<u>Overview of the changes</u>

The legislation for Childcare Vouchers changed on 6th April 2011. The change affects higher rate and additional rate tax payers who applied to **join the scheme on or after 6th April 2011** whereby a restriction is placed on the amount of vouchers that are exempt from tax and national insurance. All parents who applied to join the scheme up to 5th April 2011 will receive the current tax and national insurance exemption indefinitely - regardless of earnings.

All parents could receive up to £55 per week (£243 per month) of vouchers which are exempt from tax and national insurance.
However, higher rate tax payers who join the scheme on or after 6th April 2011 will only be able to receive £28 per week (£124 per month) tax and NI exempt. Additional rate tax payers who join the scheme on or after 6th April 2011 will only be able to receive £25 per week (£110 per month) tax and NI exempt. Basic rate taxpayers will be unaffected; however it is still worth them joining before April as doing this ensures they will still be able to receive tax exemption on the full amount if they become a higher rate taxpayer in the future.

The purpose of the new restrictions is to standardise the income tax savings as shown below.

	Rate of Income tax	Weekly tax exempt entitlement	Weekly tax saving
Basic Rate	20%	£55	£11
Higher Rate	40%	£28	£11
Additional Rate	45%	£25	£11

However in practice higher and additional rate taxpayers will save less than a basic rate taxpayer as this just considers income tax and does not take into account that higher and additional rate taxpayers pay less National Insurance.

The tables below demonstrate the difference in savings for parents who joined the scheme before the 6th April from those who join the scheme on or after the 6th April.

		Parents in the scheme before 6th April 2011	Parents who join the scheme after 6th April 2011
Higher Rate Taxpayer (40% tax 2%* NI)	Weekly tax exempt amount	£55	£28
	Monthly tax exempt amount	£243	£124
	Annual tax exempt amount	£2,916	£1,484
	Annual Savings	**£1,225**	**£623**
	Employer's NI Savings*	**£402**	**£205**

		Parents in the scheme before 6th April 2011	Parents who join the scheme after 6th April 2011
Additional Rate Taxpayer (45%** tax 2%* NI)	Weekly tax exempt amount	£55	£25
	Monthly tax exempt amount	£243	£110
	Annual tax exempt amount	£2,916	£1325
	Annual Savings	**£1370**	**£623**
	Employer's NI Savings*	**£402**	**£183**

* new NI rate applicable from April 2011
New tax rate applicable from April 2013

Basic Earnings Assessment

At the start of each tax year and when an employee joins the scheme after 6th April 2011, employers must complete a basic earnings assessment of that employee.

This should be using figures applicable at the start of that tax year. If they join the scheme midway through the year, the employer should pro-rata their monthly salary to establish the annual amount and determine which tax band they will fall into.

This should include Basic Salary, Guaranteed, contractual bonus , Taxable benefits and shift allowances.

However the assessment should not include tax exempt benefits (such as childcare vouchers, pension contributions via salary sacrifice, bikes to work), overtime payments, discretionary or performance related bonuses.

Once the employee has been assessed, the tax free allowance is set until the next tax year regardless in any changes in an employee's circumstances. For example if an employee was assessed as a basic rate taxpayer when they joined the scheme, but had a subsequent pay rise that took them into the next tax bracket, they would still be entitled to £243 until the start of the next tax year. The basic earnings assessment should be based on the information that is available to the employer when the employee enrolls on the scheme.

To give a very rough guide, an employee who has the standard personal allowance, receives no other benefits and wishes to salary sacrifice the maximum amount for childcare vouchers would be considered a basic rate taxpayer if they were earning up to £44,366. This is because the higher rate threshold for the year 2013 – 2014 is £32,010. The personal allowance (£9,440) is deducted from the overall figure to give £34,926 and the tax and NI exempt childcare voucher salary sacrifice can also be deducted as the employee wishes to take the maximum (£2,916) which brings it down to £32,010.

The employer is required to keep a record of the figures used to determine the employee's basic earnings. If the employer gets the initial assessment wrong and provides an employee with tax exemption they are not entitled to, the excess should be reported on the P11D.

Employees currently receiving Childcare Vouchers

Employees currently receiving childcare vouchers are unaffected indefinitely unless they change employers or leave the scheme. HMRC have confirmed that an employee can stop receiving childcare vouchers for a period of up to 12 months and still be considered 'in the scheme' and therefore not be subject to the new restrictions.

An employee is still considered as in a scheme if:

- Their employer changes childcare voucher provider
- They are moved to another employer due to a merger or acquisition
- They have been transferred to another employer under a TUPE arrangement
- They re-enrol on the scheme as part of annual flex renewal or suchlike
- They change the amount of childcare vouchers they receive

HMRC have confirmed that if an employee has submitted an application to receive childcare vouchers on or before 5th April 2011 they are entitled to the full £243 regardless of when they receive their first vouchers, however they **have to have a qualifying child prior to 6th April 2011** or they will be subject to the new restrictions.

Please visit http://ehub.edenred.co.uk/ Edenred's online portal of information, or speak to your account manager for more information.