

Tax relief for child care

Salary sacrifice

- 7.1 As outlined in chapter three, employer-sponsored child care is exempt from fringe benefits tax (FBT), where provided on business premises. This means that employers can give staff the option of salary sacrificing child care fees, by which employees forgo part of their salary and employers pay the child care fees. Employees do not pay income tax on the portion of salary they have sacrificed, so they gain what amounts to a tax deduction in every pay packet.
- 7.2 Without the exemption under the *Fringe Benefits Tax Assessment Act 1986*, employers offering this would incur a fringe benefits tax penalty of 46.5 per cent of the value of the benefits provided. Regardless of whether this liability would be borne by the employer or transferred to staff by means of an employee contribution, it would mean that salary sacrificing would not be worthwhile.
- 7.3 The intention of the exemption, therefore, was to encourage employers to participate in solutions to their employees' child care needs. This would assist not only employees but contribute to the government's objectives for increased women's workforce participation.
- 7.4 In fact, the committee has found that the business premises limitation of the exemption, combined with continuing uncertainty about the Australian Taxation Office's rulings on the exemption legislation, is discouraging employers from getting involved.

Who is salary sacrificing for child care?

- 7.5 The exact number of employees salary sacrificing for child care is not known, and nor is the value of this practice as a tax expenditure by government. This is because exempt benefits do not have to be reported to the Australian Taxation Office. As the Office told the committee:
- In-house child care benefits – that is the exempt benefits – provided under salary sacrificing arrangements or otherwise are exempt fringe benefits that are not required to be reported in the payment summary or disclosed in the FBT returns. We would have no information on that.¹
- 7.6 The Australian Taxation Office also disclosed that due to the self-assessment of fringe benefits by employers, it was possible that there were employers offering salary sacrificing for child care that was not exempt and not reporting the fringe benefits tax liability. Commissioner of Taxation, Michael D’Ascenzo, said that, ‘There is no requirement in the law or in our practices for people who salary sacrifice to indicate to the Tax Office that they are salary sacrificing’.²
- 7.7 In modelling commissioned by the committee, consultants Econtech calculated that the cost to revenue of the fringe benefits tax exemption for child care fees is approximately \$14.08 million per year.³ This figure was based on evidence gathered by the committee on private companies and Australian Government departments currently offering salary sacrifice; evidence presented in submissions and public hearings; and available workplace surveys from recent years.
- 7.8 Available data suggests that there are very few employers offering salary sacrificing for child care. The impracticalities of the exemption for most businesses, together with the inhibiting effect of Australian Taxation Office rulings, are evidenced by low levels of take up around Australia. A review in 2000 found that there were only 65 employer-sponsored child care centres nationwide.⁴

1 Chooi A, transcript, 29 November 2006, p 10.

2 D’Ascenzo M, transcript, 29 November 2006, p 4.

3 Econtech, Appendix E, p i.

4 Department of Family and Community Services and Department of Employment and Workplace Relations, *Australia’s background report (2002) for the OECD Review of family-friendly policies: The reconciliation of work and family life*, p 49.

7.9 Deloitte and 37 other top 200 companies made a submission to the Federal Treasurer on the subject of this exemption in 2005. Deloitte said:

Numerous surveys indicate that there are very few child care facilities located on the employer's business premises... From our own survey in 2005 of 599 employers with a total workforce of over 300,000 employees, less than ten employers provided a facility that qualified for this exemption.⁵

7.10 Similarly, salary packaging provider McMillan Shakespeare told the committee that across their 1000 employer clients there was a very small number who were able to take advantage of the exemption:

I guess as a provider of salary packaging services to a wide range of employers across the country, from the Kimberley to far north and far south of the country, with 160,000 people packaging [for a range of benefits], it is pretty damning to say that fewer than 1,000 people are currently participating in salary packaging arrangements [for child care] out of the 160,000 that we have. Of the 1,000 employers, obviously very few are able to offer that as a benefit.⁶

