

Daycare Trust response to 'Tax credits: improving delivery and choice'

1. Daycare Trust is the national childcare charity, campaigning for quality, accessible, affordable childcare for all and raising the voices of children, parents and carers. We lead the national childcare campaign by producing high quality research, developing credible policy recommendations through publications and the media, and by working with others. Our advice and information on childcare issues assists parents and carers, providers, employers, trade unions and policymakers.
2. Established in 1986, Daycare Trust has seen its campaigning translate into policy change, including the establishment of the national childcare strategy. However, access to quality childcare services is still dependent on where families live and on their income. As the leading campaigning childcare charity, Daycare Trust is uniquely qualified to give a voice to parents facing a range of multiple challenges.
3. Daycare Trust welcomes the opportunity to respond to the consultation, 'Tax credits: improving delivery'. The financial support through tax credits for low-income families with their childcare costs provides a welcome contribution to the costs that parents face when using formal childcare. This help with costs is essential to enable parents to move into paid work and lift their families out of poverty, and will continue to be so in any reformed scheme where parents have to pay part of the costs for childcare.
4. In spite of increasing numbers of families using the childcare element of Working Tax Credit (WTC), this represents only a small proportion of families overall. Only a quarter of families receiving WTC also receive the childcare element. This is partly due to the complicated eligibility criteria or lack of eligibility, but also in recent years because of fear of overpayments.¹ Consequently, the consultation to simplify the delivery of childcare support through tax credits is welcome and timely.
5. This consultation represents the first opportunity to address some of the entrenched problems with the childcare element since the tax credits system was introduced. Improving the delivery of childcare support through tax credits could make childcare more accessible to those low-income families who would really benefit from increased access to childcare services. Childcare has a key role to play in helping more families move into paid work and in reducing child poverty. It is for this reason that it is essential that the childcare support provided by tax credits is improved.
6. Before responding to the specific questions raised in the discussion paper, we would like to take this opportunity to provide our views on how childcare support for parents might be improved.

¹ See, for example, Daycare Trust (2007) *Listening lone parents about childcare*

How childcare support for parents can be improved

7. The Government's childcare strategy takes two different approaches: free part-time early years education for three and four year olds to improve child outcomes and reduce the gap between disadvantaged children and their peers; and childcare for working parents delivered via a market approach with subsidies for some parents. The former has largely worked, with high take-up of part-time early years education for three and four year olds. Yet delivery of the strategy aimed at working parents is mixed. The advances made in childcare provision in disadvantaged areas is jeopardised by uncertain government funding and the effectiveness of the market to respond to parents' diverse needs is in question.²
8. Despite an increase in childcare provision – mainly as a result of the government's childcare strategy – market imperfections on the supply-side are demonstrated by the fact that although a substantial minority of parents report a shortage of childcare places, a significant number of service providers report vacancies.³ In addition, childcare costs continue to rise at a rate well above inflation. Daycare Trust's 2008 childcare costs survey revealed that costs in England had risen nearly 5 per cent in the last year. Daycare Trust's annual summer holiday childcare costs survey showed that families in Britain also faced an 8 per cent rise in the cost of summer holiday childcare.
9. The childcare element of the Working Tax Credit is an important component of the Government's welfare to work and childcare strategies, and it is valuable in assisting low-income parents in paying for childcare. However, the way in which it is currently structured and operates presents complex and interlocking problems of take-up, eligibility, qualifying hours, the proportion of costs which should be covered and regional disparities. Take-up of the childcare element has increased to nearly 450,000 parents in April 2008. Yet, as stated above, only a quarter of these families also claim the childcare element. And while the latest figures show that the average amount claimed has now reached £65, it still does not cover the full cost of a childcare place. The bottom line is that the cost of childcare is still beyond most families, particularly those families on low to medium incomes and lone parent households.

Supply side funding

10. In spite of substantial increases in Government spending on childcare and early years education in recent years, parents still pay the lion's share of childcare costs – around 75 per cent, compared with around 30 per cent in Denmark.⁴ Given the success of supply-side funding demonstrated by the free entitlement for three and four year olds, Daycare Trust believes that there should be further exploration of how childcare funding can be directed to providers to reduce charges to parents, with the aim of introducing long-term direct funding through local authorities.
11. While extending supply-side funding must be a priority – and is Daycare Trust's preferred method of childcare funding – the subsidies for parents that are provided via the tax credit system will remain a vital part of childcare funding for families on a low-income. Consequently, reforms to improve the delivery of childcare support via tax credits must not be ignored.

