Title: Childcare Payments Act 2014
IA No: 01/2017

RPC Reference No:
Lead department or agency: HM Revenue and Customs
Other departments or agencies: **HM Treasury**

Impact Assessment (IA)

Date: 13/03/2017

Stage: Final

Source of intervention: Domestic

Type of measure: Primary legislation

Contact for enquiries: tax-free.childcare@hmrc.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: Not Applicable

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANDCB in 2014 prices)	**One-In, Three-Out**	**Business Impact Target Status**
£m	£m	£m	Not in scope	Non qualifying provision

What is the problem under consideration? Why is government intervention necessary?

This Impact Assessment updates the original one published in November 2014.

Finding reliable, high quality, affordable childcare is a major concern for working families- and for some families it does not pay to go to work. Survey data suggests that many more mothers would move into work or increase their hours if they could arrange reliable, affordable, convenient and good quality childcare. The current scheme to support parents with the cost of childcare, Employer Supported Childcare (ESC), is neither effective nor fair, as many working families are unable to access the scheme.

What are the policy objectives and the intended effects?

Supporting parents with childcare is a top priority for the government. The government believes there is a strong case for improving access to childcare and assisting working families with their household budgets, helping more parents to go out to work, or work more, if they want to.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The government could have taken no action to further support parents with childcare costs and instead rely on the ESC scheme. However, this would fail to support self-employed parents and over half of employees who cannot access ESC. The government could have sought to mandate that employers offer ESC. But this would place an unacceptable burden on business. It would also mean that self- employed parents would still not receive childcare support. Other weaknesses of ESC would also not be addressed. For example, ESC disadvantages lone parents by basing support on the number of eligible parents rather than the number of children.
Instead, at Budget 2013 the government announced the new scheme, Tax-Free Childcare (TFC). This will deliver support to all eligible families through childcare accounts. NS&I will provide the accounts for the scheme.

Will the policy be reviewed? It will not be reviewed. **If applicable, set review date:** 12/2018

Does implementation go beyond minimum EU requirements?		No		
Are any of these organisations in scope?	**Micro** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)		**Traded:**	**Non-traded:**	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: ***Date:*** 30 March 2017

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

The main government cost will be top-up payments to parents, to be spent on childcare. The estimated total costs of TFC in each year are:£390m/ £780m/ £865m/ £910m/ £980m, rising to around £1bn in steady state. The government will provide funding to NS&I for the provision of TFC accounts and associated support, and to other suppliers to deliver the scope of the programme. Employers offering vouchers will see their NICs saving gradually reduce when the disregard is closed to new entrants.

Other key non-monetised costs by 'main affected groups'

The government announced at Budget 2016 that Employer Supported Childcare (ESC/vouchers) will close to new entrants in April 2018. While ESC will remain open for those already in the scheme, the gradual decline in participants will affect voucher providers current business model.

Childcare providers may experience small one-off costs preparing for the new scheme.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

All eligible working families will receive 20% government support with their childcare costs, up to an annual limit of £2000 per child (or £4000 for disabled children). Around 2.3 million families will be eligible, of which 1.5 million are likely to have qualifying childcare costs. Around 1.2 million families will be better off under the new scheme.The average support to families will be £800 per year. As the existing support is being grandfathered, there will be no direct losers.

Other key non-monetised benefits by 'main affected groups'

As well as the significant financial benefits, parents will benefit from a simple and flexible scheme, and improved access to childcare. Childcare providers will also benefit from the simple system and more parents being able to access childcare support. The government also expects employers to benefit from more employees being able to work or work more.

Key assumptions/sensitivities/risks **Discount rate (%)**

Ahead of the scheme's introduction, HMRC will trial the new joint childcare service. This will enable HMRC to test the system and ensure an excellent experience for parents.The scheme will be introduced and gradually rolled out in 2017. The service will be made available to all eligible families by the end of that year. The volumetrics contained in this impact assessment take into account the impact of the 30 hours free childcare offering.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs:	**Benefits:**	**Net:**	

Evidence Base (for summary sheets)

This Impact Assessment updates the original one published in November 2014.[1]

Background

Finding reliable, high quality, affordable childcare is a major concern for working families[2]. Survey data suggests that more than half of mothers not in paid work would prefer to be in paid employment, and nearly a third of mothers in paid work would increase their working hours if they could arrange such childcare.[3]

The current scheme to support parents with the cost of childcare, Employer Supported Childcare, is neither effective nor fair, as many working families are unable to access the scheme.

