Tax-Free Childcare to which they may be entitled in respect of another eligible child, now or in the future. This facility would continue until their youngest child attains the age of 12 (or 16 if the child is disabled). Alternatively they could set excess Tax-Free Childcare against a present or future entitlement to universal credit childcare. They should only have to repay any balance that is not attributed to supported childcare under either system throughout the period during which any of their children remain eligible.

4.49 Example: John and Betty have a child, Anna, aged five in August 2015. They claim Tax-Free Childcare as they are both in full-time work. However, in March 2016 John is made redundant, takes a much lower paid job and the couple claim universal credit. They continue to claim Tax-Free Childcare for Anna until September 2016, when something prompts them that they are no longer eligible. On ceasing their claim to Tax-Free Childcare they have the choice of (a) setting the £600 they have been overpaid (£100 a month from March to September) against any future Tax-Free Childcare entitlement between then and September 2022 when Anna will be 12, or (b) setting it against the universal credit childcare element that they would have been entitled to had they claimed it between March and September 2016. Either the Tax-Free Childcare they have received will match exactly the universal credit childcare element they could have claimed instead, in which case the books will balance; or they will have received more, or less, Tax-Free Childcare than the universal credit childcare to which they would have been entitled. If more, they can carry forward the excess and set it against future universal credit childcare entitlement (in which case they will not be paid universal credit childcare until the excess is used up); if less, they are not paid the balance of universal credit childcare which they might have received had they claimed it.

4.50 In addition, it is worth mentioning that some parents, through no fault of their own, find the childcare provider they appointed in good faith has ceased to be Ofsted-approved but not informed them. It is a source of considerable distress when parents find they are overpaid substantial amounts of tax credits for a failure of their childcare provider over which they had no control, and which they had no opportunity of finding out about.

Questions 19 to 21

4.51 We do not propose to answer these questions in detail as they are mainly for voucher providers to advise upon.

4.52 However, there is one important point to make about the recovery of excess payments by Government. If these are dealt with as we recommend in our answer to Q18, things will be much easier for the voucher holder as they will only have to repay the excess to the extent that they

cannot set it against universal credit childcare support or future Tax-Free Childcare. They will also be easier for the voucher provider as there will be less likelihood that they will have to become involved in the recovery process on behalf of the Government.

4.53 It will also be important to make provision for situations that occur where recovery would not be appropriate, such as the death of a child.

Q22: What channels need to be established to enable parents, voucher providers and childcare providers to communicate with each other and the Government to resolve queries and problems?

4.54 This is a question for others to comment on in detail. We merely make the point that if only online channels are provided for parents to use, there is a risk of discriminating against those among whom digital exclusion is most prevalent – for example the elderly, disabled people, and those who live in areas not well served by internet connections (see the FTT decision in *Bishop, Aztec, Rhos and Brinklow v HMRC Commissioners* (issued 30 September 2013)).

4.55 It is also important that support provided to parents be sufficient to answer questions about better off calculations. One problem with the current childcare voucher vs. tax credits dilemma for parents is that the tax credits helpline is unable to answer questions about childcare vouchers and the voucher providers cannot help with tax credits, leaving parents in an incredibly difficult situation.

Questions 23 to 25

4.56 Again, these questions are for others to answer in detail. The only comment we make, as it is vitally important in understanding error and fraud, concerns paras 4.30 to 4.32.

4.57 It is unhelpful in the extreme to conflate fraud and error as though they were one and the same, when in fact they are two entirely different concepts which demand separate and distinct remedies. What is said in paras 4.30 to 4.32 is appropriate where fraudulent behaviour is an issue, and of course it is important to detect, prevent and deter fraudulent applications for Tax-Free Childcare. It is however entirely inappropriate where genuine mistake is involved. Genuine mistakes may be made by both claimants and officials, or official computer systems, and if claimants of Tax-Free Childcare are to be blamed for following wrong advice given by officials, it will only bring the new relief, and the tax system in general, into disrepute.

Questions 26 to 30

4.58 Any market solution must give parents the widest possible choice consistent with the maximum protection.

Q31: How will the proposed change to Universal Credit affect people who have earnings that change from month to month?

4.59 The proposal to increase childcare support through universal credit to 85% for lone parents and couples who pay tax is unfair, almost certainly unworkable and will damage work incentives for some of the lowest paid. Instead we think that using the additional funding to increase

everyone's childcare help to 80% would be fairer and less complex both for DWP to administer and for claimants to understand their position.

4.60 The flaw in the Government's thinking lies in the reference in para 6.13 to a 'monthly income tax personal allowance'. There is no such thing. The income tax personal allowance is annual, and an individual only pays tax once their income for the year exceeds that allowance. The fact that their income in any month exceeds the personal allowance divided by 12 does not mean that they will be taxpayers in the year in which that month falls.

4.61 People whose earnings change from month to month are a far larger part of the working population now than they once were. The rise of zero-hours contracts, part-time and agency working has created great uncertainty about how much work people can rely on obtaining. If a worker on a PAYE basic rate coding has 1/12 of their personal allowance reflected in their code month by month, but loses their job, or has to resort to part-time working, or is laid off, during the tax year so that at the end of the year it turns out they are not liable to pay any tax, they are likely to submit a claim for repayment of the tax they have paid through their PAYE code. That repayment may be given through the worker's PAYE code in the following year. If in any month in which they paid tax through PAYE they claimed the 85% childcare support through universal credit, but at the end of the year it turns out that they were not liable to pay tax after all, will they have to refund the 15% difference between that and the standard rate of support of 70%? And how will that be done? Overpayments of the childcare element are already a vexed feature of tax credits – the Government's proposals risk making the debt problem worse under universal credit.

