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BRIEFING

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Tax-free childcare: how does it work?

The government's new tax-free childcare scheme was finally launched this April – after a legal challenge resulting in a delay of over a year.

Initially it will only apply to parents with a child aged under four on 31 August 2017. However, as soon as one child becomes eligible it may be possible to use the scheme for other children. The scheme will be rolled out throughout 2017 for other parents who can sign up now for an email alert at www.childcarechoices.gov.uk.

Who is it for?

Tax-free childcare is available for working parents with children aged under the age of 12 (or under 17 if they are disabled). For every £8 the parent pays in, the government will automatically add a further £2, so parents effectively get basic rate tax relief for childcare costs.

Parents can use the scheme to pay for up to £10,000 of annual childcare costs for each child, potentially saving some £2,000 – and the amounts are doubled for disabled children. If your childcare costs come to more than £10,000, the first £10,000 benefits from tax relief, and you will have to bear the full cost of additional payments.

Setting up an account

The tax-free childcare account must be set up online and can then be used for one-off payments or regular savings. Employers, grandparents, friends or other people can also pay into the account, which can be used to pay for childcare such as nurseries, nannies, childminders and out-of-hours school clubs. Crucially, the childcare provider must also be signed up with the tax-free childcare scheme.

Who qualifies?

Both parents need to be working, with average earnings equal to at least 16 hours at the national minimum/living wage, £120 a week if they are aged 25 or over, although there are certain exceptions to this. Parents are not eligible for tax-free childcare if either partner expects to earn £100,000 or more a year.

Free childcare provision differs across England, Scotland, Wales and Northern Ireland. Tax-free childcare cannot be used at the same time as childcare vouchers from an employer – so you may need to choose between the two schemes.

A parent can still join an employer's childcare voucher scheme up to April 2018, and once a member they will be able to continue for as long as the scheme is available or until they change jobs.

Parents should obviously remain in a voucher scheme,

even if they don't qualify for tax-free childcare, for example because only one parent works, or their earnings are not sufficient or they exceed £100,000. The voucher scheme is available for children aged up to 15, not just up to age 12. Tax-free childcare is very helpful for the self-employed, who cannot benefit from childcare vouchers, and others whose employer does not offer them.

Scheme suitability

The help available under the tax-free childcare scheme increases with the number of children, unlike the position with childcare vouchers. So opting for tax-free childcare should be beneficial if you have more than one child and high childcare costs.

For other parents, the decision is more complicated and will depend on their tax position and the level of childcare costs. For example, the maximum tax relief available under the childcare voucher scheme is £933 if it is available to just one parent who is taxed at the basic rate. Childcare costs would need to exceed £4,665 before tax-free childcare resulted in more relief – double that if vouchers were available to both parents.

Parents who switch from childcare vouchers to tax-free childcare should make sure they can either receive a refund for unused vouchers (which is often not possible) or they can use them up. Get in touch with us to discuss your position.

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Employment in the gig economy

The growth of the 'gig' economy has been controversial. Some workers like the flexibility of short-term contracts – giving them choice of when and where they work.

Others need the security of longer-term employment with guaranteed hours. Employers in some industries value the ability to engage the best person for each project. Others need a stable workforce.

Criticism centres largely on two areas: the lack of employment rights for workers, including the minimum wage, and the tax consequences of workers' self-employed status, especially lower national insurance contributions (NICs) and in some cases avoidance of VAT.

In July the government announced the setting up of a working party within the Department for Transport to enquire into the pay and working conditions of drivers for the taxi company Uber after claims that some were taking home as little as £2 an hour. Uber classifies its drivers as self-employed, but last year an employment tribunal decided that two drivers who brought a test case were working as employees, so were entitled to employment rights. The decision is under appeal.

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Who is a 'worker'?

A review of the impact of modern employment practices, commissioned by the government and led by Matthew Taylor, has recommended a clearer definition of the intermediate employment law category of 'worker' – covering casual, independent relationships – who would enjoy limited employment rights. The review proposed renaming such individuals 'dependent contractors'.

Earlier, the food delivery firm Deliveroo announced that it would pay sickness and injury benefits to its riders if the law is changed. Deliveroo says it classifies its riders as self-employed to give them flexibility to work whenever they want, but they cannot therefore offer enhanced employment rights.

Deliveroo has recently changed its agreement with riders by removing a clause prohibiting them from challenging their employment status at an employment tribunal. It now states that riders do not have to wear branded clothes while working, clarifies that riders can work for other companies and removes riders' obligation to give two weeks' notice to terminate their engagement. The last three changes are clearly directed at strengthening the argument that riders are self-employed.

