

# KiddiVouchers

Accounting for VAT on your Childcare Voucher scheme



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HMRC has issued guidance on the VAT treatment of benefits provided through salary sacrifice schemes. This guide explains how the VAT guidance may apply to your Childcare Voucher scheme.

## Overview

- Childcare Vouchers are exempt from VAT, but VAT is chargeable on Childcare Voucher scheme administration fees. Historically, administration fees have been viewed as a normal business overhead and many employers have been able to reclaim the VAT on their scheme administration fees.
- A change in the VAT treatment of employee benefits means that, from 1st January 2012, employers may be unable to reclaim VAT on any input costs which relate directly to their Childcare Voucher scheme. In particular, it may no longer be possible for employers to reclaim the VAT on their Childcare Voucher scheme administration fees.
- In addition, employers who provide Childcare Vouchers (or other VAT exempt benefits) to their staff may no longer be able to reclaim some of the input VAT relating to their general overheads.
- Many employers will be protected from the change under the “de minimis” rules, which allow organisations to effectively ignore small volumes of VAT exempt sales.
- The effect of VAT guidance on Childcare Voucher schemes will vary between different employers depending on their VAT status. While the effects are expected to be minimal for most employers, we recommend that you ask your accountant for further advice on how your scheme may be affected.

### ! Jargon buster

VAT (Value Added Tax) is a tax which is charged on most supplies of goods and services. The standard rate of VAT is currently 20%, but some goods and services attract VAT at different rates. Some goods and services, such as Childcare Vouchers, are VAT exempt.

Every VAT registered business must account to HMRC for the VAT on its sales and purchases. Businesses must pass on to HMRC any VAT which they collect on their sales (output VAT), but they can generally reclaim the VAT which they have incurred on purchases (input VAT).

Where businesses sell a mixture of taxable and VAT-exempt goods or services, they may not be able to reclaim all of their input VAT. Instead, they are required to complete a partial exemption calculation to determine how much of their input VAT can be reclaimed. Input VAT relating directly to taxable supplies can be reclaimed in full, so the partial exemption calculation only applies to general overheads.



# Background

The January 2012 changes to VAT guidance have arisen as a result of a judgement made by the Court of Justice of the European Union (CJEU) on 29th July 2010 in the case of *Astra Zeneca v HMRC* (ref C-40/09).

Astra Zeneca had been using a flexible remuneration scheme which allowed employees to sacrifice part of their salary in exchange for high-street vouchers. While Astra Zeneca was reclaiming input VAT on the business cost of purchasing the vouchers, it was not accounting for output VAT when the vouchers were passed on to its employees.

Traditionally, HMRC has made a distinction between goods which are paid for by a deduction from salary and those which are provided under salary sacrifice. Deductions from salary have always been treated as a payment for goods or services and are subject to normal VAT rules. However, where an employee has received a benefit as a result of entering into a salary sacrifice agreement, HMRC has traditionally accepted that the salary reduction does not constitute a payment. Where goods or services are provided for no payment, no VAT is due. Therefore, benefits provided under salary sacrifice have traditionally not attracted any VAT.

In the *Astra Zeneca* case, the CJEU judged that the provision of high-street vouchers to employees constituted a supply of services in exchange for payment. The judgement was based on there being a direct link between the value of the vouchers provided to employees and the amount of cash remuneration which the employees had given up.

As a result of the ruling, Astra Zeneca was allowed to continue to recover input VAT on the purchase cost of vouchers, but they were also required to account for output VAT on the “sale” of the vouchers to their employees.

Although the *Astra Zeneca* case related to the provision of high-street vouchers, the principles are deemed to apply across a range of salary sacrifice schemes. Where an employer provides goods or services as a result of a salary sacrifice, they are now considered to be selling those goods or services to their employees. This sale of goods or services then becomes subject to normal VAT rules.

In most cases the value of the benefit for VAT purposes will be the same as the amount of salary deducted or the amount foregone under a salary sacrifice arrangement. Where the benefit is provided at a discounted price, the value of the benefit for VAT purposes should be based on the original cost to the employer.

HMRC considers that the judgement is limited to the application of VAT legislation. There are no plans to amend the existing income tax and National Insurance exemptions of Childcare Vouchers as a result of this court case.

## Key point

From 1st January 2012, employee benefits which are provided through salary sacrifice will be treated as a “sale” of goods or services from the employer to their employees. VAT will be due on this sale in the same way as if the employer were selling the goods or services to the general public. As Childcare Vouchers continue to be exempt from VAT, Childcare Voucher schemes are affected less than some other benefits.

# What you need to do

## Salary sacrifice schemes

### How salary sacrifice schemes are affected

Where Childcare Vouchers are provided through salary sacrifice, employers should include the total face value of the vouchers in their VAT calculations as a VAT exempt sale.

Employers will not be able to reclaim VAT on any input costs which relate directly to their Childcare Voucher scheme, unless they are granted a reprieve under the “de minimis” rules. Employers may also be unable to reclaim a proportion of the VAT relating to their general overheads. The calculations and “de minimis” rules are explained overleaf.

