Funding apprenticeships through Pay As You Earn

Embedding good jobs for young people

August 2013

UK COMMISSION FOR EMPLOYMENT AND SKILLS

SIMPLICITY

Recruit and register an apprentice and recover some of your costs via tax relief.

PURCHASING POWER TO YOU

Employers as customers select and pay the best training providers for their needs.

FAMILIARITY

Businesses understand and use the tax system on a regular basis.

FLEXIBILITY

Employers can start training for apprentices at any point throughout the year.

WHY FUND APPRENTICESHIPS THROUGH THE TAX SYSTEM?

STABILITY

A change to the tax system would be for the long term. This provides stability for employers, providers and apprentices.

HARDWIRE APPRENTICESHIPS INTO BUSINESS BEHAVIOUR

Apprenticeships become an investment decision. Securing the talent pipeline becomes a part of business planning.

MORE APPRENTICESHIPS

Changes to tax reach businesses of every size and sector, making it easier for any business to engage with apprenticeships.

STAYING THE COURSE

A percentage payment on completion of the apprenticeship incentivises both employer and apprentice to stay the course.

> *"I believe we could see far greater engagement from business if apprenticeship funding was jointly from government and business, but channelled through the employer via the already-existing and familiar PAYE system. This would reconnect employers with their critical responsibility to play a significant role in training their next generation of employees. It would also raise course quality, provide better taxpayer value for money and help reduce the UK's current skills shortages."*
>
> Andrew Churchill
> Managing Director, J.J. Churchill

Scott Johnson
Chief Executive, Chas Smith Group Ltd
and UKCES Commissioner

For the past 18 months the UK Commission for Employment and Skills has been developing proposals to transform the way in which young people move into the world of work, especially for those not going to university. The current apprenticeship system has certainly delivered many successes; apprenticeships are now available in more sectors of the economy and for more people than ever before. However, we are yet to embed apprenticeships as the new norm for young people embarking on a career. To achieve this we need to raise standards and engage many more employers, especially smaller businesses, in the provision of high quality apprenticeships. This is completely consistent with the recommendations made by Doug Richard in his review.

Both the UK Commission and Doug Richard agree that the key to achieving this step change is in the funding. In short employers must become the true customers of apprenticeships and this means that the funding must flow to them directly as opposed to colleges or training providers. Therefore we strongly welcome the government's consultation on reforming apprenticeship funding in England.

We urge employers and their representatives to respond to the government's consultation and take this opportunity to transform the apprenticeship system and put employers in the driving seat.

INTRODUCTION

In 2011 the UK Commission launched its vision for Employer Ownership of Skills, and one of our most radical proposals was that the public funding for apprenticeships should flow directly to employers as opposed to training providers and colleges, and that this should be done through the tax system. This call was repeated by Doug Richard in his review of Apprenticeships in November 2012. The UK Commission firmly believes that in order to incentivise the kind of work-based vocational training pathways that will help the economy to grow, and at the same time create more and better opportunities for young people, we need to create the conditions for employers to drive the agenda. Fundamental to this is ensuring that public funding for apprenticeships flows directly to employers.

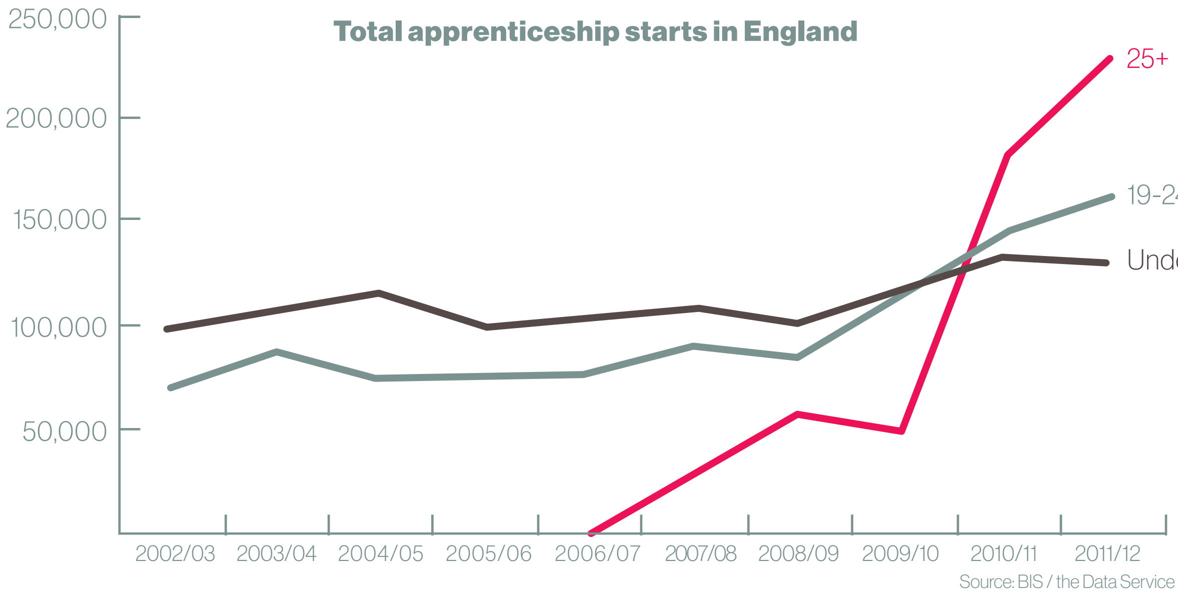
The Department for Business, Innovation and Skills (BIS) is now consulting on how this can be best achieved. The UK Commission welcomes the consultation, which proposes three models. The first uses direct grant funding to employers; the second uses the employer National Insurance (NI) and PAYE system. In the third, funding continues to flow to providers but is conditional on employers also contributing financially.

