Llywodraeth Cymru
Welsh Government

The Childcare Offer for Wales

Assessing parents' income to determine eligibility for the Offer

Frequently Asked Questions for Local Authorities

Version 1: July2020

The Childcare Offer for Wales

Assessing parents' income to determine eligibility for the Offer

Frequently Asked Questions for Local Authorities

This information document has been developed jointly between the Welsh Government and HMRC and is intended to address many of the issues and questions raised by local authorities around the assessment of parental income, particularly that of the self-employed. The document has also been informed by the "assessing income" workshop held by the Welsh Government and HMRC for local authorities in Cardiff on 27th February 2020.

The Welsh Government welcomes ideas about how the document can be improved. Feedback should be sent to the mailbox: TalkChildcare@gov.wales

Introduction

The main policy aim of the Childcare Offer for Wales ("the Offer") is to assist people into work or those in work to work more; to enable people to stay in work and to remove childcare costs as a potential barrier to work.

This information sheet is intended to help local authorities in their assessment of whether a parent meets the minimum income threshold to be eligible for the Offer and whether their earnings are below the upper limit of £100,000 gross per annum which would make them ineligible for the Offer.

1. Why is a parent's income assessed?

The minimum income test is how we determine whether a parent is in paid work. The purpose of the minimum income test is to establish whether the parent needs the funding to enable them to work and therefore the Government is looking for evidence that the parent is receiving a financial reward in return for work undertaken. This helps provide some assurance that Government funding is being targeted in a way which is consistent with the policy intention.

The maximum income test is a means test. The purpose of the maximum income test is to establish whether the family can afford to fund childcare from their own resources and this is why all sources of income are taken into account. If any parent in the family earns more than £100,000 gross per annum, then the Welsh Government considers it unlikely that childcare costs will be a barrier to employment in these circumstances.

2. Employees/workers and Pay As You Earn (PAYE)

Most of the people eligible for the Offer will be either employees or workers - i.e. they will have a contract to do work in exchange for a financial reward.

As a general rule, the income earned by these individuals will be subject to income tax and NI contributions and these will be deduced by the employer before the employee receives their salary through the **Pay As You Earn (PAYE) scheme**.

However, personal allowances designed to help the low paid mean that most employees are not required to pay income tax for earnings up to £12,500 per financial year and will only have to pay National Insurance contributions if they earn more than £166 per week. There are also some special cases where persons employed in the UK do not pay tax in the UK, e.g. individuals undertaking work for organisations like the UN or NATO under international treaties.

For most people living and working in the UK, their Income Tax will be paid through PAYE and they will not be required to complete a tax return.

3. The self-employed and Self-Assessment (SA) Tax Returns

Some people may run a business for themselves and take full responsibility for its success or failure, in which case they are likely to be **self-employed**. According to figures for September 2019, 14.2% of the total of those in employment in Wales were self-employed.[1]

If a person is self-employed and makes sufficient profit, they are required to register with HMRC and become responsible for calculating and paying their own tax and National Insurance contributions. They are required to complete and submit a self-assessment (SA) tax return to HMRC by 31 January every year for the previous tax year.

Even if a self-employed person does not earn enough profit to require them to register for SA they may still opt to do so.

People who own a limited company work for themselves but are not classed as self-employed by HMRC. Instead they are both the owner and employee of their company.

Some people that are employees will also complete SA returns. This might be because they also run a self-employed business or have significant unearned income, e.g. from share ownership or investment properties.

Further information on parents working for themselves can be found here: https://www.gov.uk/working-for-yourself

4. Unique Tax Reference (UTR)

A UTR number is a 'unique taxpayer reference' number which HMRC assigns to each self-assessment taxpayer in order to track their tax records. Parents who are newly self-employed and registered for self-assessment should receive a letter from HMRC containing their UTR within 10 days.

5. Self-Assessment forms

There are two ways in which a person can do a Self-Assessment tax return. They can:
(i) file their self-assessment tax return online
(ii) complete a form

The main SA form is the SA100. The SA100 form is the main document an individual needs to file when doing their SA tax return.

