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Social Security (Contributions) (Amendment) Regulations SI 2018/120

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1. Summary

The Social Security (Contributions) (Amendment) Regulations SI 2018/120 were laid on 1 February, and came into force from 6 April 2018. The regulations make three changes to National Insurance contributions (NICs):

- to align the NICs treatment of salary sacrifice schemes with the way these schemes are subject to income tax, following changes made to their tax treatment by *Finance Act 2017*.
- to make consequential changes to the NICs treatment of childcare vouchers provided by an employer, in line with changes to be made to the income tax treatment of employer supported childcare.
- to ensure that employers continue to be exempted from having to pay Class 1A NICs where a sportsperson in their employ receives payments from a sporting testimonial organised by an independent committee. Employers' potential liability to this NICs charge was an unintended consequence of a reform to the taxation of sporting testimonial payments in 2017, but the current statutory provision to ensure employers are not liable for this charge applies for the tax year 2017/18 only.

There has been quite a lot of comment, not about the regulations themselves, but about the policy underpinning the second of these changes – the Government's decision to introduce a new scheme to support parents' childcare costs - Tax Free Childcare - and its intention to close employer-supported childcare (ESC) to new applicants from April 2018. This issue is examined at length in, *Childcare Vouchers and Tax-Free Childcare - Frequently Asked Questions*, Commons Briefing Paper CBP8055, 20 April 2018.

On 13 March the House considered and approved four statutory instruments, including these regulations.[1] On this occasion the Government announced that it would **defer** the closure of ESC schemes to new applicants for six months, until October 2018.[2]

1 HC Deb 13 March 2018 cc755-823
2 See also, Employer Supported Childcare Written Statement HCWS616, 29 March 2018

2. Background

2.1 Salary sacrifice schemes

In the 2016 Budget the Government announced that it would consult on reforming the taxation of benefits in kind (BIK), in response to concerns over the growing use of schemes by employers to offer employees certain benefits in place of part of their earnings (known as 'salary sacrifice'), partly as a means to reduce the tax they paid.[3] The consultation document, published in August, gave some details of this practice:

> Many BiKs are offered in addition to salary, but HMRC has seen a growth in salary sacrifice arrangements in recent years. These are agreements between an employer and employee to change the terms of an employment contract and reduce the employee's entitlement to cash pay in exchange for some form of non-cash BiK. The effect of this, depending on the BiK, is often to reduce the amount of income tax, employee and employer NICs due on the employee's remuneration.

Example: salary sacrifice savings for a mobile phone contract
The provision by an employer of a mobile phone to a director or employee for private use is exempt from tax and NICs. Therefore, if it is provided in addition to salary, there is no extra tax or NICs liability. However, where it is provided under a salary sacrifice agreement, there can be savings for both the employer and employee relative to the employee purchasing a phone from their take home pay.

A 24-month contract for a new mobile phone could cost over £1,000. This example shows the amount of tax and NICs saved on a contract of £700 purchased through salary sacrifice by an employee in each income tax band, by an employer, and the overall cost to the Exchequer.

Contract cost: £700	Basic	Higher	Additional
Employee reduces gross salary by	£700	£700	£700
Cost to employee (reduction in net pay)	£476	£406	£371
Employee saves*	£224, 32%	£294, 42%	£329, 47%
Employer saves**	£97, 13.8%	£97, 13.8%	£97, 13.8%
Cost to Exchequer	**£321**	**£391**	**£426**

* The employee's income tax and Class 1 NICs
** The employer's NICs

> Not all employers offer BiKs to their employees. In addition, where BiKs are offered only through salary sacrifice arrangements, employees with earnings at or near the National Minimum Wage or the National Living Wage cannot participate because salary sacrifice arrangements cannot reduce an employee's cash earnings below the National Minimum Wage or National Living Wage rates. Those employees who are not able to participate in salary sacrifice arrangements are at a disadvantage. They have to fund what might otherwise be offered as a BiK from their net pay, whereas others can receive the BiK at a reduced cost at the expense of the Exchequer …
>
> HMRC has seen significant growth in these schemes. There has been an increase of a third in PAYE clearance requests from employers for salary sacrifice arrangements between 2009/10 and 2014/15. The government believes that the growth of salary sacrifice has resulted in an increasing cost to the Exchequer due to the loss of tax and NICs. Also, salary sacrifice can artificially increase entitlement to tax credits or Universal Credit.[4]