4.62 The Government's proposal will only work for people in secure, stable jobs with an even rate of pay and a predictable future. There are fewer and fewer such workers in the world outside Whitehall. It is claimed (para 6.11) that "For some parents childcare costs to work an extra hour can be greater than the extra they would earn after tax, National Insurance Contributions and any benefits, such as tax credits, are withdrawn." Surely this problem can better be alleviated, in a way that respects both simplicity and fairness, by restoring the 80% level of childcare support in universal credit, as recommended above.

4.63 Not only will the Government's proposal only work for those in secure, stable jobs it will also benefit those who earn higher amounts and leave those who are working full time at NMW without the additional support. So for example someone working 30 hours at NMW would earn less than £10,000 and so not qualify for this additional support. We cannot see any justification for this if the aim is to improve work incentives for everyone. Besides, perversely, every time the Government increases the income tax personal allowance (a policy it is known to favour) more people will be rendered ineligible for the 85% rate, thus raising their marginal deduction rate and reducing their gain from being taken out of tax.

4.64 There is no reference in that specific section of the consultation document about how the monthly income threshold would work for the self-employed who are subject to the minimum income floor. If the minimum income floor is being applied, then it would be only fair that the person receives the additional support.

Q32: The proposal is to use gross taxable earnings as a proxy for people whose earnings are above the tax threshold. What other proxies could the Government use?

4.65 As we make clear in our answer to Q31, we believe the Government's proposal to be wholly misconceived. We have suggested reverting to the 80% level of childcare support that applied up to 2011/12.

Q33: The Government wishes to ensure help is targeted at those who need it most within the fiscal constraints it faces. Should people who are getting Statutory Sick Pay, Statutory Maternity Pay, Ordinary Statutory Paternity Pay, Additional Statutory Paternity Pay, Statutory Adoption Pay and Maternity Allowance be entitled to the 85 per cent support or not?

4.66 If people getting those statutory payments are to be included in the scope of the childcare element (which would be a continuation from the present regime) it is entirely fair and reasonable that they should benefit from whatever rate of support is applicable to their circumstances.

Q34: What information will people need to understand the impact of the measure on their own circumstances?

4.67 A great deal, because of the enormous complexities inherent in the proposal (we explore these in our response to Q31) and the risk to the claimant of getting it wrong, particularly retrospectively (eg if the claimant claims the extra support in a particular month when they pay tax through their tax code, but at the end of the year it turns out they were not liable after all).

4.68 Claimants will not only need to fully understand the eligibility criteria and financial implications of the Tax Free Childcare scheme but be provided with enough information to make comparisons with Employer Supported Childcare, universal credit and tax credits. The 'better off' calculations will need to be looked at from an eligibility perspective as well as financially, for example the age criteria for Tax-Free Childcare for non-disabled children are less generous than Employer Supported Childcare so that could have a bearing on someone's decision.

Q35: Is offering a choice between Universal Credit and Tax-Free Childcare the best approach without driving up costs to the Government or increasing complexity for claimants? Should there be a limit on the number of times that a parent can switch?

4.69 We very much welcome the proposal to offer parents a choice as to which of two options works best for them providing that they are given enough information to make the correct choice. We are uncertain whether it is intended that parents should be required to relinquish just the childcare element of universal credit before receiving Tax-Free Childcare, or whether they have to come off universal credit completely. The latter would not make much sense – at present, if a tax credits claimant wishes to join an employer's voucher scheme, for example, rather than receive the childcare element of working tax credit, they do not have to relinquish all the other elements to which they are entitled.

4.70 Subject to that objection, we think it makes good sense for parents to be able to choose whether to take the childcare element of universal credit or Tax-Free Childcare.

4.71 We have no strong views on whether there should be a limit on the number of times a parent can switch.

Q36: How can the Government best design the process to ensure that the journey off Universal Credit is as smooth as possible? And Q37: What information and tools do families in this position need to inform their decision, and how can this be best provided?

4.72 These two questions are best answered together. At present HMRC operate an online calculator which enables tax credit claimants to work out whether they are better off claiming the childcare element or participating in their employer's voucher scheme. That is good as far as it goes. However, there are limitations on its use in certain circumstances: not everyone can use it.

4.73 But wherever the market allows a choice between different providers, there is likely to be competition and not all sales techniques exhibit as much concern for the welfare of the purchaser as for the profits of the seller. There is likely to be at least some mis-selling. HMRC will have a role in countering that. HMRC must publicise the fact that parents have a choice between universal credit and Tax-Free Childcare sufficiently widely to ensure that they are not unduly pressurised by voucher companies to choose Tax-Free Childcare where another alternative would be more to their advantage.

Q38: A person who moves from one scheme to another will have practical concerns, for example how the balance on their childcare voucher account might affect their Universal Credit award. What factors are parents likely to take into account when deciding which scheme works best for them, and under what circumstances?

4.74 We do not have experience of what factors parents are likely to take into account when deciding which scheme works best for them. We would expect the main driver to be financial. It would be important to ensure that any balance left in their Tax-Free Childcare account were not treated as an amount of capital when they cross over to universal credit (we set out an alternative scheme in the answer to Q18).

LITRG

15 October 2013