² For more analysis of the childcare strategy, see, Butt, Goddard, La Valle and Hill (2007) *Childcare Nation: Progress on the Government's childcare strategy and priorities for the future*, London: Daycare Trust and National Centre for Social Research

³ Kinnaird, Nicolson and Jordan, (2007) *2006 Childcare and Early Years Providers Surveys: Overview Report*. London: DCSF

⁴ Daycare Trust (2004) *Universal Early Education and Care in 2020: costs, benefits and funding options*, London: Daycare Trust

12. The Government has made huge strides in providing childcare to give children a better start in life and creating the opportunity for parents to enter and remain in paid work. While recognising that resources are always finite, we believe that families deserve universal childcare and the Government must ensure that childcare becomes a public good.

A separate childcare element?

13. A large proportion of the calls to our Information Line are from parents inquiring about the childcare element. They are often very confused about their tax credits claim, how much they might receive, how much of their WTC claim covers their childcare costs and about the overall complexity of the system. We also know from our Information Line that many parents, childcare providers and employers get very confused by the complexity resulting from the provision of the childcare element of WTC and employer-supported childcare. To help reduce complexity, we believe that the childcare element should be separated from Working Tax Credit and either included under the Child Tax Credit or made into a separate programme.

14. Attaching the childcare element to the Child Tax Credit might be preferable, however, as to further aid take-up, the application process could remain a single form for parents to complete.

15. A more radical step could be to remove the work requirement for parents so that childcare support could be provided if a parent is claiming just the Child Tax Credit. This is based on the premise that we know that childcare brings positive outcomes for children and should not depend on whether both of their parents are in paid work. This would also enable parents who are students to claim the childcare element.

Increase the childcare element

16. The rationale behind the demand-side subsidy provided by the childcare element of WTC is that it increases the 'purchasing power' of parents who would otherwise be unable to afford the 'market price' for childcare. Parents still have to pay at least 20 per cent of the costs, up to a maximum of £175 per week for one child and £300 for two or more children. Our own research shows that for many parents this – and the possibility of overpayments – simply discourages them from claiming the credit.⁵ A similar finding was reported in research on Working Families Tax Credit⁶ and in research commissioned by DWP after the tax credit reforms in 2003.⁷ The requirement to pay 20 per cent of costs is regarded by the Treasury as a 'shopping incentive' to encourage parents to find the services that best suits their needs. To our knowledge, there is no evidence of this actually happening and it presupposes that there is a functioning market in all areas. As pointed out above, the childcare market does not function very effectively, is unresponsive to parental demand and this is particularly marked in the most disadvantaged areas. The fact is that many parents often do not have a choice of providers in their area that offer a service of sufficient quality to meet their needs.

17. Consequently, Daycare Trust argues that the proportion of help with childcare costs available through the tax credits should be increased from 80 to 100 per cent. At the very least, creating a 100 per cent childcare costs subsidy should be considered either for families on very low incomes, or for specific families – in a similar way that the Government is currently doing for 50,000 workless parents undergoing training to prepare for work. Providing free, registered childcare to enable parents to work is good for parents and good for children.

⁵ Bell A *et al* (2005) *A question of balance: lone parents, childcare and work*, DWP Research Report 230. Norwich: CDS

⁶ Nicolls J and Simm C (2003) *The childcare tax credit element of Working Families' Tax Credit: a qualitative study*, Research Report 7. London: Inland Revenue

⁷ Bell A *et al* (2005) *A question of balance: lone parents, childcare and work*, DWP Research Report 230. Norwich: CDS

Large families

18. A further important step to help a particular group of families who are at greater risk of poverty would be to increase the support for larger families. Currently, the maximum level of childcare costs that can be claimed is up to 80 per cent of £175 for one child and £300 for two or more children. A possible reform might be to introduce a similar payment system to that used by Child Benefit so that a higher rate is paid for the first child and a lower rate for any number of subsequent children. For example, a payment rate could be set at £175 for the first child and £150 for each subsequent child, so that a family with two children would get up to £325 and a family with three children would get up to £450.

Holiday childcare costs

19. At Daycare Trust we frequently hear from parents on our Information Line about the difficulties in not only finding childcare during school holidays, but also getting the finances to pay for it – particularly during the long summer holiday period. Many parents often do not include holiday childcare costs in their tax credits claim: either because they do not have the information to do so and to plan ahead, or because they do not require holiday childcare for more than four weeks and so are unable to claim for the short rise in their childcare costs.

