

Employer-supported Childcare (ESC)

In order to qualify for tax and national insurance contribution exemptions an ESC scheme must be open to all employees and cover only registered or approved childcare.

The scope of exemptions has been considerably extended in the past, with the hope of encouraging more employers to help their employees with their childcare responsibilities. An exemption for the employee does not encourage employers to give help – it only encourages employees to ask for it.

For individuals in ESC schemes at 5 April 2011, the following arrangements are free from tax and NICs and are not counted as income for tax credit purposes:

- The first £55 a week of the cost of providing childcare vouchers
- The first £55 a week of the cost of providing childcare through a third party
- The provision of childcare in a workplace nursery which the employer is wholly or partly responsible for managing and financing

Relief is given at the employee's marginal rate of tax, meaning that the exemption is worth £11 per week to a basic rate taxpayer, £22 per week for a 40% taxpayer and £27.50 per week for a 50% taxpayer.

However, with effect from 6 April 2011 higher rate relief is no longer available to those joining employer-supported childcare schemes. Those employees already receiving vouchers or employer-supported childcare, or who joined schemes before 6 April 2011, will continue to benefit at the higher rates where applicable. The effect of this measure is that the tax exemption is worth the same in monetary terms regardless of the employee's marginal rate of tax.

Practical application

Where an employee joins an employer-supported childcare scheme on or after 6 April 2011 and receives either childcare vouchers or directly-contracted childcare, the employer is required to estimate the employee's employment income before the tax year starts and whether the employee is likely to be a basic rate, 40% or 50% taxpayer. This estimate determines the value of the childcare exemption in monetary terms to which the employee is entitled, as shown in the table below.

Employee's marginal rate of tax	Monetary value of the exemption	Tax saving as a result of exemption
Basic rate (20%)	£55 per week	£11 (£55 x 20%)
Higher rate (40%)	£28 per week	£11.20 (£28 x 40%)
Additional rate (50%)	£22 per week	£11 (£22 x 50%)

From a tax perspective, the exemption is worth virtually the same to all taxpayers.

The rules apply equally where the vouchers or childcare are provided as part of a salary sacrifice arrangement.

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The nursery facilities can also be made available to another employer's staff who work on the premises (typically someone from another company seconded to work elsewhere).

The £55 weekly limit applies to each individual employee. It is not affected by the number of children in the employee's family or whether one or two parents receive a childcare benefit-in-kind.

Childcare may be provided *in addition to* an employee's normal salary or *instead of part* of normal salary (known as *salary sacrifice*). For salary sacrifice to be effective for tax purposes, it must be covered by a proper contractual arrangement. In addition, there is a need to consider any adverse effects on:

- eligible childcare costs for Working Tax Credit
- entitlement to contribution-based state benefits

The legislation has been amended to ensure that tax relief for employees earning at or near National Minimum Wage levels is not compromised by their being legally prevented from using salary sacrifice arrangements.

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