

# KiddiVouchers

## Understanding Tax Credits



Call us free on 0800 612 9015

[www.kiddivouchers.com](http://www.kiddivouchers.com)

# Tax credits – the basics

## What are tax credits?

Tax credits are payments from the Government which are received by many working parents.

Tax credits are linked to earnings, so low income families typically receive more than higher earners.

Some parents receive tax credits specifically to help with childcare costs, while others receive a smaller amount to help with the general costs of looking after children.

## What have tax credits got to do with childcare vouchers?

Childcare vouchers can affect the amount of tax credits you receive. Unfortunately, the effect is quite complicated and it varies depending on individual circumstances.

In some cases, using childcare vouchers may increase your entitlement to tax credits. However, in other cases using childcare vouchers will cause a reduction in tax credits.

## How can KiddiVouchers help?

This leaflet is designed to help you understand whether it is in your interest to use childcare vouchers, or whether you will be better off without them. If you have any questions, or if you would like a personalised calculation based on our understanding of the tax credit system, please call us on 0800 612 9015.

Please be aware that KiddiVouchers cannot provide financial advice and neither our calculations nor our guidance leaflets should be treated as financial advice.

## Where can I find out more about tax credits?

If you're not sure whether you are entitled to receive tax credits, or if you would like independent advice, you can phone HMRC's Tax Credits Helpline on 0345 300 3900.

Information is also available online at [www.hmrc.gov.uk](http://www.hmrc.gov.uk).



# The childcare element

## What is the “childcare element”?

The “childcare element” is the part of Working Tax Credit which directly helps parents with the cost of childcare.

Parents who are entitled to the childcare element can get up to 70% of their childcare paid for through tax credits.

## What types of childcare are eligible for the “childcare element”?

The childcare element covers any childcare which is registered with Ofsted or equivalent ... in fact, exactly the same types of care which can be paid for with childcare vouchers.

The amount of care which is eligible for the childcare element is capped at £175 a week for one child or £300 a week for two or more children. The childcare element then pays for up to 70% of these costs.

You can use childcare vouchers for any childcare costs in excess of £175pw (or £300pw if you have two or more children in childcare) without affecting your tax credits.

## How do childcare vouchers affect the “childcare element”?

Parents can't claim the childcare element of tax credits on any childcare which is paid for with childcare vouchers. In some cases, this can mean that parents are better off without childcare vouchers.

For example, if your childcare costs £500 a month and you receive £200 in childcare vouchers, your childcare element will be based on just £300 a month of childcare. If you attempt to claim tax credits for the full £500, you may be required to repay your tax credits, even if your claim was made in innocence.

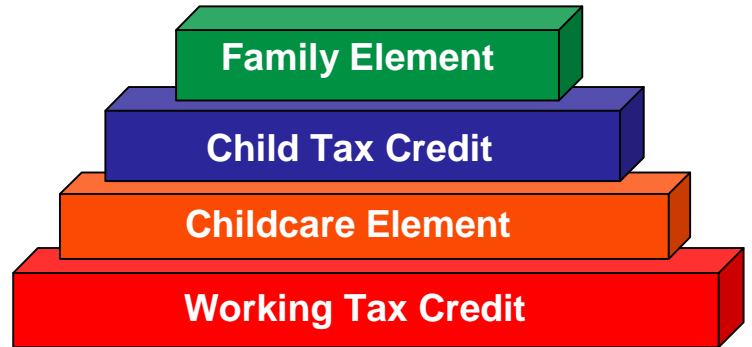
## I don't receive the “childcare element” - does that mean I can safely order childcare vouchers?

Unfortunately, it isn't quite that simple. Although the childcare element is the only tax credit which is *directly* affected by childcare vouchers, other tax credits can be *indirectly* affected. To understand how this works, we need to look at tax credits in a bit more detail.

# Building the tax credit tower ...

## Understanding the jargon

It helps to think of your tax credit award as a tower of building blocks, with each type of tax credit being represented by a different block.



The bottom layer in our tower is **Working Tax Credit**. Working Tax Credit is itself made up of many elements but we'll group all these together apart from one, the **Childcare Element**, which is handled separately in your tax credit award.

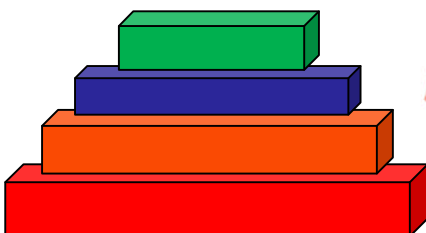
Our next building block is **Child Tax Credit**. Again, this includes a number of elements and we'll group all these together apart from one, the **Family Element**. The Family Element (around £45 a month) is often the only type of tax credit received by middle income families.

## Working out your tax credits

To work out your tax credit award, HMRC start by building you an individual tower. The blocks of the tower represent the maximum amount of tax credits you could be entitled to, ignoring your income. At this stage, your entitlement to the childcare element is calculated as 70% of your eligible childcare costs.

Having built your tax credit tower, HMRC then reduce your tax credits to reflect your income. They take your income into account by removing the blocks, starting from the bottom layer. This process is called tapering. Your final tax credit award is made up of any tax credits which have not been tapered away.

Your tax credit tower before tapering



Your tax credit tower after tapering



In this example, the tapering removes the parent's entitlement to the childcare element, but they remain entitled to some child tax credit and to the family element.

# ... and knocking it down again!

## What tapering does to the childcare element

Many parents find that tapering removes their entitlement to the childcare element. For example, in the diagram on the previous page, the orange block which represents the childcare element is completely removed by tapering.