An SA302 is the tax calculation performed by HMRC based on the figures provided to them by the parent. It is a statement of their overall tax and national insurance liabilities and shows which income has been used to work this out, which typically

[1] *Source: StatsWales:* https://statswales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/People-and-Work/Employment/Persons-Employed/StatusOfEmployedPersons-by-WelshLocalAuthority-Measure. Of a total of 1,459,700 in employment in Wales, 1,239,400 were employees and 207,400 were self-employed.

includes profits etc. It's not a section of the Self-Assessment form itself, but rather a calculation that is made after the form is submitted, whether it be online or a paper form. The advantage of using an SA302 or other SA forms or documentation from accountants is that we know the figures have been submitted to HMRC, and we can have greater confidence of their authenticity. Fictional examples of SA302 are at Annex 1.

Individuals may complete more sections, known as "supplementary pages", if they are telling HMRC about specific types of income e.g. from property or oversees or if they are set up as a partner or director.

Further information about the various types of SA sections can be found here:
https://www.gov.uk/government/publications/self-assessment-tax-return-sa100

Local authorities should always be mindful that a parent may be both employed and self-employed (i.e. they may have a payslip but may also be getting other income from property, for example) and therefore it is important to determine as far as possible **the totality of their income for the maximum income test**.

Application forms for the Childcare Offer should clearly require parents to declare all sources of income and local authorities should be asking for evidence in respect of **all** income streams. For example, parents should be invited to tick all the boxes relevant to their circumstances on a form – i.e. the "employee" and "self-employed" boxes if they consider themselves to belong to both categories.

Local Authorities may also wish to add to their standard applications forms (if not already included) words to the effect of:

"Should the local authority find that monies have been wrongly claimed by a parent under the Childcare Offer for Wales (as a result of information provided or with-held during the application or re-check stages), appropriate steps may be taken to recover the funding."

6. What do we mean by the lower income threshold and what counts?

This is the test of whether a parent is in qualifying paid work, with parents earning the threshold meeting the test. Consequently it only takes income from work into account and not income from investments.

By this we mean a weekly minimum equivalent of 16 hours at national minimum wage (NMW), national living wage (NLW) or apprenticeship minimum wage (AMW) (hereinafter "the relevant minimum wage").

Local authorities should be aiming to establish if the individual is earning the required amount in the form of **income from work.** All of the following should be taken into account when assessing whether an individual earns more than the minimum threshold:

- Wages/regular salary;
- Bonuses;
- “benefits in kind” (BIK) which are considered part of an employee’s remuneration and should be reflected in an employee’s normal payroll and tax records. BIK includes any gratuity or other profit or incidental benefit of any kind obtained by the employee if there is a quantifiable monetary value. BIKs are not common for employees at or near the minimum income, but if employees get them then they count;
- profits from self-employment;
- income from property if the applicant is using the property to run a business (e.g. running a B&B) or if the parent is actively involved in the running of the rental business and maintaining the property themselves;
- Fostering allowance. Foster carers receive an allowance for each child placed in their care and this financial support is classed as an income and would be taxed but for the fact that an exemption applies. Foster carers are classed as self-employed.

Dividend income and other income from investments does not count as income from work. Director loans do not count as income from work either. As long as a company is in profit, it can declare a dividend at any time. Shareholders get the money because they own shares not because of work done. Even if shareholders work in the business there is no direct or clear correlation between hours worked and income received through dividends, or if it does exist it is not easily evidenced. This is why dividend income does not count towards the minimum income test and this is also why some Directors may find they are ineligible for the Offer if they rely solely or largely on dividend income as opposed to drawing a salary from the business. Some individuals will need to pay tax on dividends received but this will depend on their individual circumstances. Dividends never attract employer NI contributions.

Investment income and income from stocks or shares do not count as there is no direct correlation between hours worked and the income generated from the investments.

7. How can the minimum income be evidenced?

The simplest way of evidencing someone’s earnings is by looking at their **payslip or employment contract.** As of April 2019, all employers have to provide employees and workers with payslips. Employees are also entitled to a written statement of the main terms of their employment (employment contract).