7.11 In its submission, the South Australian Government claims that there is only one employer large enough to sustain an onsite child care centre in the entire state, so that the fringe benefits tax exemption in practice offers no assistance to close to 100 per cent of South Australian workers.⁷ Meanwhile, Westpac Bank claimed to have opened the first corporate child care centre in Brisbane only in August 2006.⁸

7.12 There are, as the committee has discovered, a minority of employees in major banks, universities and Australian Government departments who are able to salary sacrifice for child care. Employers offering salary sacrificing for child care in Australia include those detailed below in figures 7.1 - 7.3:

5 Deloitte et al., 'Submission to the Federal Treasurer: Exemption of child care from fringe benefits tax' (2005), synopsis, pp 2, 4.

6 Podesta A, transcript, 1 November 2006, p 2.

7 South Australian Government, sub 155, p 14.

8 'Westpac opens the first corporate child care centre in Brisbane', media release, 25 August 2006.

Figure 7.1 Private sector employers offering salary sacrificing for child care

ANZ Bank
Westpac Banking Corporation
National Australia Bank
Shell Australia

Source: Correspondence with employers, various, 2006.

Figure 7.2 Universities offering salary sacrificing for child care

Monash University
Griffith University
Curtin University
University of Western Australia
University of Wollongong
University of Adelaide
University of Western Sydney
University of New England
Flinders University
Queensland University of Technology

Source: Correspondence with employers, various, 2006.

Figure 7.3 Australian Government agencies offering salary sacrificing for child care

Department of Foreign Affairs and Trade
 Department of Finance and Administration
 Department of the Treasury
 Department of Defence
 Attorney-General's Department
 Department of Employment and Workplace Relations
 Department of Agriculture, Fisheries and Forestry
 Department of Industry, Tourism and Resources
 Department of Immigration and Multicultural Affairs
 Australian Taxation Office
 Australian Sports Commission
 Commonwealth Science and Industrial Research Organisation
 Australian Bureau of Statistics
 Australian Fisheries Management Authority
 Biosecurity Australia
 Land and Water Australia
 Dairy Adjustment Authority
 Office of Parliamentary Counsel
 Office of the Privacy Commissioner
 Australian Sports Commission
 Australian National Museum
 Special Broadcasting Service (SBS)
 Australian Broadcasting Corporation (ABC)
 Telstra
 Australian Communications & Media Authority
 Australian Sports Anti-Doping Authority
 Commonwealth Grants Commission
 Austrade
 Private Health Insurance Administration Council
 Tourism Australia
 Australian National Audit Office
 Office of the Governor-General
 Australian Securities and Investment Commission
 Australian Office of Financial Management

Source: Correspondence with agencies, various, 2006.

- 7.13 It should be noted that not all employees of these agencies and companies will have access to salary sacrificing for child care, if their work location is not in proximity to a child care facility that meets the requirements of the fringe benefits tax exemption. Staff members in outlying campuses and branch offices in regional and outer metropolitan areas are unlikely to be able to take up salary sacrificing

for child care, because there will not be a sufficient concentration of staff for employers to establish a child care centre.

- 7.14 Australian Government departments are advantaged in respect of the exemption by section 4(1) of the *Fringe Benefits Tax (Application to the Commonwealth) Act 1986*, which says that a department should be regarded as if it were a company, and each other department or authority of the Commonwealth should be regarded as a related company.
- 7.15 This means that if employees of one department salary sacrifice for child care on the premises of another government department, that will qualify as the 'business premises' of a related company and hence qualify for exemption from fringe benefits tax. For example, the Department of Finance and Administration has advised that its staff can salary sacrifice for child care fees at a centre located in the Treasury building. The Australian Tax Office has advised that its staff can do the same at a centre owned by the Australian Bureau of Statistics.⁹
- 7.16 Employees of Australian companies, universities and public sector agencies that do offer salary sacrificing for child care fees are fortunate to work for an employer with both the initiative and capacity to establish a child care centre on business premises. However, the available information suggests that they are a privileged few in relation to Australia's total workforce.
- 7.17 Lenore Taylor writes in the *Australian Financial Review*:
- When one woman at our Canberra mothers' group confided she could salary sacrifice for child care it was like the famous scene from *When Harry Met Sally*. En masse. We all wanted what she was having.¹⁰