20. After careful consideration of this issue we propose that the current requirement that parents must inform HMRC of changes to childcare costs of £10 per week a more only if the change lasts for at least four weeks in a row must be removed. This would enable parents to notify HMRC of their holiday childcare costs as they arise.

Response to consultation questions

Question 6.2: The Government would therefore welcome views on whether further run-ons of entitlement should be introduced, including for customers whose hours fall below 30 hours a week.

We would like to propose that the Government introduce a run-on to cover the final 13 weeks of Additional Maternity Leave (AML). Currently, entitlement to the childcare element of WTC ends after the first 13 weeks of AML as women on maternity leave are treated as no longer being in paid work from this point. This falls particularly hard on lone parents who lose their childcare funding for their older children and face financial hardship if they chose to continue using the childcare, or the difficult task of removing their children from the setting they are using. This uncertainty is unfair to both the children and parents and can be very unsettling. We would like to see a new run-on introduced to address this issue.

Question 7.1: The Government seeks views on whether basing childcare support on actual costs incurred, and therefore paid in arrears, would simplify the system for customers, or create problems for customers and/or providers in managing their cash flow. If such a system were adopted, the Government would also welcome views on whether customers or providers should have responsibility for informing HMRC about childcare costs incurred.

Introducing payments for childcare support that are based on actual costs incurred rather than an average presents several difficulties for parents. On the one hand, this would make it easier for parents to calculate the amount of childcare support they would be entitled to and would also deal with periods of peak childcare costs, such as school holidays. Yet, in our view, these benefits would not outweigh the negatives.

As acknowledged in the discussion paper, basing payments for childcare support on actual costs incurred would necessitate payments to customers in arrears, possibly on a monthly basis. Daycare Trust objects to this proposal on the basis that it could create significant difficulties for working parents in managing their finances. Most childcare providers require their fees to be paid in advance therefore the potential time lag between parents needing to pay their childcare fees and receiving the childcare element of tax credits could push parents into real financial hardship.

It seems likely that basing payments on actual costs incurred would create a large workload for HRMC and also many parents would not be able to cope with the regular reporting requirement. Tax credits would become more like weekly means-tested benefits. Further, placing onerous reporting requirements on parents is likely to lead to lack of compliance and risks increasing the likelihood of overpayments.

We know from calls to the Daycare Trust information line that many parents still experience long waiting periods on the tax credits helpline. Arguably, this situation could worsen if payments were based on actual childcare costs. Further resources would be required for HMRC to deal with the increased demand placed on its services, particularly during school holidays.

In addition, an important issue that requires further consideration is that many providers also require a deposit to be paid in advance. This could be as much as a months' fee, in addition to the monthly payment. Although the deposit is usually returnable, it poses a severe financial barrier to many parents beginning to use a childcare provider.

Question 7.2: The Government seeks views on whether basing entitlement to childcare support on income bands, rather than a precise income level, would simplify the system for customers, relative to the current system.

Daycare Trust supports the principle of basing entitlement to childcare support on income bands rather than precise employment income levels. Taking this important step to introduce a 'lighter touch' means-test would substantially reduce the complexity of tax credits; introduce greater transparency on entitlement; and would encourage higher take-up of childcare support. There is some trade-off between the greater simplicity and certainty this offers as against the rough justice it would introduce for those at the edge of the income bands. Our judgement is that certainty is more important to parents. The introduction of income bands would also provide the opportunity to raise the proportion of childcare costs to 100 per cent (see paras 16-17 for more detail).

Question 7.3: The Government would also be interested in views about the appropriate balance between minimising the number of income bands to provide simplicity, and ensuring that customers do not face significant decreases in support (cliff edges) as their income increases.

One of the key aims of the reforms to childcare support through tax credits is to simplify the delivery for parents. As stated above, we support the principle of introducing entitlement to childcare support based on income bands, rather than a precise income level. The difficulty will be to balance the trade-off between fewer income bands with larger increases and decreases in support; or more income bands bringing reduced simplicity but less dramatic increases or decreases in support. While it is important to ensure that parents get as much financial support as possible to help cover their childcare costs, we believe that introducing fewer income bands – and more simplicity – would be preferable.

Reiterating the point above, the introduction of entitlement to support based on income bands would provide the ideal opportunity to introduce financial support covering up to 100 per cent of childcare costs.

Question 7.4: The Government seeks views on the advantages and disadvantages of increasing certainty for customers over their entitlement to childcare support, by basing entitlement to childcare support on the school year and on the previous year's income.