Whether a person is self-employed or an employee for tax purposes is determined by several factors. You can check whether an engagement is employment or self-employment by using HM Revenue & Customs' online employment status indicator at www.gov.uk/guidance/check-employment-status-for-tax.

Who has significant control?

It is now simple for anyone to find out who really owns and controls a private company, even where shares are held in nominee names.

Unlisted UK companies now have to disclose to Companies House the names of all persons who have significant control over their ownership or management, and keep that information up to date. The requirement – in place since 2016 but widened from 26 June 2017 – is intended to improve corporate transparency and prevent money laundering and terrorist financing.

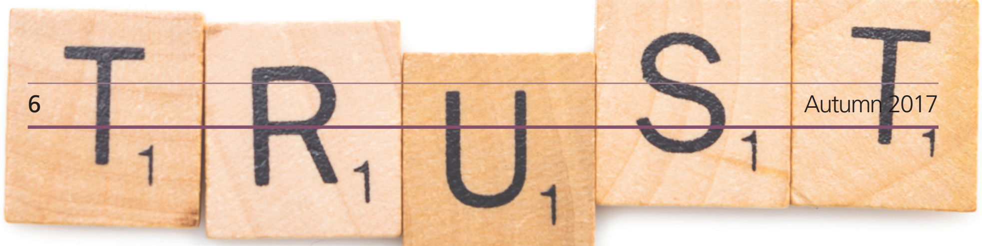
Since 2016, all UK unlisted companies and limited liability partnerships have had to keep a register of people with significant control (PSCs) and include that information on their annual confirmation statement. Unregistered companies and some listed companies have now been brought into this regime, and so have most Scottish partnerships – although with some modifications. Also from 26 June 2017, companies and LLPs have to update their PSC register within 14 days of any change and send that information to Companies House within a further 14 days.

Identifying PSC's

Identifying a company's PSCs is often straightforward: it is any individual who owns more than 25% of the shares and/or voting rights, or has the right – under the company's Articles – to appoint or remove the majority of the directors. But it also includes any other individual who has the right to exercise or actually does exercise significant influence or control over the company.

Some companies have several PSCs; others may have none. A company that has no PSCs must still keep a PSC register, which must declare that fact. Companies must take all reasonable steps to identify its PSCs and contact them to obtain all the required information. This consists of their name, date of birth, nationality, country of usual residence, service address, usual residential address if different and date they became a PSC of the company. It is a criminal offence if PSCs do not provide this information and most of it will appear on the public register. The main exceptions are date of birth and residential address where a service address is different.

Companies must also keep the information up to date, for example if an individual's rights or shareholding changes, or if they change their address. Please contact us to help you meet the requirements for your business.



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Preventing guilt by association

From 30 September, businesses that provide advice to clients could be guilty of a criminal offence if they fail to prevent an employee or agent from facilitating or assisting tax evasion by others.

The managers or directors of the business might not have been involved in, or even aware of, the employee's actions to be found guilty under the Criminal Finances Act 2017 (CFA), which received Royal Assent earlier this year.

The provisions of the Act come into effect at the end of September 2017, but many businesses have little awareness of them. Financial services, accounting and legal businesses are the most likely to be affected, but other sectors are also at risk. Businesses that pay large sums to consultants, engage casual workers and contractors, handle goods and services where organised fraud is a risk, or carry out cross-border transactions, may also fall foul of the CFA, which covers both UK and non-UK tax.

Deliberate tax evasion

The CFA is only concerned with tax evasion that is deliberate and dishonest – not tax avoidance or mere mistakes. Tax evasion is criminal broadly where a person knows they have a tax liability and dishonestly intends not to declare it. The CFA extends criminal liability to firms where an employee engages in tax evasion. Previously, a firm could only be prosecuted where its senior managers were involved in the illegal activity.

Businesses have a defence if they have implemented reasonable prevention procedures or can show that it would have been unreasonable or unrealistic to expect procedures to have been put in place. Firms should review their current practices and put in place appropriate training and monitoring of staff.

Six core principles

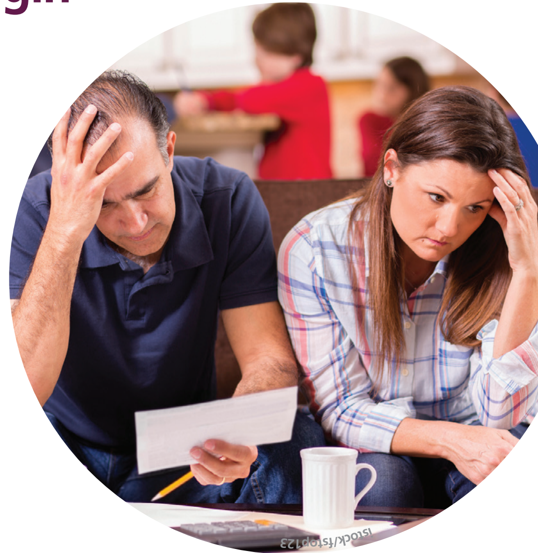
HM Revenue & Customs has issued draft guidance which sets out six principles for businesses to consider.