Since Childcare Vouchers are VAT exempt, no VAT is due on the voucher face value and the amount which employees sacrifice will remain unchanged.

### Addition-to-salary schemes

Some employers choose to provide Childcare Vouchers to their employees in addition to their salary, rather than through salary sacrifice. In these cases, the employee is not “paying” for the benefit either through a salary deduction or a salary sacrifice. As there is no payment, the benefit is not considered to be a “sale” and the Astra Zeneca ruling does not apply.

As a result, where employers provide Childcare Vouchers in addition to salary, the voucher face value should not be treated as VAT exempt turnover and it should not be included in VAT calculations. In these cases, employers may continue to treat Childcare Voucher scheme administration fees as a normal business overhead and reclaim the VAT on these fees in their normal way.

Some employers may benefit by converting their scheme from a salary sacrifice arrangement to an addition-to-salary arrangement. This is most likely to be of interest to small owner-director businesses.

## Flexible benefit arrangements

Some employers operate flexible benefit schemes where employees can choose to allocate a “benefits pot” in a variety of ways, such as for Childcare Vouchers, pension contributions or additional holiday.

In some such schemes, employees can choose to receive cash rather than a benefit. These schemes will fall within the Astra Zeneca ruling in the same way as salary sacrifice arrangements.

In other schemes, employees may be unable to receive any part of their benefits pot as cash. As the Astra Zeneca ruling rests on an employee giving up part of their cash remuneration in exchange for a benefit, these schemes may fall outside the Astra Zeneca ruling. However, we would recommend that employers seek further advice before relying on this approach.

### Employer funded vouchers during maternity leave

Where an employer’s standard practice is to provide Childcare Vouchers through salary sacrifice, but with the employer bearing the cost of the vouchers while an employee is on maternity leave, a grey area arises. However, since the employer-funded vouchers still relate to an underlying salary sacrifice agreement, we would suggest that the Astra Zeneca judgement does apply in these cases.



# Understanding VAT calculations

## De minimis rules - a reprieve for employers

Employers are allowed to reclaim the input VAT relating to exempt sales if the amounts involved are sufficiently small, as defined by the de minimis limits.

For Childcare Voucher schemes, the input VAT is 20% of the scheme administration fee. Even for schemes with hundreds of members, the VAT amount tends to be sufficiently small to meet the de minimis criteria.

Therefore, it is likely that employers will only be unable to reclaim the VAT on their Childcare Voucher schemes if:

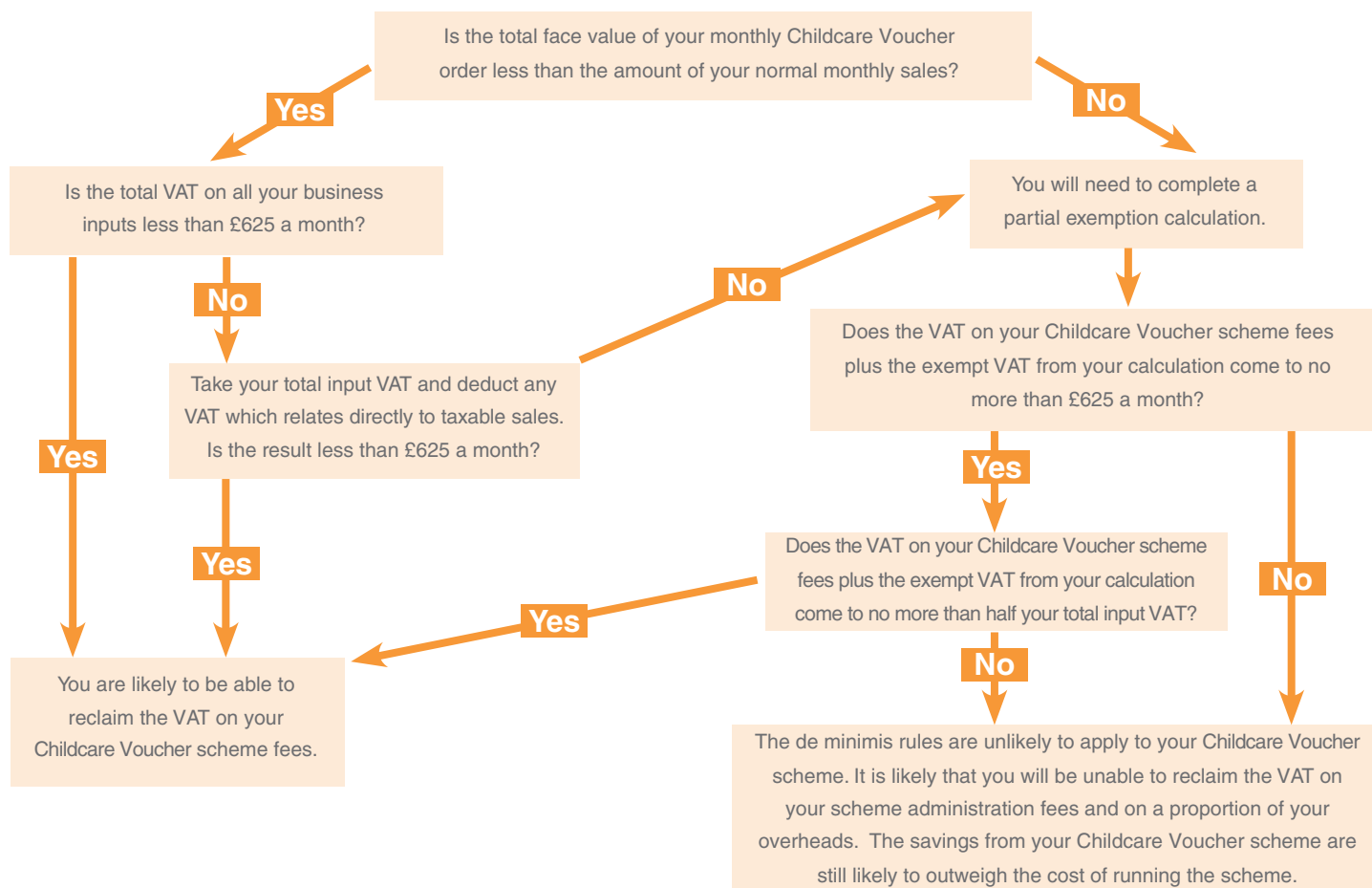
- their scheme has a high number of members, or
- they already have a mixture of taxable and VAT-exempt sales.