3 Budget 2016, HC 901, March 2016 para 1.147
4 Consultation on salary sacrifice for the provision of benefits-in-kind, August 2016 para 1.2-3, 1.7

The Government proposed to limit the tax and NICs advantages of these 'optional remuneration arrangements' (OpRAs), although a few BIKs would be specifically excluded: "employer pension contributions; employer-provided pension advice based on the recommendations of the Financial Advice Market Review (FAMR); employer-supported childcare and provision of workplace nurseries; and, cycles and cyclist's safety equipment which meet the statutory conditions."[5]

In November 2016 the Government confirmed its plans, subject to certain modifications in the light of the responses it had had to the consultation.[6] In general it appears that respondents had agreed with the case for reforming the rules;[7] draft legislation was published the next month.[8] Subsequently at the time of the 2017 Budget the Government confirmed that it would include this provision in the forthcoming Finance Bill.[9] Following the Prime Minister's announcement of a General Election on 8 June, the House completed all of the remaining stages of the Finance Bill in the Commons on a single day, Tuesday 25 April.[10] With cross-party support the Government removed a series of clauses from the Bill, with the intention of legislating for these at the start of the new Parliament, but this provision was retained. Many of the clauses to the Bill were agreed with no debate, including this one.[11]

In turn, part 1 of the Social Security (Contributions) (Amendment) Regulations SI 2018/120 – the '2018 Regulations' – "mirrors these changes for a non-cash voucher provided through OpRA. As a result, the Class 1 NICs charge in respect of such a voucher will be calculated on the greater of the amount of salary given up by the employee, or the taxable value of the voucher which would otherwise arise under existing legislation. The instrument also removes the NICs advantages to reimbursing certain motoring expenses through an OpRA. This change also mirrors previous changes to the tax treatment of motoring expenses."[12]

2.2 Qualifying childcare vouchers

In general the costs of childcare or home help services are not tax deductible. In its 2004 Budget the Labour Government announced a new tax relief for childcare benefits: from April 2005, employees would be entitled to receive up to £50 a week of childcare free of income tax and National Insurance contributions (NICs) where their employers contracted with an approved childcarer or provided childcare vouchers for the purpose of paying an approved childcarer. Employers would be entitled to a similar relief for the first £50 of this type of childcare for the purposes of both secondary Class 1 NICs and Class 1A NICs.[13] This limit was increased by £5 to £55 from April 2006.[14]

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5 *op.cit.* para 3.2-4, 3.6
6 Autumn Statement, Cm 9362, November 2016 para 4.13
7 Consultation on salary sacrifice for the provision of benefits in kind - Summary of Responses, December 2016 para 2.4-7
8 See, Income Tax: limitation of salary sacrifice – tax information & impact note, 5 December 2016
9 HM Treasury, Tax Legislation & Rates, March 2017 para 1.7
10 HC Deb 25 April 2017 c1027
11 Initially this formed clause 8 of the Bill; it now forms section 7 and schedule 2 of the Finance Act 2017
12 Explanatory Memorandum to the 2018 Regulations, paras 7.3-4
13 *Budget 2004* HC 301 March 2004 para 5.26. Employees are charged primary class 1 NICs on earnings above the lower earnings limit. Employers are charged secondary class 1 NICs on their employees' earnings above this limit and class 1A NICs on most benefits in kind they give to their employees.
14 *Budget 2006* HC 968 March 2006 para 5.23. This change was made by Order: SI 2006/882.

From April 2011 the relief was restricted to ensure that new recipients of employer-supported childcare (ESC) receive the same amount of tax relief, irrespective of whether they are basic, higher or additional rate taxpayers.[15]

In the 2013 Budget the Coalition Government announced it would introduce a new scheme, Tax-Free Childcare, from autumn 2015. To be eligible, families would have to have both parents in work, with each earning less than £150,000 a year, and not in receipt of support for these costs from tax credits or, when introduced, Universal Credit.[16] Following a consultation exercise, in March 2014 the Government published further details. Eligible families would be entitled to receive 20% of their yearly childcare costs, up to a maximum of £10,000 for each child: ie, support worth up to £2,000 per child each year.[17] Statutory provision to introduce TFC was made by the *Childcare Payments Act 2014*; further background on this legislation are in the Commons Briefing papers prepared for its scrutiny in the Commons.[18]

Initially the intention was that TFC would be rolled out to all eligible families with children under 12 within the first year of its operation. Tax relief on employer provided childcare would only continue to be given to existing members of employer schemes, though they would be able to move to this new scheme if they wished. In the 2016 Budget the Government confirmed that the roll-out of TFC would start in early 2017, and that ESC would be closed to new entrants from April 2018:

> From early 2017, the government is introducing Tax-Free Childcare to help working parents with the cost of childcare, ensuring more parents who want to can go out to work or increase the number of hours they work. Tax-Free Childcare will be rolled out in such a way that allows the youngest children to enter the scheme first, with all eligible parents brought in by the end of 2017. The existing scheme Employer-Supported Childcare will remain open to new entrants until April 2018 to support the transition between the schemes.[19]

In March 2017 the Government published an updated impact assessment, which shows the anticipated Exchequer cost of this policy approaching £1 billion a year once fully implemented.[20]

Over the last few months there have been calls for the Government to postpone the cancellation of ESC for new entrants,[21] and queries as to whether any parents will lose out from claiming TFC.[22] Treasury Minister John Glen reiterated the Government's case for this reform when this issue was debated in Westminster Hall on 15 January:

> Let me draw Members' attention to the three key reasons why we support the replacement of childcare vouchers with tax-free childcare. First, the Government believe that childcare vouchers are unfair. Tax-free childcare is fairer and better targeted than the voucher scheme. For example, only about 5% of employers offer vouchers, which limits their reach to about half of working parents, not to mention that self-employed parents are completely excluded from the scheme, which pays no

[15] HM Revenue & Customs, *Reduced childcare relief for higher earners* (TIIN 8275), 23 March 2011. For further details see, Tax relief for childcare, Commons Briefing paper CBP19, 14 March 2018.
[16] HM Treasury press notice 29/13, *New scheme to bring tax-free childcare for 2.5 million working families*, 19 March 2013. See also, HM Treasury, *Tax-free childcare Q&A*, 19 March 2013
[17] *Budget 2014*, HC1104, March 2014 paras 1.182-3
[18] Childcare Payments Bill, RP14-35, 26 June 2014; and, Childcare Payments Bill: Committee Stage Report, RP14-59, 6 November 2014.
[19] *Budget 2016*, HC 901, March 2016 para 1.138
[20] HMRC, *Impact Assessment on its introduction of Tax-Free Childcare*, March 2017
[21] As noted above, the issue is examined at greater length in, Childcare Vouchers and Tax-Free Childcare - Frequently Asked Questions, Commons Briefing Paper CBP8055, 20 April 2018.
[22] PQ118344, 18 December 2017; PQ120037, 21 December 2017.

> regard to the number of children in each family and disadvantages lone-parent families.
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> Secondly, tax-free childcare has a broader reach. It is open to all working families with children aged under 12 that meet the earnings criteria. That ensures that families who were excluded from childcare vouchers can be brought into tax-free childcare, and benefits families with the highest childcare costs—namely, most of those with young children.
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> Thirdly, tax-free childcare is simpler to use … Employers usually pay third-party providers to administer childcare voucher schemes. The Government do not believe that paying third-party providers is a good use of taxpayers' money. Some £220 million has gone on such administration since the scheme began. A voucher scheme is therefore an ineffective way of delivering support to families. Under tax-free childcare, parents manage their own accounts online. The case for change is clear, as it was to the Labour party when it announced at its 2009 conference, when it was in government, that the existing system would be shut down.[23]

As noted, statutory provision for the introduction of TFC is made by the *Childcare Payments Act 2014*, including the procedure for closing ESC to new applicants.

Sections 63-4 of the Act amend the provisions of the *Income Tax (Earnings & Pensions) Act (ITEPA) 2003*, which provide tax exemptions for childcare vouchers and directly-contracted childcare. The 2014 Act added two new provisions – s270AA and s318AZA – to *ITEPA 2003*, with effect from 21 April 2017 (under reg 3(f) of SI 2017/578).

Both exemptions are to be unavailable to those not already in an ESC scheme from "the relevant day" - a day to be specified by regulations:[24]