- **Risk assessment** – identify the risks, both business areas and individuals, and how to manage them. Are there any gaps in the business's controls?
- **Proportionality** – if the risk assessment shows a very low risk, little more may be necessary.
- **Top-level commitment** – senior management must understand and be prepared to act on countering their exposure to the new offences with appropriate procedures and monitoring.
- **Due diligence** – on existing and new associates and partner organisations.
- **Communication (including training)** – a clearly communicated policy acts as a deterrent. Training should be proportionate to the risk.
- **Monitoring and review** – this should occur regularly.

A written record of all procedures and risk assessments is essential. Businesses found guilty could face unlimited fines and serious reputational damage, so prepare for the new law now.

It can hurt at the margin

The 45% additional tax rate doesn't kick in until your income exceeds £150,000, but you could find yourself paying an even higher marginal rate of tax at a lower income level.



These high marginal rates occur because of the way in which various reliefs are withdrawn on a cliff-edge basis or are tapered away. Take the personal savings allowance. This is £1,000 if you are a basic rate taxpayer, but the allowance is halved if you have just a pound or two of income taxed at the higher rate – losing maybe £100 of tax relief and resulting in a marginal tax rate of anything up to 10,000%.

Where your income is between £50,000 and £60,000, you might be in the position of having a child benefit claim tapered away – you actually pay a tax charge, but it comes to the same thing. The marginal rate will depend on the amount of child benefit, which is based on the number of children you have. With three children, child benefit is £2,501 a year. For each £1,000 of income between £50,000 and £60,000, you will lose £250 of benefit. Add in 40% higher rate tax and maybe 2% of NICs, and you have a marginal rate of 67%.

The effective marginal rate of income tax is 60% if your personal allowance is withdrawn because your income is between £100,000 and £123,000. Again, another 2% of NICs might also come into play.

Time for tax planning

At this level of income, you will probably want to consider some form of tax planning, especially if you have advance knowledge of your income level – which should be the case if you are an employee. You might consider a pension contribution. If aged 55 or over, you could immediately take back 25% tax free, so the effective net of tax cost for the remaining £750 invested from a £1,000 gross contribution would be just £150. Or maybe opt for additional holiday entitlement or shorter working hours rather than a pay rise.

To make matters even worse, at a roughly similar income level, you could also find yourself facing the cliff-edge withdrawal of the benefit from tax-free childcare (being introduced during 2017). When combined with a 60% marginal tax rate, that promotion or new job might suddenly lose its attraction once you work out the tax implications. Please get in touch if you think you may be affected.

VAT flat rate – is it still worth it?

Changes to the VAT flat rate scheme mean some small businesses should reassess whether to be in the scheme. The scheme simplifies the way in which small businesses calculate their VAT liability, and it can also result in VAT savings.

Under the flat rate scheme, VAT is calculated by applying a flat rate percentage to the VAT-inclusive turnover and most input VAT on purchases is ignored. However, from 1 April a flat rate of 16.5% has been introduced for 'limited cost businesses' (LCBs).

With the normal basis, a business would pay VAT of £200 on turnover of £1,000. A flat rate of 16.5% results in a liability of £198 (£1,200 at 16.5%) – virtually the same. For an LCB with even a modest amount of input VAT, the flat rate scheme is no longer attractive.

You are classed as an LCB if the amount of goods you purchase are less than either 2% of your turnover or £1,000 a year (£250 a quarter). Unfortunately, only goods count, and these must be used exclusively for business purposes. There are numerous exclusions.

Defining your business

You have to determine your LCB classification for each quarterly or annual VAT period. So if your turnover or goods purchased fluctuate,

you could find yourself alternating between the 16.5% rate and your normal trade percentage. If you are permanently classed as an LCB, you will probably want to leave the flat rate scheme.

You can still continue to use the cash accounting and annual accounting schemes even if the flat rate scheme is no longer beneficial for you. This is particularly useful if you give credit to customers, because VAT is not accounted for until you receive payment. You do not have to pay VAT on bad debts. There are various qualifying conditions, but generally your turnover must not exceed £1.35 million and you must be up to date with your VAT returns and payments. We are here to advise you.

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