There are three tests which employers can do to check whether they qualify for the de minimis reprieve. If an employer passes any one of the tests, there is no need to check the other two.

Employers are normally required to perform the check every time they complete a VAT return, but in some cases this can be replaced with an annual check.

Details of the de minimis tests are available on the HMRC website.

If you have no VAT exempt sales other than your Childcare Vouchers, you can use our flowchart as an indicator of whether the de minimis rules apply. We suggest you also discuss your VAT calculations with your accountant.



## Partial VAT exemption calculations

Some employees will need to perform a partial exemption calculation, either to prove that they meet the de minimis limits or to determine the amount of VAT which they can reclaim.

### a) Standard method

Where employers have business overheads which don't relate directly to either a VAT exempt sale or to a taxable sale, they are allowed to reclaim a proportion of the input VAT relating to these.

The proportion is calculated as total taxable turnover divided by total turnover. For the purpose of this calculation, the employer's total turnover will increase by the face value of Childcare Vouchers sold to its employees. The result is applied to VAT on general business overheads to determine how much can be reclaimed. Any input VAT which relates directly to taxable sales continues to be reclaimable in full.

### b) Special methods

Use of the standard method is not mandatory and a business can use a "special method" that suits their business activities better. Any special method has to be "fair and reasonable" and it has to be agreed with HMRC in advance.

Commonly used special methods include those based on staff numbers, floor space, purchases (the standard method uses sales) or transaction counts.

While employers may not be able to reclaim the VAT on their scheme administration fees, they may be able to use a special method to avoid any knock-on effect on residual input VAT.

## ! Action point

We would advise all employers who believe they may be affected by the new rules to discuss partial exemption calculations and special methods with their accountants.

## VAT exempt businesses

Employers who are not VAT registered cannot reclaim any VAT on their purchases. These employers will not be affected by the change in the VAT treatment of Childcare Voucher schemes.

If an employer who is not VAT registered decides to offer its employees VAT-able benefits through a salary sacrifice scheme, the value of these benefits will form part of the employer's taxable sales. If this pushes the total value of taxable sales above the VAT registration limit, the employer will need to become VAT registered.

Childcare Vouchers are VAT exempt and so this issue will not arise in respect of Childcare Voucher schemes.

## ! Key point

The effect of the new rules will vary between different employers, but for most employers the additional cost will be incidental compared to the savings provided by their Childcare Voucher scheme.

## ! Top tip

Employers who meet the de minimis rules can continue to reclaim the VAT on their scheme administration fees.

The de minimis tests are directly dependent on the amount of your scheme administration fees. If you are not yet using KiddiVouchers for your Childcare Voucher scheme call us on 0800 612 9015 to find out how we could cut your fees and help you meet the de minimis tests.

# Conclusion

Revised VAT guidance means that some employers will no longer be able to reclaim the VAT on their Childcare Voucher scheme administration fees.

In some cases, employers may also no longer be able to reclaim the VAT on a proportion of their general overheads.

The “de minimis” rules mean that many businesses will be able to continue reclaiming their input VAT in full, but the revised guidance may lead to some added complexity in their VAT reporting.

Where employers are affected by the new rules, the costs are likely to be small relative to the National Insurance savings provided by their Childcare Voucher scheme.

Larger employers, or those which also operate other salary sacrifice schemes, may wish to seek legitimate ways of minimising the effect of the revised VAT guidance. Further information on this is available in our separate discussion document.

We recommend that employers speak to their accountants for further advice.

## Further reading and resources

Please do feel free to contact us on 0800 612 9015 or email [info@kiddivouchers.com](mailto:info@kiddivouchers.com) if you have any queries, feedback or suggestions.

## HMRC’s guidance

HMRC’s VAT helpline can be reached on 0845 010 9000.