> **Withdrawal of Existing Tax Exemptions**
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> 275. Sections 63 and 64 amend the *Income Tax (Earnings and Pensions) Act 2003 (ITEPA)* to restrict the availability of the existing tax exemptions for childcare vouchers and directly-contracted childcare (referred to here together as Employer-Supported Childcare). The purpose of the section is to make the tax exemption unavailable to those not already in an Employer-Supported Childcare scheme on a day which will be specified in regulations under the provisions being inserted in *ITEPA*.
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> 276.Subsections (2) and (3) of each section amend sections 270A and 318A of *ITEPA*, adding to them the concept of an 'eligible employee'. In order for an employee to continue to be eligible for the exemption from income tax for Employer-Supported Childcare, they will need to be an 'eligible employee'.
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> 277.Subsection (4) of each section inserts new sections 270AA and 318AZA after sections 270A and 318A of ITEPA and defines what is meant by an eligible employee. An employee will need to meet three eligibility conditions to be an eligible employee:
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> - they were employed by their employer before the relevant day and have not ceased to be employed by that employer on or after that day;
> - they have been in receipt of Employer-Supported Childcare at least once in a period of 52 weeks ending on or after the relevant day; and
> - they have not given their employer a 'childcare account notice' to say that they no longer want to receive Employer-Supported Childcare, so that they or their partner can open a childcare account.
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> 278.Together, these conditions mean that an employee who was already in an Employer-Supported Childcare scheme on the relevant day will be able to continue to

[23] HC Deb 15 January 2018 c240WH. Chief Secretary to the Treasury Elizabeth Truss was asked about this issue when she gave evidence on 31 January as part of the Treasury Committee's inquiry on childcare policy and its impact on the economy: *Oral Evidence: Childcare*, HC 757, 31 January 2018 Qs53-63.

[24] Childcare Payments Act 2014: Explanatory Notes, "Withdrawal of existing tax exemptions"

> receive the tax exemption, as long as they have not voluntarily given up the tax exemption in order to move into the new scheme provided for by the Act.

Section 717 of *ITEPA 2003* provides for the procedure for making regulations under the Act. Under s717(4), regulations made under certain provisions of the Act are exempt from parliamentary procedure, meaning that they are made on signing and do not need to be laid. This *includes* regulations to be made under s270AA and s318AZA.

Turning to the '2018 Regulations', Part 2 of the Regulations "removes the availability of ESC from employees who do not fall within the definition of an "eligible employee" in section 270A of *ITEPA 2003*. The changes made are purely consequential to amendments to the income tax treatment of ESC that had effect from April 2017":

> Paragraphs 6B to 7A of Part V of Schedule 3 to the Social Security (Contributions) Regulations 2001 (S.I. 2001/1004) (SSCR) provide for payments of qualifying childcare vouchers to an employee to be disregarded in the calculation of liability to Class 1 NICs …
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> [Part 2 of the 2018 Regulations] make very limited consequential changes to the NICs disregards for childcare vouchers in paragraphs 6B to 7A of Part V of Schedule 3 to the SSCR. The regulations limit the availability of these disregards in the same manner as the corresponding income tax exemption, by restricting their availability to "eligible employees". The definition of "eligible employee" is taken from the corresponding income tax definition of this term in s270AA ITEPA.
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> These regulations do not make any amendments in connection with directly contracted childcare as the NICs disregard for these schemes mirrors the scope of the corresponding income tax exemption automatically. Amendments that have been made to the tax exemption for this scheme have therefore been matched by a corresponding amendment to the NICs disregard without the need for separate NICs legislation.
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> The effect of these amendments is that the availability of the disregards in these paragraphs will be limited in the same way as the tax exemption is currently limited. This means that the NICs disregards:
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> (1) will cease to be available to employees who do not meet Condition C in the definition of "eligible employee" with immediate effect, once the regulations come into force (which means employees that have already given their employer a "childcare account notice" in order to open a TFC Childcare Account will be unable to access these disregards); and
>
> (2) will additionally cease to be available to employees who do not meet Conditions A or B in the definition of an "eligible employee" from a date to be appointed by HM Treasury, known as the "relevant day", onwards (which means that employees who did not enter into a voucher scheme before the relevant day or who had fallen out of their employer's scheme before then will be unable to access these disregards).[25]

As noted above the House considered, and agreed, the '2018 Regulations' along with three other Orders on 13 March. At the close of the debate the Secretary of State for Education, Damian Hinds, reiterated the Government's approach to supporting early years and childcare, before announcing that the closure of ESC for new entrants would be postponed for six months:

> **The Secretary of State for Education (Damian Hinds) :** There are five main elements to our support in early years and childcare ...
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> First, there are 15 hours a week of free early education for disadvantaged two-year-olds … Secondly, there is the universal 15 hours a week free childcare for three and four-year-olds … and now with the early years pupil premium ... Thirdly, there are an additional 15 hours for working parents … Fourthly, up to 85% of childcare costs can

[25] Explanatory Memorandum to the 2018 Regulations, paras 2,.2, 4.3, 7.6-8

be reimbursed through universal credit … Finally, tax-free childcare will provide support for nearly 1 million more families than the existing vouchers scheme.