Business premises limitation

- 7.18 Under section 47(2) of the *Fringe Benefits Tax Assessment Act 1986*, where:
- the recreational facility or child care facility, as the case maybe, is located on business premises of:
- (i) the employer; or

9 Department of Finance and Administration, transcript, 11 October 2006, p 1; Australian Taxation Office, correspondence, 14 August 2006.

10 Taylor L, 'A sacrifice worth making', *Australian Financial Review*, 19 August 2006, p 30.

(ii) if the employer is a company, of the employer or of a company that is related to the employer;

the benefit is an exempt benefit.

7.19 The Commissioner of Taxation and the courts have assessed 'business premises of the employer' by way of a two-part test. Firstly, business premises must be the site of business operations; and secondly, in order to be *of the person*, there must be a relationship of ownership or control between the employer and the premises.

7.20 The first test has been interpreted broadly by the Commissioner and the courts, who have held that child care provision is a part of business operations. The site of a child care facility may therefore be business premises.¹¹ Justice Merkel of the Federal Court found that:

Once it is accepted that the provision of benefits to employees in the form of child care at business premises of an employer is an important factor in recruiting, retaining and otherwise rewarding employees and, as such, is part of the business operations of the employer, it does not seem to be relevant whether the child care facilities are located at the premises where the employer carries out other business operations, or are located at premises of the employer which have been procured solely for the purpose of the provision of a child care facility thereon.¹²

7.21 If, for example, an employer takes a commercial lease on a site several blocks away from the office, in order to operate a child care facility there, that may qualify for the exemption. Another example, provided in the Commissioner of Taxation's public ruling, is of a mining company, whose staff are located in a company town 30 kilometres from the site of mining operations. Should that mining company construct a child care centre in the town, for the use of employees, that would be considered fringe benefits tax exempt.¹³

7.22 The second part of the test, whether the premises are *of the person*, has been more contentious. In both of the examples above, the employer has sufficient control of the premises and of the child care operations to satisfy the requirement for possession. In another of the

11 Federal Commissioner of Taxation's private ruling, cited by Merkel J, *Esso Australia Ltd v FC of T* 1998 ATC 4953.

12 *Esso Australia Ltd v FC of T* 1998 ATC 4953.

13 Federal Commissioner of Taxation, public ruling TR 2000/4, 'Fringe benefits tax: meaning of "business premises"'.

Commissioner of Taxation's examples, however, a professional child care provider establishes a centre in the CBD of a major city, and enters in arrangements with surrounding employers to provide child care to their children. Even if these employers enter into a series of subleases for undivided shares of the premises, they still cannot demonstrate sufficient control of the premises or of the management of the child care operation.¹⁴

- 7.23 For most employers, the expense and increased legal liability incurred in doing that will be too onerous. Deloitte has asserted:

The cost of an [on site child care facility] and the associated administration costs will usually outweigh the benefits for most employers... The administration and risks associated with government regulations and industry accreditations in operating and managing a child care facility are significant.¹⁵

- 7.24 Establishing an in-house child care facility also exposes employers to considerable risk should business needs change. McMillan Shakespeare told the committee:

We have some cases where employers have set up such establishments and then they find it is a white elephant a number of years later because the demographics change and they have been caught.¹⁶

- 7.25 Aegis Consulting confirms the cost of an employer establishing a child care centre in the Sydney CBD can be upwards of \$2 million; the Department of Finance and Administration advised that it had cost \$2 million to establish their child care in Canberra's Parliamentary Triangle.¹⁷ Deloitte claims that an on-site centre might take ten years to become financially sustainable for an employer.¹⁸

- 7.26 It is difficult for employers to justify taking on such a risk when it does not relate to a company's core business.¹⁹ BHP Billiton told the

14 Federal Commissioner of Taxation, public ruling TR 2000/4, 'Fringe benefits tax: meaning of "business premises"'.

15 Deloitte et al., 'Submission to the Federal Treasurer: Exemption of child care from fringe benefits tax' (2005), synopsis, p 3.