It is our view that of all the options under consideration, it is the PAYE model that will have the greatest impact. In this paper we set out why we believe that the tax system is the best option for routing apprenticeship funding via employers and how it could work in practice. The UK Commission's thinking has been led by our Commissioner Scott Johnson, owner and chief executive of a small construction business; Scott's leadership means that designing a system that works for SMEs has been our main driver.

We've had discussions with employers of various sizes and sectors up and down the country and have heard universal support for the principle of employer routed funding and near unanimous support for doing so through PAYE. Quotes from both employers and training providers feature throughout this paper.

> *"The funding models put forward by the Department for Business, Innovation and Skills (BIS) are precisely the steps needed to encourage more businesses to take on apprenticeships and view young people as the valuable resource they are."*
>
> Doug Richard
> Entrepreneur and founder of the School for Startups

THE PROBLEM WE MUST SOLVE



While the problem of youth unemployment is serious, the challenging economic circumstances of the last six years are not the sole cause. The labour market has seen a long-term structural decline in the number of entry level jobs in the economy, and within that there are too few 'good' jobs, where young people have the opportunity to gain the competencies they need to increase their worth and the competitiveness of the companies they work for.

Employment in high skill technical, managerial and professional roles has grown by over 900,000[1] over the course of the recession and recovery and this growth is set to continue. Between 2010 and 2020 growth in these jobs is forecast to be 1.9m, over thirteen times greater than the 140,000 growth forecast for the sales and elementary occupations that young people rely on for their first job.[2] But the employers who specialise in these high skill roles are the least likely to recruit young people and where they do, they tend to rely on university graduates. Creating more non-graduate routes into technical, professional and managerial jobs would offer ladders of opportunity to young people, and feed the talent pipeline for employers. Apprenticeships offer just such a gateway for young people and bring well documented returns to employers. They deliver highly productive, well trained and loyal staff for business, access to a successful career for young people and strong benefits for the exchequer and the economy as a whole.

As such the UK Commission strongly backs the ambition of apprenticeships becoming the "new norm" for young people not going to university. The current system has certainly delivered many successes; apprenticeships are now available in more sectors of the economy and for more people than ever before, there are now over half a million people starting apprenticeships each year. However, we are a long way from apprenticeships as the new norm for young people. In England, growth in apprenticeships has been driven overwhelmingly by older apprentices while those for 16 to 18 year olds have plateaued by comparison. Before 2006/07 there were no apprentices over 25, there are now almost a quarter of a million starting each year and as such they make up almost half of all apprentice starts. Only 15% of employers in the England offer apprenticeships and just 6% of 16 to 18 year olds are on an apprenticeship.

1 - Source: ONS Labour Force Survey, Labour Market Statistics table EMP08
2 - Source: UKCES, Working Futures 2010-2020

WHAT'S THE ANSWER?

> *"A skills tax credit concept is a much welcomed simplification of the existing system. It sits well with the employer ownership of skills thinking and can only help incentivise employers to take on more apprentices."*
>
> Dave Newborough
> UK HR Director, E.ON UK

There is increasing evidence that this picture could be transformed. In the space of only 18 months, using the Employer Ownership challenge fund, we have seen mounting evidence of employers' readiness to lead the creation of these opportunities for young people. What's more, given the encouragement and freedom to develop their own approaches, employers from different sectors and regions have come forward with proposals which leverage government funding with cash and in-kind investment at a ratio of 2 : 1 (private to public).