Emma Little Pengelly (Belfast South) (DUP) : Given the concerns raised across the House about the April closure of the childcare vouchers scheme, does the Secretary of State agree that the closure should be delayed to allow for those concerns to be addressed?

Damian Hinds : I have heard the concerns about the timing, and I can confirm that, following the hon. Lady's representations, we will be able to keep the voucher scheme open to new entrants for a further six months.[26]

Subsequently the Government has laid regulations to set 4 October as the 'relevant day', when ESC will be closed to new entrants:

Employer Supported Childcare: Written statement - HCWS616

Elizabeth Truss (The Chief Secretary to the Treasury)

This government is providing more help with the cost of childcare to working parents than ever before. As well as introducing Tax-Free Childcare in April 2017, the government has doubled the free childcare available to working parents of 3 and 4 year olds in England to 30 hours a week, and increased the support available through Universal Credit to cover up to 85% of childcare costs. In 2019/20 the government will spend around £6 billion on childcare support – a record amount.

Since opening the Childcare Choices service through which parents apply for 30 hours free childcare and Tax-Free Childcare more than 370,000 customers have successfully applied and are now using the service. Of these, more than 335,000 parents are eligible for 30 hours free childcare. Over 210,000 have a Tax-Free Childcare account. The government will encourage more parents to take up the offer they are entitled to.

Parents can apply via the Childcare Choices service for both 30 hours free childcare and Tax-Free Childcare. The application is straightforward and can be accessed via: https://www.childcarechoices.gov.uk/.

Tax-Free Childcare is a fairer and better targeted system than childcare vouchers. Through Tax-Free Childcare all families who are eligible can get support regardless of who their employer is, or whether they are self-employed, and support is based on the number of children in a family, rather than the number of parents. Tax-Free Childcare is targeted at a similar income population as childcare vouchers but will provide support to nearly 1 million more families compared to the number currently using vouchers.

The decision to phase out childcare vouchers and directly contracted childcare, and replace this support with Tax-Free Childcare was made in 2013, and received parliamentary approval through the Childcare Payments Act 2014.

Today the government has made The *Income Tax (Limited Exemptions for Qualifying Childcare Vouchers and other Childcare) (Relevant Day) Regulations 2018* (SI 2018/462). These Regulations set 4th October 2018 as the date when childcare vouchers and directly contracted childcare, part of Employer Supported Childcare, will close to new entrants. After that date, parents who are already using vouchers can continue to do so for as long as they remain with their employer, and their employer continues to offer the scheme.

To reflect concerns about the timing of the closure of childcare vouchers and the transition to Tax-Free Childcare, the government has decided to keep childcare vouchers open for a further six months until October. This will allow more time for Tax-Free Childcare to bed in, for awareness to increase and for families to understand the support they can receive under the scheme. Now that Tax-Free Childcare is fully rolled out, the government will keep it under review to ensure it is delivering the support needed for working families.[27]

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26 HC Deb 13 March 2018 cc801-2 – see also PQ133041, 21 March 2018
27 HCWS616, 29 March 2018

2.3 Sporting testimonial payments

Following a consultation exercise in 2015, the Government introduced legislation as part of the Finance Act 2016 to clarify the tax treatment of income from sporting testimonials.[28] A one-off exemption of £100,000 applies to income received from events held during a single testimonial or testimonial year.

In December 2016 the Government published draft provisions to be included in a National Insurance Bill to make a number of changes to NI legislation, including provision for the NI treatment of sporting testimonial payments.[29] In March 2017 the Government introduced secondary legislation to tackle an unintended consequence of the tax changes – that where an independent sporting testimonial committee organised a testimonial match for a sportsperson, the sportsperson's employer could become liable for the Class 1A NICs charge, rather than the testimonial committee. This secondary legislation applies for the 2017/18 tax year (SI 2017/307). It had been planned that a National Insurance Bill would be introduced in 2017, and include provisions to deal with this anomaly on a permanent basis. However, the introduction of this primary legislation has been delayed, so Part 3 of the '2018 Regulations' ensure the exemption continues for the 2018/19 year and beyond.[30]

28 HMRC, Income Tax: update to treatment of income from sporting testimonials – tax information & impact note, November 2017. Provision to this effect was made by s12 of FA2016.
29 This is collated on Gov.uk.
30 Explanatory Memorandum to the 2018 Regulations, para 7.13