16 Podesta A, transcript, 1 November 2006, p 3.

17 Aegis Consulting, sub 107, p 8; and Department of Finance and Administration, Hutson J, transcript, 11 October 2006, p 5.

18 Deloitte et al., 'Submission to Federal Treasurer: Exemption of child care from fringe benefits tax', 11 November 2005, p 11.

19 Deloitte et al., 'Submission to the Federal Treasurer: Exemption of child care from fringe benefits tax' (2005), synopsis, p 3.

committee that they wanted to assist employees with child care, and were even willing to provide seed funding for a child care venture near one of their mining operations in Western Australia. They felt, however, that they did not have the necessary expertise or inclination to operate a child care centre. 'The BHP Billitons of this world do not know how to run child care', said the company in evidence.²⁰ Additionally, where the company was installing major mining operations adjoining small regional towns, it was unwilling to create a climate of community resentment by reserving 'soft' infrastructure and services such as child care for BHP Billiton employees.

- 7.27 The committee considers this a reasonable attitude, particularly when there are already professional providers with child care expertise, not to mention facilities in which they are already operating child care services.
- 7.28 The Department of Defence's dilemma is another case in point. Defence own 19 child care centres which are available for employee use; shortly before giving evidence to the committee they had acquired a further 30 centres through a lease licence arrangement with ABC Learning Ltd. A significant number of Defence children are already enrolled, and the Department has applied for a private ruling on whether the parents of these children would be able to salary sacrifice for the child care fees. At the time of giving evidence, the Department of Defence felt that given the restrictions of the business premises test, it was unlikely to be successful.²¹
- 7.29 Centrelink told the committee that they were negotiating with tenderers but were yet to apply for a private ruling which would cover their 38,000 employees across Australia. At the time of writing, however, it was not clear what the terms of the application would be and whether it would be successful.²²

Small and medium-sized workplaces

- 7.30 If the establishment of a child care centre is daunting for a company of BHP Billiton's size, the exemption certainly discriminates against small and medium-sized businesses. These typically have smaller workforces, have lesser financial resources, and are less likely to pay for professional legal advice for a matter outside their core business.

20 Murray F, transcript, 30 June 2006, p 49.

21 Stodulka J, Defence Community Organisation, transcript, 21 August 2006, pp 23-24.

22 Cotterill P, 13 September 2006, transcript, private briefing, pp 3-4.

7.31 In a survey conducted by Aegis Consulting, employers said that they felt it was uneconomical to establish a child care centre unless there were at least 1,000 employees in any one location and at least 40 children using the facility.²³ Three and a half million Australians, however, are employed by small businesses with less than 20 workers, representing 49 per cent of all private sector employment.²⁴ As at June 2004, 32.8 per cent of all small businesses employed between one and four people.²⁵ Under current fringe benefits tax legislation and the Commissioner of Taxation's rulings, a number of such businesses cannot combine together in order to operate a child care cooperative for the benefit of their workers.²⁶

7.32 Aegis told the committee, 'At the moment there is what we would consider an anomaly in the tax system that discriminates against small and medium sized employers'.²⁷ Under questioning about the fringe benefits tax exemption for child care, the Australian Taxation Office agreed that, in a practical sense, this was so:

Legally, all taxpayers are able to enter into the same arrangements as described in our public ruling and get such an exemption. But we are aware that it is not very practical for small business.²⁸

7.33 The committee received a number of comments on this subject:

As a PAYE employee without access to employer supplied child care, there is no possible mechanism for me to pay child care fees from pre-tax income. If my employer was a university or a large bank or another employer with child care facilities on-site, this would be possible, saving me 32 per cent of child care costs...Why are these avenues open to only select people within society?²⁹

It is unfortunate that salary sacrifice is available to a select few. It is impossible for a small business to erect and maintain

23 Aegis Consulting, sub 107, p 8.

24 Australian Bureau of Statistics, *Small business in Australia, 2001* (2002), Cat No 1321.0, p 1.

25 Australian Bureau of Statistics, *Characteristics of small business, Australia, 2004* (2005), Cat No 8127.0, p 31.

26 Federal Commissioner of Taxation, public ruling TR 2000/4, 'Fringe benefits tax: meaning of "business premises"'; see also Konza M, Australian Taxation Office, transcript, 21 June 2006, p 19.