To capitalise on employers' readiness to create these opportunities the public contribution for apprenticeships must be channelled directly to employers instead of providers and colleges. There are a variety of ways in which employers could be given this purchasing power and government is currently consulting with businesses and others on three such models. The first of these is a grant system whereby employers receive funding directly into their bank accounts. The second model uses the tax system and employers would receive the funding via a reduction in their PAYE liability in a similar way to statutory maternity pay. In the third funding would continue to go direct to training providers but would be conditional on employers paying fees.

The UK Commission believes that the tax model is the best solution. A move to tax would "hardwire" apprenticeships into business behaviour, in the same way that maternity pay is hardwired into current business practice. Tax changes have been shown to be an extremely powerful mechanism to influence employers (the example of R&D tax credits is the clearest example). Every employer pays payroll tax and is used to claiming reliefs via the payroll, most obviously statutory maternity pay and statutory sick pay.

A key advantage of this approach is the reach it will provide to SMEs. For obvious reasons this is the hardest audience to reach and yet without greater take up in smaller businesses we will not succeed in raising skill levels and the competitiveness of the economy. The evidence on the importance of small business to job creation and therefore future apprenticeship opportunities is clear. Between 1998 and 2010 existing small businesses (less than 50 employees) created a third of all new jobs while start-ups created a further third.[3]

A common critique of skills policy from employers is that it changes constantly. A change that puts buying power in the hands of employers through the tax system would represent a commitment to long-term stability as the tax system is not and cannot be subject to constant change in the same way that a standard government budget can be. It would allow employers to be more certain of the system over the long term and allow them to plan and invest on this basis. Stability and predictability are key issues for SMEs. Furthermore decisions about tax and investment are made at a senior level in most businesses, while skills and apprenticeship decisions are not. A shift to tax would position investment in apprenticeships alongside other investment decisions. Use of the Her Majesty's Revenue and Customs (HMRC) infrastructure would complement HMRC's current and important role in enforcing the apprenticeship minimum wage.

Using PAYE relief to encourage employers to offer quality apprenticeships would send the strongest possible signal of the government's determination to make skills central to a plan for growth. In the next section find out how we believe the model can work in practice.

3 - BIS – "Job creation and destruction in the UK: 1998 – 2010" (October 2011)

HOW THE MODEL CAN WORK IN PRACTICE

Apprenticeships are a joint investment between the employer, the apprentice and the government. The employer invests their time and resources managing, training and paying their apprentice's wages and apprentices accept lower wages while they are developing. The purpose of the government investment should be to support the development of a "good" job, reinforcing not just high quality training and support but other aspects, for example pay, conditions and opportunities to progress. The government contribution towards apprenticeships could be claimed by the employer in the same way that statutory maternity pay is paid and recovered currently. This means that instead of funding going directly to training providers and colleges the equivalent amount would be deducted from employers' PAYE / NI contributions.

The UK Commission agrees with Doug Richard's principles that the price for apprenticeship training should be free to vary according to demand and that employers and government should share the costs. So once an employer has decided to recruit an apprentice they would approach an approved college(s) or training provider(s) and negotiate the price, payment schedule and agree the training required to meet the standard for that apprenticeship.

The amount of the government contribution could be decided in one of two ways. Government could just pay a fixed share of the negotiated price, for example 70%, with the actual government contribution(s) linked to payments that employers make to providers. Alternatively there could be a small series of payment bands per apprentice per month, so for example band A could be £50 per apprentice per month, band B would be £65 per apprentice per month and so forth. These bands could applied according to sector, age of apprentice, region etc.

The employer, or a provider on their behalf, would register the apprentice via an online system with BIS. This would provide BIS with information about the apprentice including their age, framework, level of study etc and key information about the employer, in particular its PAYE reference number. This in turn allows BIS to notify HMRC that the employer can start to reduce its PAYE / NI contributions and determines what the government contribution should be (i.e. which band or which co-funding rate).

By October 2013 all businesses will be required to provide information to HMRC on a monthly or weekly basis (this will depend on the employer's payroll arrangements). This change is known as the shift to Real Time Information (RTI) and it should allow the shift to employer routed funding to be much more flexible. Under this system employers with apprentices would simply enter the monthly amount they are entitled to deduct in a box on the RTI / PAYE system. This would most likely form part of the "Employer Payment Summary" (EPS) return which is used if an employer wants to recover statutory payments (statutory maternity pay (SMP) or statutory sick pay (SSP) for example), Construction Industry Scheme (CIS) deductions or the National Insurance Contributions (NICs) holiday for start-ups.