Summary of Policy

Tax-Free Childcare will be available for up to 2.3 million families. Of the 1.5 million families expected to have qualifying childcare costs, there will be around 1.2 million families who will be better off as a result of the scheme, including around 1.6 million children. The average support to families will be £800 per year. The remaining 200,000 families may maintain their current level of support through Employer Supported Childcare for as long as the scheme remains in operation and their employer continues to offer it.

To help parents understand which scheme is right for them, the government has developed an online childcare calculator. This will help parents understand what they are eligible for and how much support they could receive. This calculator brings together Tax-Free Childcare, 30 hours free childcare for 3 and 4 year olds, the existing free entitlement offer (for 2, 3 and 4 year olds), childcare vouchers, Tax Credits and Universal Credit.

Current scheme

Through Employer-Supported Childcare, the government provides support to working parents via a tax exemption and National Insurance (NICs) disregard. However, Employer Supported Childcare is offered by less than 5%[4] of employers so many parents are unable to access it. The new scheme – Tax-Free Childcare – will be available to more families, including the self-employed and those parents whose employer does not offer Employer Supported Childcare.

At Budget 2016 it was announced that Employer Supported Childcare will remain open to new entrants until April 2018 to support the transition between the schemes.

There are three forms of Employer Supported Childcare, each of which attracts a tax exemption and NICs disregard:

- An employer can give its employees childcare vouchers worth up to a maximum £55 per week (depending on the earnings of the employee), on which there is a tax exemption for the employee and a NICs disregard for the employee and employer. Employees can use these vouchers to purchase childcare provided by any childcare provider which is registered by an appropriate regulatory body.

- Alternatively an employer can pay for childcare up to a maximum of £55 per week for their employees directly (depending on the earnings of the employee), typically entering into a contract with a childcare provider, and paying for childcare on the employee's behalf. This is known as directly-contracted childcare.

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[1] Original Tax Free Childcare Impact Assessment published here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/377091/Tax-free_childcare_Impact_Assessment.pdf

[2] Childcare and early years survey of parents, 2014-2015

[3] Childcare and early years survey of parents, 2014-2015

[4] HMT and HMRC, 'Delivering Tax-Free Childcare: the government's response to the consultation on design and operation' Annex B https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/293084/PU1607_Tax_free_Childcare_response.pdf

- The third form of Employer Supported Childcare – which will not be directly affected by the changes – is workplace nurseries.

In most instances employers pay a voucher provider a fee for administering Employer Supported Childcare, which is outweighed by the level of NICs savings that they make from the scheme. There are a number of different voucher providers operating in an open market who range in size of business from very small specialist firms offering only Employer Supported Childcare vouchers, to those who are part of large corporate groups with a range of other business-to-business services.

Why the tax exemption and National Insurance disregard for Employer Supported Childcare are being removed

The ability for Employer Supported Childcare to provide wide ranging, effective and fair support to working families is limited by a number of drawbacks:

- its coverage is limited – only available to parents whose employer offers it (5% of employers, reaching half the workforce);
- it is not available to self-employed parents;
- it is generally not available to those paid near or at the National Minimum Wage;
- the tax exemption and NICs disregard is of no benefit to employees earning below the relevant thresholds[5];
- it is poorly targeted, with no maximum income limit; and
- it takes no account to the number of children in each family. For example, a lone parent with two children will receive substantially less than an eligible two-parent family with one child.

The employer NICs disregard is poor value for money for taxpayers. The disregard generates a saving for employers of up to 13.8% of the cost of the childcare vouchers provided. This is a significant government cost (forgone receipts) embedded in the scheme which is not spent on childcare.

New scheme: Tax-Free Childcare

Eligibility

Eligibility to receive government support from Tax-Free Childcare will depend on meeting the following criteria:

- both parents (or a lone parent) must be in paid work and earning at least 16 hours at National Living Wage per week (on average) and not more than £100,000 per year each;
- children must be under the age of 12. Disabled children must be under the age of 17;
- the parent must be 16 or over and be responsible for, and normally live with, the child;
- both parents (or a lone parent) must not be in receipt of any government support through tax credits, Universal Credit, Employer Supported Childcare (childcare vouchers or directly-contracted childcare) or other government-funded support for childcare costs such as a Childcare Grant or an NHS Bursary. Accessing a government-funded childcare place, such as the 15-hours-per-week early years offer in England, or the new 30 hours free childcare schemes, will not affect entitlement to the new scheme.