27 Beri V, transcript, 22 July 2005, p 19.

28 Konza M, transcript, 21 June 2006, p 17.

29 Fulton P, sub 38, p 1.

a child care facility whilst the Australian Government and other large groups, e.g. banks, are able to fully sustain their own work based child care centre.³⁰

Regional and rural workplaces

7.34 For the same lack of economies of scale, regional and rural workplaces are unlikely to benefit from the fringe benefits tax exemption for child care. In many rural centres, it is difficult to sustain a single public access child care centre, let alone to establish another for the employees of one company.

7.35 Businesses with a national distribution of staff are finding that they are unable to offer regional employees the same conditions as their metropolitan counterparts. It is not feasible for them to enter in leasing and operating arrangements for child care centres in every town where they have branches. ANZ Bank gave evidence on their suite of family-friendly provisions, including five child care centres, to be followed with a further six leased through an agreement with ABC Learning:

Whilst many of our ANZ families have utilised child care provided through ANZ's partnership with ABC, it is impractical for a company that operates in so many communities across Australia to ensure these centres are accessible to every employee.

ANZ locates centres in areas where there is likely to be a high demand from ANZ families which tends to be CBD locations. This excludes many of our staff outside CBD locations and staff based in regional Australia.

We receive regular feedback from staff requesting the ability to salary sacrifice child care other than that provided by ABC, however due to current fringe benefits tax arrangements salary sacrificing outside of our ABC partnership arrangement is not tax effective for either ANZ or for our staff.

These tax restrictions prevent ANZ from providing support to defray the cost of child care for staff in non-metropolitan areas. The removal of FBT on all child care would enhance

30 Childcare Queensland, sub 198, p 6.

ANZ's ability to assist our people with their caring responsibilities.³¹

Are workplaces places for children?

7.36 A further problem with the exemption is that many business premises and related areas are inappropriate places to have a child care facility. As Justice Merkel of the Federal Court noted:

Common sense would dictate that in many instances basic requirements for child care facilities may be such that it is inappropriate for the facilities to be located upon the same premises where the other business operations of an employer are conducted.³²

7.37 Deloitte argued that:

Business premises are generally not designed to house child care facilities creating significant set-up and investment costs for employers... A CBD location brings its own concerns. [They include] the difficulty in accommodating drop-off zones for parents as well as the difficulties involved in meeting noise, health and safety, fire and pollution regulations.³³

7.38 ABC Learning gave evidence to the committee that:

We are seeing a lot more child care centres in business parks. We have corporate care services, where we provide centres at the workplace... One of the difficulties we have is that, in many instances, it is unlikely that councils will approve centres in locations that are quite industrial. Also, state regulations have a requirement that centres not be provided in hazardous environments. So where there is storage of chemicals and petroleum products, or concrete batch plants and so on, that will often rule out placing a child care centre in that area.³⁴

7.39 As another example, the Western Australia Police Service told the committee that police stations were not appropriate places for

31 ANZ Bank, sub 133, p 6.

32 *Esso Australia Ltd v FC of T* 1998 ATC 4953.

33 Deloitte et al., 'Submission to the Federal Treasurer: Exemption of child care from fringe benefits tax' (2005), synopsis, p 3.

34 Kemp M, transcript, 22 July 2005, p 11.

children, and that the business premises limitation was having an impact on which child care options they were able to consider.³⁵ The inflexible requirements of the legislation, as interpreted by the Australian Taxation Office, are holding back many employers on the basis of the nature of their business and the working environment of their staff.