These monthly amounts would most likely be greater than the monthly employer NI payments for an individual apprentice and so reimbursements would be offset against an employer's total PAYE and NIC liabilities. Where PAYE liability is insufficient to cover apprenticeship costs (this could occur for the smallest employers) a direct payment from HMRC, again similar to that operated for SMP, would need to come into effect.

Once the apprenticeship is completed and the apprentice has passed the final assessment the employer and the provider would notify this and a final outcome payment (deduction from NI) of, for example, 20% of the total cost would be released. The purpose of this is to provide an incentive for all parties to complete the apprenticeship. This process would also enable BIS to notify HMRC that normal PAYE / NI payments should resume.

WORKED EXAMPLE

This example shows how the PAYE model would work under a fixed co-funding rate system.

1. An independent retail business employs around 10 people. The company is expanding and they have just taken on a 19 year-old apprentice for the first time.

2. They register their apprentice and company details on the online system. The system informs them that the government will reimburse 70% of their training costs for that apprentice, up to a maximum of £5,000. 20% of the government's contribution will be withheld until the apprentice has achieved the industry standard.

3. The business identifies two local providers that can supply relevant, high-quality training, and purchases one course from each – agreeing the exact content and price of training with them.

4. The business makes payments to the providers, and uses the online calculator to determine how much they can claim back from government for each apprentice.

5. They make a total claim through their PAYE return (waiting until successful completion to claim 20% of total support).

6. An independent assessment body assesses the apprentice. The retail business reclaims 70% of the price of assessment, in the same way as for training costs. The apprentice is assessed to have reached the standard and has thus completed their Apprenticeship.

7. The assessment body confirms the apprentice has achieved the standard, and the system confirms to the retail business they can now claim the outstanding 20% completion payment through their next PAYE return.

> “*This could be a watershed moment for apprenticeships, putting employers genuinely in the driving seat for the first time. A radical overhaul is long overdue and business has been arguing loudly for targeting funding directly through employers. The new system must keep red tape to a minimum if we want more firms to take on apprentices. A skills tax credit is by far the best option on paper but needs detailed piloting to ensure the transition is smooth.*”
>
> Neil Carberry
> Director of Education and Skills, Confederation of British Industry (CBI)

KEY POLICY QUESTIONS

The UK Commission firmly believes that this is the right policy to improve both quality and take-up of apprenticeships in England. However, we understand that safeguards must be in place to ensure quality and value for money. Below we set out how this system would ensure high quality, minimise deadweight and maintain fiscal control.

q: How do we ensure high quality provision under this system?

a: The Richard Review proposals more generally will reinforce and raise standards in apprenticeships. It is important to see employer routed funding and efforts to increase standards through the Richard Review proposals as mutually reinforcing. By placing buying power with employers we will drive the system to only provide training that is relevant and valued by employers, this will have a direct impact on quality.

Our proposal is that employers would be able to claim relief via PAYE where they commit to employing an apprentice, provided they met quality apprenticeship standards. These would be broader than just quality training and could include aspects such as decent pay, conditions and opportunities to progress into a secure job.

The appropriate apprenticeship standard for the sector would need to be agreed and certified by the industry sector with accreditation required from government to ensure it meets the minimum quality threshold recommended by Doug Richard.

All training provision would be conducted by approved training providers (be they internal or external to the employer) whose performance would continue to be scrutinised in the same way and be subject to OFSTED inspections. At a macro level quality should continue to be measured by the on-going evaluations (from both the individual and employer perspective) and the apprenticeship pay survey.

> “*Funding apprenticeships and other workforce training through the tax system should encourage and empower employers to take the lead in developing effective and efficient approaches to education and training in the workplace. However we must ensure that all employers are ready for this level of ownership and have the ability to establish the appropriate partnerships to guarantee that the system is universally coherent, consistent, fair and of the necessary quality.*”
>
> Barry Brooks
> Strategic Adviser to the Board, Tribal Group

q: How would deadweight be minimised?

a: Deadweight arises when government pays for training that employers or individuals would have paid for anyway. While giving employers purchasing power gives them greater control over the nature of provision, the risk of deadweight is mitigated by measures to enhance quality. The sort of training that would be at risk of deadweight is likely to be narrowly defined, firm specific and less transferable as firms have less interest in providing transferable skills. The reforms that the Richard Review proposes would make this sort of training very difficult to fund as the intention is for the standard to be raised and for it to be very broad and hence provide transferable skills. Essentially the higher and broader the apprenticeship standard, the lower the risk of deadweight.