Where a family receives Employer Supported Childcare and wishes to move to Tax-Free Childcare, they must tell their employer within three months of applying for the new scheme. This allows a limited period (up to three months) of dual provision to ensure there is a smooth transition between the schemes. If the family changes its mind and decides to stay with Employer Supported Childcare then they will have to repay any government support they received under Tax-Free Childcare.

Tax-Free Childcare will provide support with childcare costs to self-employed parents. In recognition that many newly-established businesses do not make a profit when they start trading, self-employed parents will not need to meet the minimum income threshold during their first four entitlement periods (around twelve

[5] In 2015-16, those born after 5 April 1938 generally do not pay income tax on the first £10,600 they receive; this figure is slightly higher for those born earlier. Employees generally do not pay NICs on the first £155 they earn per week.

months). To reflect that many self-employed people do not make a consistent level of profit across the year, such parents will be able to meet the minimum income threshold on an annual basis. This will be assessed using their expected income for the tax year.

Parents will only be able to use their childcare support accounts to pay for childcare which enables them to undertake paid work. However, we have provided for a number of circumstances where parents are regarded as being in qualifying paid work. This covers parents that are on sick leave, maternity, paternity and adoption leave. It also means that households where one member of a couple is in work and the other is in receipt of Carer's Allowance, or contribution-based or 'credits only' Employment and Support Allowance, are able to access support. This means that approximately 40,000 additional families will be able to receive support through the new scheme.

Autumn Statement 2015 Policy Changes to Eligibility

It was announced at Autumn Statement 2015 that the upper income threshold of £150,000 per parent would be reduced to £100,000 per parent. This new threshold better targets the support provided through Tax-Free Childcare at the families who need it most. Around 60,000 families are affected by the reduction to the upper income threshold.

It was also announced that parents would be expected to earn the equivalent of at least sixteen hours at the National Minimum or Living Wage (around £115/week at current levels). This was previously set at the equivalent of eight hours per week. As Tax-Free Childcare is intended to support working families with the costs of childcare, it is important that those parents who use Tax-Free Childcare are in substantive paid work. The minimum income level for Tax-Free Childcare provides work incentives, whilst continuing support for those working part-time. Around 80,000 families are affected by the increased minimum income threshold. Both these changes align with the rules for the 30 hours free childcare scheme for three and four year olds, which will be introduced by the Department for Education and will be applied for through the same system as Tax-Free childcare.

Families on low incomes will be able to receive more generous support through Tax Credits or Universal Credit. In addition, all three and four years old are entitled to 15 hours of free early education or childcare per week. Some two year olds from disadvantaged backgrounds are also eligible for 15 hours of free education.

Parents

To benefit from the scheme, parents will need to complete the application process to confirm their eligibility, and confirm that they remain eligible via a light-touch process each quarter. The scheme has been carefully designed and user tested to ensure that this process is as simple as possible for families.

Qualifying Childcare

Support will only be provided where a parent uses childcare which is formally registered or approved. For these purposes, this will mean childcare which is registered with Ofsted in England, with equivalent authorities in Scotland, Wales and Northern Ireland, or other recognised regulatory bodies such as the Care Quality Commission. This is consistent with the rules of Employer Supported Childcare, Tax Credits and Universal Credit. Childcare providers who are not required to be registered with one of these bodies may choose to register voluntarily. Childcare providers will also need to pay a small annual charge associated with registration, along with any associated costs such as first aid certification. Approved childcare can include care provided by nurseries, play schemes, childminders, nannies and after school clubs.

Childcare providers

Childcare providers will need to complete a simple online process to sign up for Tax-Free Childcare to receive payments from parents. They will also need to be registered with a regulator (Ofsted or equivalent). Parents will then be able to send payments directly from their Tax-Free Childcare account to the childcare provider's bank account. Each child will have a unique Tax-Free Childcare reference number to help providers identify the payments.

Employers

Employers will be able to play a role in the new scheme if they wish. Any such action will be entirely voluntary. The government expects that employers will benefit from more of their employees being able to receive support with their childcare costs, as they will be able to work more. This is especially the case for employers who do not offer Employer Supported Childcare.

Ensuring compliance with the scheme

To mitigate the threat of ID fraud, parents will verify their identity online at the start of the application process. Parents will then apply for the scheme online and must provide sufficient information to enable HMRC to confirm their eligibility.