- 7.40 Child Care Associations Australia, the national peak body representing primarily private long day care centres, reported that the child care market in the Australian Capital Territory was being distorted by the limitations to the exemption. This was because parents could not exercise choice over where they put their children without losing a financial benefit:

Within the ACT this [business premises limitation] creates distortions in the local market with parents making their choices about child care not on the basis of centre of choice, but the centre offering the most affordable care available. Individual parents in the ACT have found the choices distressing emotionally as they are not necessarily in the best interests of their child. It can also influence the employment decisions made by parents.³⁶

Reforming the business premises limitation

- 7.41 Evidence received by the committee indicates that the business premises limitation is distorting the intended outcome of the exemption and imposing penalties on those whom it was designed to benefit.
- 7.42 The Australian economy is already suffering from skills shortages, which are likely to be exacerbated by demographic changes. Therefore, the provision of child care should be a legitimate way for businesses to attract and retain staff, should they choose to do so.
- 7.43 The committee is also concerned that the Australian Taxation Office's interpretation of the legislation is not giving employers certainty about whether they might qualify for the exemption, and that the Office's jurisdiction is potentially straying into policy grounds. It notes that the Inspector-General of Taxation expressed similar concerns in his 2005-06 Annual Report:

35 Harrison-Ward J, transcript, 30 June 2006, p 46.

36 Child Care Associations Australia, sub 130, p 8.

I am concerned about how the Tax Office approaches interpretation and administration of the law in some significant cases and the potential for this issue to be systemic... I notice that the Tax Office from time to time seems to blur the gap between tax policy and administration... I have noted signs that the Tax Office is willing to interpret and administer the law in line with its view of policy even if the letter of the law does not adequately support it.³⁷

- 7.44 Considerable financial and legal resources are being expended in order to meet the business premises rule. Evidence was taken from multiple witnesses who had applied for, or were in the process of applying for, a private ruling from the Taxation Office on their specific circumstances. Despite expenditure of time and money by employers who have a genuine wish to offer child care to their staff, private rulings are returned in the negative. This has been the case for salary packaging provider McMillan Shakespeare, who revealed that their two applications for a private ruling had cost an estimated \$50,000 apiece.³⁸ The Australian Taxation Office, on the other hand, incurred no such expenditure in order to institute its own salary sacrificing arrangements for child care. In response to a question from the Chairman, it advised:

The Tax Office, as an employer, after reviewing publicly available guidance issued by the tax administration arm of the Office, formed its own view in relation to the application of fringe benefits tax exemption for the salary packaging of child care expense payments.³⁹

- 7.45 All this effort, from the committee's point of view, is to satisfy a requirement that is at odds with the encouragement of family-friendly workplaces.
- 7.46 Removing the business premises limitation to the exemption would give employers the opportunity to legitimately assist employees with child care without having to make a long-term commitment to an inflexible and prohibitively expensive child care facility. Removing the fringe benefits tax liability for child care altogether would be even better.

37 Inspector-General of Taxation, *Annual report 2005-06* (2006), pp 4-5.

38 Podesta A, transcript, 1 November 2006, p 3.

39 Australian Taxation Office, correspondence, 14 August 2006, p 4.

- 7.47 This would mean that small and medium sized businesses could better compete against large firms in attracting and retaining staff who want family-friendly working provisions. It would allow, for example, a small business owner to buy several child care places at a local centre for his staff. It would allow, as well, employees to choose where their children are cared for without losing the ability to salary sacrifice for child care fees.
- 7.48 Employers could also be much more responsive to the changing needs of their workforce. Under the current system, it is difficult for an on-site child care facility to cope with changes in demand. Too much demand, and parents are put onto a waiting list; too little demand, particularly on the last few days of the week, and the centre becomes unsustainable. The Australian Chamber of Commerce and Industry have said:
- If an employer can buy childcare from a number of providers, then sudden changes in demand can be managed. It is less likely that an on-site provider would be able to cope with sudden demand changes.⁴⁰
- 7.49 The committee notes that salary sacrificing is used most for vehicles, superannuation and computers, none of which require a business premises test or indeed any other test except that they are work-related. Child care should be treated in the same way.