It's tempting to think that these parents can safely use childcare vouchers, but that isn't always the case. Let's look again at our tower, this time taking childcare vouchers into account.

## Looking at how childcare vouchers affect your tax credit tower

Let's suppose that the parent in our example now decides to use childcare vouchers to pay for all of their childcare. This means that none of their childcare is eligible for the childcare element, so the orange block disappears from their original tower (see the diagram below).

When HMRC apply the tapering, the orange block is no longer there for them to take, so instead they take a bigger chunk of the other blocks. You'll notice that in the diagram below, the whole of the blue block now gets tapered away.

So, even though this parent's childcare element was already being fully tapered away, their final tax credit award would still be reduced if they start to use childcare vouchers. This explains why childcare vouchers can sometimes affect your tax credits even if you are not receiving the childcare element.

Similarly, if you are receiving the childcare element but it only partly covers your childcare costs, you can't assume that it is safe to use childcare vouchers for your remaining childcare costs. The only exception is in respect of costs which exceed the cap of £175 a week (or £300 a week for more than one child).



The childcare element is missing from the tower because you can't claim the childcare element for care which is paid for with childcare vouchers.

# Frequently asked questions

**My employer provides my childcare vouchers as a benefit in addition to salary. Is it safe for me to join their scheme?**

If your employer provides childcare vouchers in addition to your pay, it will normally be in your interest to accept them. However, if you are employed by your own company and you provide yourself with childcare vouchers in addition to salary then this may not hold true.

Regardless of whether you receive your childcare vouchers in addition to salary or via salary sacrifice, you must still declare them to HMRC as your tax credits may be affected.

**I only receive the Family Element of tax credits. Should I sign up for childcare vouchers?**

If you are only receiving the Family Element of tax credits, which is around £45 a month, then it will normally be in your interest to use childcare vouchers.

The most common exceptions to this rule are:

- If your circumstances change during the tax year so that you become retrospectively entitled to higher tax credits, or
- If you are receiving a reduced amount of tax credits due to a previous overpayment.

Even if you are receiving £45 a month or less in tax credits, you must still declare your childcare vouchers to HMRC as your tax credits may be affected. However, in these circumstances, the tax and National Insurance savings from childcare vouchers will normally outweigh any effect on your tax credits.

**Are all parents eligible to receive the childcare element of tax credits?**

The childcare element of working tax credit is normally only available to parents who work at least 16 hours a week. In a two-parent household, both parents must work at least 16 hours a week in order to be eligible for the childcare element.

If you are on sick leave, maternity leave, paternity leave or adoption leave, HMRC may treat you as if you are working more than 16 hours a week.

If either parent has been unemployed for more than 4 weeks, or works less than 16 hours a week, then using childcare vouchers will not affect your tax credits.



## What happens if my circumstances change?

Your tax credit award will be based on your personal circumstances, including the number of hours you work, the number of children you have, your marital status and your total family income. If your circumstances change during the tax year, your entitlement to tax credits may also change.

For example, if your income falls due to redundancy or maternity leave, you may become entitled to a higher amount of tax credits. This increased entitlement may be applied retrospectively to the whole tax year.

If you know in advance that your circumstances are likely to change (if you are pregnant, for example) then please ask us for guidance on how your tax credits might be affected.

If your circumstances change unexpectedly during the tax year then, depending on your employer, you may be able to stop receiving childcare vouchers. However, any childcare vouchers which you have already received in this tax year may affect your tax credit claim.

We recommend that you inform HMRC promptly of any changes in your circumstances.

## What happens if my tax credits are affected by a previous overpayment?

If you are receiving a reduced amount of tax credits (or no tax credits) because of a previous overpayment, you still need to check whether using childcare vouchers is in your best interests. Childcare vouchers may reduce your theoretical entitlement to tax credits, which could mean that it will take you longer to clear any overpayment.

## How could childcare vouchers increase my tax credits?

Childcare vouchers are normally provided through salary sacrifice, which means that you opt to receive childcare vouchers in exchange for a reduced salary.

As your entitlement to tax credits is based on your household income, your salary reduction may make you entitled to higher tax credits in the next tax year.

If you are using childcare vouchers and you would like to check whether you could benefit from temporarily opting out of the scheme, please contact us for a free calculation.

# Next steps

## Your personal tax credit calculation

We can provide you with individual guidance on your tax credits, including running a calculation based on our understanding of the current legislation.

If you would like us to run a calculation for you, we will need you to provide us with details from your latest tax credit award and with information about any changes in your circumstances.

Please remember that our calculations should not be treated as financial advice.

## Contacting HMRC's tax credit helpline

You may also find it helpful to contact HMRC's helpline. Here's what you need to do:

Work out your average weekly childcare costs – let's call this your *original* qualifying childcare amount.

Now deduct the amount of childcare which you would like to pay for with childcare vouchers. The reduced amount is your *new* qualifying childcare amount.

Phone the tax credit helpline on 0345 300 3900 and ask "If my qualifying childcare falls from [insert your original amount] to [insert your new amount], will my tax credits be affected"?

If the answer is no, you can go ahead with childcare vouchers. If the answer is yes then you will need to decide whether the savings from your childcare vouchers will offset your reduction in tax credits.

## Getting in touch

If you've got any queries, please phone us on 0800 612 9015, visit us online at [www.kiddivouchers.com](http://www.kiddivouchers.com) or email us at [info@kiddivouchers.com](mailto:info@kiddivouchers.com).