A series of eligibility and compliance checks will ensure that the scheme effectively prevents, or where necessary responds to, cases of carelessness, deliberate error and fraud. The compliance approach will be underpinned by real-time checks of HMRC data, supported by gateways for the exchange of information between HMRC and other Government Departments and public bodies, to ensure that parents do not claim Tax-Free Childcare in addition to Tax Credits, Universal Credit or other government support with childcare costs such as Employer Supported Childcare.

Exchequer costs

The estimated total costs of Tax-Free Childcare are as below:

	2017/18	2018/19	2019/20	2020/21	2021/22
Cost (£m)	-390	-780	-865	-910	-980

The annual cost will rise to around £1bn in steady state. These costs have been updated in line with the revised forecast and strategy in launching the scheme.

Economic Impact

It is not possible to produce a full, monetised cost-benefit analysis of the scheme due to insufficient data and evidence, as well as limits to how reasonably such costs and benefits can be monetised to provide meaningful results.

The government will conduct a Post-Implementation Review after the scheme has been fully implemented, to assess whether Tax-Free Childcare is meeting its objectives. In addition, HMRC and the Department for Education commissioned *Frontier Economics*, an economic consultancy, to explore how it may be possible to measure the impact of Tax-Free Childcare and early years entitlement in England on the labour and childcare markets. This research[6] was published in February 2016 and set out that childcare subsidies can have small but significant impacts on parents' employment or childcare use.

The fiscal costs of the scheme are not considered a cost in the economic assessment as they represent a transfer from one set of agents in the economy to another. Similarly, the positive impact on household incomes for those who receive support under the new scheme are not included as an economic benefit.

Other Costs

Employers

Once Employer Supported Childcare has been closed to new entrants, employers currently offering Employer Supported Childcare will gradually see reductions in their NICs savings. As some of the NICs savings cover employers' administration costs, the loss in benefit will be partly offset by a reduction in costs if the employer winds down its scheme. Advance notice and gradual withdrawal will enable employers to prepare for this.

[6] This research is published at the following link: https://www.gov.uk/government/publications/feasibility-study-into-evaluating-the-labour-and-childcare-market-impacts-of-tax-free-childcare-and-the-free-early-education-entitlement

Employer Supported Childcare Voucher providers

There is likely to be an increase in demand for childcare vouchers, before Employer Supported Childcare is closed to new entrants from April 2018, as employees decide to access the scheme prior to closure. The tax exemption and NICs disregard will remain available to parents who are existing scheme members, so they will require vouchers for a period of time.

Organisations that administer these vouchers are then likely to see a gradual reduction in demand as the tax exemption and NICs disregard are phased out. The Budget 2016 announcement gives voucher providers sufficient time to plan for and respond to these changes, which should help enable them to diversify and minimise risks of closure.

Parents

There will be some time costs for parents as they have to apply, set up an account, and reconfirm eligibility periodically. Such time costs are likely to be small relative to the financial benefits of the scheme.

Childcare Providers

Childcare providers will incur small costs in familiarising themselves with Tax-Free Childcare and signing up so that they can receive payments. The government expects these costs to be broadly proportionate to the size of the business. Once the new scheme is introduced, childcare providers may see an increase in business.

Benefits

Labour supply

The scheme will mean that parents currently in receipt of Tax Credits or Universal Credit will be able to increase their income and still receive support with childcare costs. This is likely to encourage some employees to increase their hours at work where they are approaching the income limit of Tax Credits or Universal Credit, where previously they may have been discouraged from doing so.

We expect that Tax-Free Childcare will have a small but positive impact on maternal employment, through encouraging mothers to either return to work or work more hours. Survey data suggests[7] that more than half of mothers not in paid work would prefer to be in paid employment, and nearly a third of mothers in paid work would increase their working hours if they could arrange appropriate childcare.

Productivity

Access to affordable, high-quality childcare can help improve productivity in the workforce by reducing absenteeism and problems with timekeeping associated with childcare emergencies.

Tax-Free Childcare will increase take-up of childcare from those parents who choose to move back into work or increase their hours.

Wider Impacts

Wider Government Childcare Offerings

Giving children the best start in life and supporting working families with the costs of childcare is a government priority. That is why the government spent an unprecedented £5 billion to support childcare last year. This will rise to over £6 billion by 2019/2020. All three and four-year olds are entitled to receive 15 hours of free early education per week, along with 40% of the most disadvantaged two-year old children. This is being extended to 30 hours per week for working parents of three and four-year olds.