Child care facility limitation

- 7.50 Under section 47(2) of the *Fringe Benefits Tax Assessment Act 1986*, the exemption is only available for a 'child care facility', a term that is subsequently defined in section 136(1) as follows:

Child care facility means a facility at which a person receives, or is ready to receive, two or more children under the age of six, not being associates of the person, for the purpose of minding, caring for or educating them for a day or part of a day without provision for residential care but does not include a facility at the place of residence of any of those children.

- 7.51 This definition includes long day care centres and after school hours care facilities, but it is unclear whether occasional care and vacation
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40 Australian Chamber of Commerce and Industry, submission to the Joint Standing Committee on Public Accounts and Audit, Inquiry into a range of taxation issues in Australia, sub 43, p 9.

care are captured. Again, there is business confusion about what does and does not qualify for the exemption. In their submission to the Federal Treasurer, Deloitte wrote that, 'The exemption does not contemplate before and after-school care arrangements... further, the exemption does not consider the demands of vacation care'.⁴¹ In the only interpretative decision made by the Commissioner of Taxation on the subject, he deemed that an after school facility located on the premises of an employer did in fact qualify for the exemption.⁴²

- 7.52 Family day care, in-home care (nanny care) and other forms of care, because they are provided in a residential setting, do not qualify for the exemption.
- 7.53 Aegis Consulting suggested to the committee that the restrictiveness of the 'child care facility' requirement meant that employers were not free to find creative child care solutions that met the needs and lifestyles of their workers:
- If an employer cannot afford to set up a child care facility and they want to provide the exact same dollar amount to employees to use at their local not-for-profit organisation or even to have the grandparents look after their children, they cannot do it. That means the majority of employers in Australia cannot support their employees' child care needs.⁴³
- 7.54 Abacus Ark Corporate Child Care told the committee that employers recognised that parents' work was contingent on their ability to find child care, but that fringe benefits tax penalties were putting them off from pursuing in-home care:
- We specialise in providing child care services to companies directly, rather than to the general public. They are saying to us, 'Yes, we'd like to subsidise child care, particularly if we need our employees to come in on their day off, for example, or when there is a project on and they need to work back late'. Somebody has to pay for the child care in that situation. [But] the FBT is putting them off, obviously.⁴⁴
- 7.55 There is also an inconsistency between the exemption in section 47(2), for in-house child care, and the additional exemption in section 47(8)

41 Deloitte et al., 'Submission to the Federal Treasurer: Exemption of child care from fringe benefits tax' (2005), 11 November 2005, p 13.

42 Australian Taxation Office, interpretative decision, ATO ID 2001/309.

43 Beri V, transcript, 22 July 2005, p 19.

44 McInnally A, transcript, 22 September 2006, p 37.

for payments made by employers to secure priority access to child care centres for their employees. Section 47(8) was extended to cover priority access payments made not only to long day care centres but to family day care, vacation care, outside school hours care and approved in-home care services.⁴⁵ It is illogical for the exemption under 47(2) to persist with a definition of a child care service that does not reflect the child care options currently available to parents.

- 7.56 In the twentieth anniversary year of fringe benefits tax, the committee considers it timely to update the exemption for child care to make its benefits available to a greater number of Australian workplaces.