The option of basing entitlement to childcare support on the school year and on the previous year's income is not attractive. One reason is that it could result in a system that is less responsive to changes in childcare use. Parents would need to plan ahead and consider their forthcoming childcare costs, which could be incredibly difficult particularly taking holiday childcare needs into account. Using the previous year's income would also pose considerable problems for parents who have had a steep income fall.

Question 7.5: The Government seeks views on whether the current system, where payments are made to the customer, remains the right approach forward.

Daycare Trust ultimately supports a fundamental shift in the provision of childcare funding away from parents and the demand-side, to supply side-funding. The success of the free early years entitlement shows that providing parents with free childcare at the point of delivery rather than providing complicated subsidies, such as tax credits, works effectively and to the benefit of families. However, it is important to distinguish supply-side childcare subsidy from subsidising parents' costs. There remains an important role for childcare support via tax credits for parents on a low income. And, we are not convinced that providing payments direct to providers is a sensible way forward.

Daycare Trust is aware that in some parts of the childcare sector there is strong support to transfer childcare payments from parents to providers. One of the reasons behind this is the belief that some parents are abusing the system by enrolling their child with a provider, claiming the childcare element and then removing their child from the setting while continuing to claim the support through tax credits. Some providers may also believe that directing the funding to themselves rather than parents will result in them gaining a larger subsidy for their costs. As the discussion paper acknowledges⁸ there are many reasons why a parent might legitimately remove their child from a childcare setting, and compliance procedures are in place to prevent abuse of the system. In addition, many providers appear to believe that when parents do claim the childcare element that they get their full childcare costs covered. This is clearly not the case as the 80 per cent cap prevents this, as well as the maximum childcare costs cap. Again, it is worth reiterating that, at April 2008, the average claim for the childcare element was £65 per week, when the average price for a full-time childcare place for a child aged under 2 is £159.

We are very cautious of changing the method of paying the childcare element by directing the payments to providers for several reasons.

- I. First, changing the method of payment would not direct more money to providers: they would not be getting the full fee (unless the subsidy cap was changed).
- II. Second, it would result in adding further complexity to an already complex system. Parents would still need to go through the same application process and would still have to pay the remaining costs that are not covered by the childcare element. Those that use more than one provider would face great difficulties in ascertaining the amounts to pay each provider. Should a tax credit overpayment occur, a parent would have to repay them to HMRC even though they may not be able to get any reimbursement from the provider, thus jeopardising low-income families' financial stability even further.

⁸ HM Treasury *Tax Credits: improving delivery and choice – a discussion paper*, para 7.16

- III. More fundamentally, it is highly unlikely that all providers would be able to cope with the information requirements that would be placed on them. Many – particularly childminders and small nurseries – simply would not have the IT equipment, skills or time to fulfill the requirements that would be placed on them.

Payment direct to providers might be acceptable when parents request it, or if payment schedules between a parent and provider had broken down – as can happen with Housing Benefit claimants who are on Income Support or Jobseeker's Allowance and are in arrears with their rent payments. The danger with this situation is that it adds further complexity to the system which this consultation is attempting to simplify.

Question 7.6: The Government is interested in identifying all options to simplify the delivery of childcare support through the tax credit system. In particular, it is interested in views on the options identified in this chapter.

With reference to the table on page 61 and box 7.10 in the discussion paper, Daycare Trust does not support the option of making payments to customers through a voucher or credit system. We are aware that this proposal has support in some sectors but we believe that the disadvantages of such a system far outweigh the advantages. The only benefits that we can see are those identified in the discussion paper: that providers would need to be formally registered childcare providers to receive any funding and that any government support that a parent receives would be invisible to their childcare provider.

The disadvantages are numerous. To begin with, whether the system was in the form of a voucher or credit system, it would require major IT investment for both providers and HMRC. As stated above, many childcare providers do not have the existing IT equipment, skills, or indeed the time, to accommodate a complicated administrative system. Complexities arise as a result of the need for money to be paid from parents and from HMRC to providers – and introducing complexity always risks error creeping in, with the possibility of overpayments being made to parents. Any tax credit overpayments might be recoverable from providers and parents if a credit system was used. But vouchers might mean that parents may not be able to get their money back from providers easily.

Further problems might arise as providers and parents would need to inform HMRC of any changes to the amount of childcare used by a parent. Parents who have more than one provider could face substantial challenges in dividing their voucher payments.