[7] Childcare and Early Years Survey of Parents, 2014-2015

Working families who are on lower incomes can claim up to 70% of their childcare costs up to £175 a week for one child or £300 a week for 2 or more children through Working Tax Credits. Or they can claim up to 85% of their eligible childcare costs through Universal Credit (similar weekly caps applying).

Families

Tax-Free Childcare support will not be affected by changes in household composition, provided all parents or partners in the household continue to meet the eligibility requirements, such as being in work.

Tax-Free Childcare will support families at key transition points. The structure of the scheme will ensure that parents will remain eligible for the remainder of their current entitlement period (3 months), regardless of any unexpected changes in circumstances. More broadly, the scheme will give parents confidence that they will qualify for support with childcare costs when they return to work following the birth of a child, or when they move job, provided they meet the eligibility criteria.

In addition, when parents take a period of parental leave, they will be able to continue to use the scheme for existing children. This will to help them to maintain their existing childcare arrangements.

Equalities Impacts

Families on lower incomes generally receive more generous support with their childcare costs from Tax Credit or Universal Credit and will not be entitled to receive support under Tax-free Childcare as well. As lone parents are more likely to have lower income levels, they are more likely to be in receipt of Tax Credits or Universal Credit. It is estimated that of the families that will directly benefit from Tax-Free Childcare, around 95% are couples, and 5% are lone-parent families.

The scheme will predominantly support working age families but, will be available to all those who have responsibility for raising a child, including working parents of retirement age and grandparents. Multiple people or parties will be able to pay into childcare accounts. This will give family members and other parties the opportunity to contribute.

The scheme will be simple for applicants as transactions will be carried out online. Although fundamentally a digital process, there will be small numbers of parents who are unable to engage with the scheme online. These parents will be able to make their application over the telephone. Similarly, any childcare provider which does not have access to digital channels will be able to receive telephone assistance.

The following areas have been considered and no impact identified: Competition; Wider Environmental Issues; Health and Wellbeing; Human Rights; Rural Proofing; Sustainable Development.

Legislation

The Childcare Payments Act provides for the overall structure of the scheme and the way in which it will operate. It is supplemented by The Childcare Payments (Eligibility) Regulations 2015 and The Childcare Payments Regulations 2015. These have since been amended to reflect the policy changes announced at Autumn Statement 2015. They also include technical amendments designed to improve the design of the scheme. Commencement orders have been used to bring into force specific sections of the Act for the purposes of information sharing, and for the trial of the scheme. Commencement orders will continue to be used to support the staggered rollout of the scheme.

Post Implementation Review (PIR) Plan

Basis of the review: The policy is to be reviewed two years after full implementation. In addition, at AS16, the chancellor announced a review would take place once rollout is completed "*to ensure it is delivering as intended and to assess the benefit it is delivering for working parents".*
Review objective: To assess whether Tax-Free Childcare is delivered effectively and supports working families as intended. In

particular, it will cover:

- delivery: assessing the user journey;
- outputs: broadening access to government support with childcare costs, whilst ensuring effective compliance with the scheme; and

outcomes: assessing the impact on the labour and childcare markets.

Review approach and rationale:

A mixture of approaches will be used including:

- analysis of internal administrative datasets;
- analysis of existing government survey data including:
  - the Family Resources Survey;
  - the Childcare and Early Years Survey of parents;
  - the Childcare and Early Years Providers Survey; and
- bespoke qualitative and quantitative primary research.

The review will consider a range of information from a variety of data sources to assess the potential impacts of the scheme. The review will draw on expertise across government.

Success criteria:

To monitor the performance of the new service during implementation, we have identified 6 Rollout Success Indicators (RSIs):

RSI 1: Parent take up

RSI 2: Positive parent experience

RSI 3: Positive CCP experience

RSI 4: Positive reputation of TFC

RSI 5: Minimise error and fraud within TFC

RSI 6: Efficient service providing good value for money

Monitoring information arrangements:

A comprehensive evaluation programme has been commissioned covering both evaluation of implementation and policy outcomes. Elements of the programme will be undertaken internally and others will be commissioned externally.

HMRC and the Department for Education commissioned Frontier Economics to look at the feasibility of evaluating the impact of Tax-Free Childcare and early years entitlement in England on the childcare and labour markets. Following the publication of this research, HMRC are now developing further actions and identifying additional research to support the evaluation on these markets.

This approach to evaluation will ensure that potential impacts of the policy are covered, allowing for insight into future policy development and providing the opportunity to refine delivery and running of the scheme.

Reasons for not planning N/A