The key question is whether a move to employer routed funding would raise deadweight. Under the current system BIS research shows that that deadweight in apprenticeships is relatively low. Around 27% of apprentices would have received some training in the absence of public funding.[4] Deadweight varies by age, it is 16% for 16-18 year old apprentices, 27% for 19 to 24 year old apprentices and 44% for apprentices who are 25 and over. However, it is important to note that these figures do not take into account the quality of the training received, so while these apprentices may have received some training in the absence of public funding it may well have been of a poorer quality. This suggests that deadweight is actually lower than these figures indicate. Nevertheless they still suggest that under the current system there is a risk that deadweight rises if the apprenticeship cohort becomes older.

One of the key advantages of employer routed funding is that the appropriate subsidy is directed as policy intends. Current policy is to provide greater subsidy to 16-18 apprentices than to 19-24 year olds but in practice employers of apprentices rarely pay fees and in fact employers of younger apprentices are more likely to pay higher fees[5]. This suggests that funding is not being distributed in the way that policy intends. Routing funding to employers directly will ensure that subsidy goes where it is intended, this means that funding should be directed more towards areas where deadweight is lower.

Another mitigating factor is the outcome payment to incentivise completion. A proportion, for example 20%, of the public funding would be held back until the completion of the apprenticeship. This provides the incentive for the employer and the provider to complete the entire apprenticeship as opposed to just the elements they are most interested in.

q: How would fiscal costs be controlled?

a: The UK Commission appreciates that moving from a grant based budget to funding through tax relief carries risks. However, we expect these risks to be controlled firstly by the application of higher standards in apprenticeships, and secondly by retaining control of the rate of relief that can be claimed. Only those employers who meet the required standards will able to claim the relief and there will be various checks and balances in place at the individual level to make sure expenditure is appropriate. For example, in most cases an external approved provider will be involved, secondly the apprentice would also be registered with an awarding organisation of some kind.

Furthermore there are several mechanisms that could be used to control expenditure. There could be a cap on expenditure per individual apprentice and the total number of apprentices could be capped at regular stages throughout the year, so when employers come to register their apprentice online they would be informed as to whether there are sufficient co-funded places available.

4 - BIS – "Assessing the Deadweight Loss Associated with Public Investment in Further Education and Skills" (May 2012)
5 - BIS – "Evaluation of Apprenticeships: Employers" (May 2012)

CONCLUSION

The government's consultation on apprenticeship funding reform in England closes on 1 October 2013. This is a great opportunity to have a say in how best to place purchasing power directly in the hands of employers, and we strongly encourage employers, their representatives and other stakeholders to respond to the consultation. You can find the link here:

https://www.gov.uk/government/consultations/apprenticeship-funding-reform-in-england

> *"As Doug Richard's recent review for the government made clear, we need an employer-driven market for training, which in turn will increase demand for apprentices and a higher-skilled UK workforce. Apprenticeship funding should be about tax incentives, first and foremost."*
>
> Dr Adam Marshall
> Director of Policy and External Affairs
> British Chambers of Commerce (BCC)

> *"As Ambassador for the National Apprenticeship Service and Chair of the Leeds Branch of the Federation of Small Businesses, as well as a small business owner, I strongly believe that funding apprenticeships via PAYE represents a great opportunity for our businesses and young people."*
>
> Bill Lumsden FRSA
> Managing Director, Complete Computer Systems

Contact us

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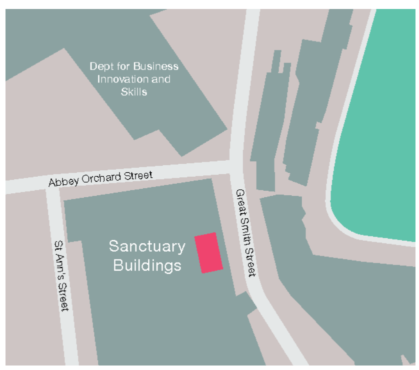

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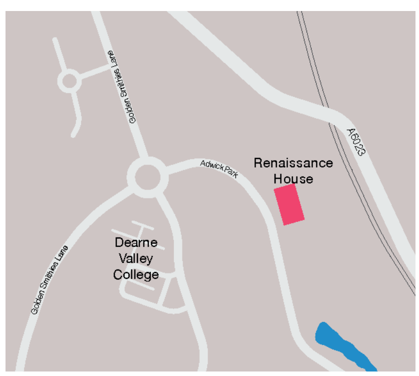

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