In the absence of payslips or employment contract, the local authority may need to ask for a letter from the employer confirming that the person is employed and earning or expected to earn above the minimum threshold. If this is the case and if a parent is deemed eligible on this basis, it is recommended that the local authority use their re-check process to re-confirm the parent’s eligibility.

8. What do we mean by "gross income" and what counts?

The maximum income, or 'gross income' test is a means test aimed at excluding parents of great means from the scheme. That is why it takes all income into account, whether from work or from investments held.

A working parent will not be eligible for the Childcare Offer for Wales if they, or their partner if any, reasonably expects their gross income in the current tax year or during the period of their eligibility for the Offer year to exceed £100,000. This is a per person limit, so if any one parent in a two parent household earns over £100,000 gross per annum, the family will be ineligible. If the parent in a one parent household earns more than this amount, their family will also be ineligible for the Offer.

The "per person" limit aligns with the UK Government's test for Tax Free Childcare.

9. What do we mean by gross income for the purpose of the Childcare Offer?

A person's total monthly income, including all payments they receive in the form of any earned income (e.g. regular wages, salary, bonuses) before taxes and other payslip deductions (for example NI contributions, pension contributions, health insurance contributions) and in the form of any unearned income (such as dividends, income from shares, rental income, maintenance allowance, guardianship allowance or interest income).

10. How to work out a person's annual gross income

If someone is paid monthly, and does not expect to get an annual bonus, it would be a matter of multiplying their monthly gross income by 12 to determine their gross annual salary.

Some employees get annual bonuses, normally towards the end of the tax year (e.g. sales staff may get a bonus for exceeding sales targets or all staff may get a bonus if the business does well). These often occur year after year and are a normal part of the employee's annual income. If an employee reasonably expects a bonus, even if they have no contractual right to one, it needs to be taken into account.

If someone is paid per hour, it would be a matter of multiplying the hourly rate they are paid by the number of hours worked per week x 52.

If someone is self-employed, their gross earnings are worked out on the basis of the gross profit of their business less certain allowable direct expenses. The following HMRC guidance provides further information on what can be considered allowable expenses for this purpose.
https://www.gov.uk/expenses-if-youre-self-employed

11. What does not count towards a person's gross income?

Any capital **sales** of assets held whether held as investments (such as shares or properties) or otherwise (for instance a family home), even if at a profit. Capital gains are not classed as income even if they are subject to Capital Gains Tax.

12. What to ask for as evidence of earnings?

- A parent employed on a standard employment contract could be asked to provide three months' worth of pay slips to evidence their earnings;

- A parent employed on a non-standard employment contract, or undertaking a number of different jobs, would supply three months' worth of pay slips in respect of all their employment, and their earnings should be averaged over the period;

- A newly employed parent without three months of payslips, would be asked to supply a letter from their employer confirming their eligibility and the start date of their new role (they would then be eligible from this date);

- A newly self-employed parent would be exempt from the earnings criteria for the first 12 months after the business was established, but should be asked to provide proof of their businesses establishment. This could be, for example through agent testimony (e.g. their accountant could vouch for their business being set up and likely income over the forthcoming tax year). Alternatively they may be able to produce a business plan including evidence of a newly acquired place of work/premises or if their business is sufficiently underway, copies of invoices, quotes or tenders with any personal, identifiable information removed. They may also be able to supply their UTR;

- An established self-employed parent would need to supply their UTR and details of their earnings over the past 12 months as set out in their Self-Assessment return. In the absence of a SA return, the LA could ask for accountant confirmation of likely income over the forthcoming tax year. Where earnings do not meet the threshold, a statement of anticipated income over the period of entitlement from their accountant/agent would be required.

13. Suggested narrative for parents – income thresholds

Suggested narrative to explain to parents why dividend income does not count towards the minimum income threshold but does count towards the maximum.

The main policy aim is to assist people into work or those in work to work more; to enable people to stay in work and to remove childcare costs as a potential barrier to work.

The minimum income test is the test of being in work. The purpose of the minimum income test is to establish whether the parent needs the funding to enable them to work and therefore the Government is looking for evidence that the parent is receiving a financial reward in return for work undertaken. This helps provide some assurance that Government funding is being targeted in a way which is consistent with the policy intention.

The maximum income test is a means test. The purpose of the maximum income test is to establish whether the family can afford to fund childcare from their own resources and this is why all sources of income are taken into account. If any parent in the family earns more than £100,000 gross, then the Welsh Government considers it unlikely that childcare costs will be a barrier to employment in these circumstances.

USEFUL LINKS

Main types of employment status**:** https://www.gov.uk/employment-status

Working for yourself: https://www.gov.uk/working-for-yourself

Getting a Unique Tax Reference - register for and file your Self Assessment tax return
https://www.gov.uk/log-in-file-self-assessment-tax-return/register-if-youre-self-employed

Difference between a self-employed person and employee:
https://www.gov.uk/employment-status/selfemployed-contractor

Income tax rates and personal allowances: https://www.gov.uk/income-tax-rates

Employment contracts – what they cover
https://www.gov.uk/employment-contracts-and-conditions/written-statement-of-employment-particulars?step-by-step-nav=47bcdf4c-9df9-48ff-b1ad-2381ca819464

How to read a payslip? https://www.gov.uk/running-payroll/payslips

What does HMRC mean by deductions?
https://www.gov.uk/running-payroll/deductions

Further information about the various types of SA sections can be found here:
https://www.gov.uk/government/publications/self-assessment-tax-return-sa100

Get a SA302 tax calculation https://www.gov.uk/sa302-tax-calculation

Expenses if you're self-employed
https://www.gov.uk/expenses-if-youre-self-employed

Annex 1: SA302 Form

An SA302 is the tax calculation performed by HMRC based on the figures provided to them by the parent. It is a statement of their overall tax and national insurance liabilities and shows which income has been used to work this out, which typically includes profits etc. It's not a section of the Self-Assessment form itself, but rather a calculation that results after the form is submitted, whether it be online or paper form. The advantage of using an SA302 or other SA forms or documentation from accountants is that we know the figures have been submitted to HMRC, and we can be confident of their authenticity.

Fictional examples of SA302s which display the customers' full income for the financial year(s) as used in the "assessing income" workshop help by the Welsh Government and HMRC for local authorities in Cardiff on 27th February 2020.

HM Revenue & Customs

Ref : 1234567890
Year : 2019
OUID : 236220
Name : MR TOM BROWN

Tax Calculation for 2018/19 (year ended 5 April 2019)

Income received (before tax taken off)						
Pay from all employments		£50,114				
plus	Benefits and expenses received	£8,481				
minus	Allowable expenses	£3,000				
Total from all employments			£55,595			
Total income received				£55,595		
minus	Personal Allowance			£11,850		
Total income on which tax is due				£43,745		
How I have worked out your Income Tax						
	Pay, pensions, profit etc. (UK rate for England, Wales and Northern Ireland)					
			Basic rate	£34,500	x 20% =	£6,900.00
			Higher rate	£9,245	x 40% =	£3,698.00
Total income on which tax has been charged				£43,745		
Income Tax charged						£10,598.00
minus	**Tax deducted**					
	From all employments, UK pensions and state benefits				£10,433.60	
	Total tax deducted					£10,433.60
Total Income Tax due						£164.40

Select here to see View Statement

HM Revenue & Customs

Ref : 12345 67890
Year : 2019
OUID : 236220
Name : MRS KAREN THOMSON

Tax Calculation for 2018/2019 (year ended 5 April 2019)

Income received (before tax taken off)

Pay from all employments	£ 16,825	
Profit from UK land and property	£2,540	
Interest received from UK banks and building societies	£1420	
Dividends from UK companies	£5077	
Total income received		£25,862
minus Personal allowance		£11,850
Total income on which tax is due		£14,012

How I have worked out your Income Tax

Pay, pensions, profit etc.	£7515	@ 20% =	£1503.00
Interest received from a bank or building society etc.	£1,000	@ 0% =	£0.00
	£420	@ 20% =	£84.00
Dividends from companies etc.	£2,000	@ 0% =	£0.00
	£3,077	@ 7.5%=	£230.77
Total income on which tax has been charged	£14,012		
Income Tax charged			£1817,77

minus Tax deducted	£993.20	
From all employments		
Total tax deducted		£993.20
Total Income Tax due		£824.57