Recommendation 15

- 7.57 **Fringe benefits tax be removed from all child care, so that all or any child care provision made by employers to assist employees is exempt, inclusive of salary sacrificing arrangements for child care.**

Business support for reform

- 7.58 Evidence given by many employers over the course of the inquiry indicates that employers are increasingly aware of their employees' child care issues. The current competitiveness of the labour market and economic projections of increased skills shortages are strengthening the business case for offering some form of assistance, whether that be a direct child care benefit or the option of a salary sacrifice arrangement. McMillan Shakespeare, who provide salary packaging services to around 1000 employers across the country, told the committee about the costs of child care shortages to employers across the country:

From our discussions with our employer base, which is predominantly state government employers, Federal Government departments and agencies, public hospitals, for example, it has become clear to me that there is an enormous cost and burden being placed upon the state in particular due to the fact that teachers, police officers and nurses often find child care access difficult and as a result would stay away from work to provide that support for their children at various times. A lack of access to child care means that the

45 For further information on the exemption under section 47(8), see chapter three.

state effectively has to replace the teacher with a replacement teacher for the day to teach the kids; likewise with nurses, the nurses have to be substituted, and I suspect that in the case of police officers it is about extra overtime and shift work that takes place to cover those shifts. So there is a real burden in terms of those occupations to which I refer and their need for child care.

Likewise, I am told by various authorities that they find it very difficult in some cases to get employees to remote locations or out of city locations because of the issues associated with child care. It is very difficult to get people to rural locations if there are no child care facilities because very often both parents have a job, be they police officers or teachers. That is often the case with hospital workers as well. There is a real need for both working parents to find access to child care in remote locations.⁴⁶

7.59 Similarly, the Business Council of Australia reported on the stress that child care shortages were placing on their members:

The vast majority of [our member companies] seek to be employers of choice. They are looking to employ the best people that they possibly can and they are increasingly competing in a very tight labour market. Work-family policies are one of those issues which allow them to attract and retain quality staff... [Child care] is an area where there is growing pressure and where businesses are finding that it is cutting across their own employees' ability and willingness to work.⁴⁷

7.60 As an example, a chartered accounting firm in Tasmania gave evidence on how the loss of female workers due to child care costs was causing a critical workforce shortage. Current fringe benefits tax arrangements, however, were making it prohibitive for employers to assist:

There seems to be no logical reason that I can possibly think of why child care on an employer's premises should be exempt from fringe benefits tax when child care provided anywhere else would not be exempt from fringe benefits tax...

46 Podesta A, transcript, 1 November 2006, p 7.

47 Cilento M, transcript, 10 April 2006, pp 2-3.

From the point of view of being an employer, I can say to you that it has a massive effect on us. The public accounting profession has a huge number of females coming into it. They come out of university, they are 21 years old and we spend a massive amount of time on training them, but by and large we will lose those females four or five years down the track because child care is just too expensive for them.

I know that we as an employer would be more than happy to consider giving child care support if it were not subject to fringe benefits tax.⁴⁸

- 7.61 McMillan Shakespeare felt that their clients, who include employers in the government, non-profit, and private sectors, would welcome the opportunity to assist with child care without the penalty of fringe benefits tax:

I think employers would be delighted to see that test being removed. If the provision of child care was fringe benefits tax exempt, if it were just seen as part of the cost of employment, like laptop computers, mobile phones, income protection insurance, for example – if it were seen as just part of our Australian workplace culture and needs – then I think employers would be delighted.⁴⁹

- 7.62 Aegis Consulting spoke about one of its clients, tourism and services group Accor, who employ about 10,000 people in Australia, and of MacDonald's:

Most of [Accor's employees] are casuals but Accor would love to be able to give them the opportunity to salary sacrifice or even in some circumstances give them an extra top-up for child care, because it is an industry that relies on people where there are skills shortages. As you know, the workforce of McDonald's is pretty casual but they are firmly behind the notion of having flexibility to provide that kind of child care benefit to their employees.⁵⁰

- 7.63 On 11 November 2005, Deloitte and 37 other corporate participants lodged a submission with the Federal Treasurer appealing for reform

48 Leighton C, partner of Ruddicks Chartered Accountants, Joint Committee of Public Accounts and Audit, Inquiry into Certain Taxation Matters, transcript, 24 August 2006, pp 32-33.

49 Podesta A, transcript, 1 November 2006, p 8.

50 Beri V, transcript, 22 July 2005, p 28.

of the fringe benefits tax treatment of child care. The group, which included many top Australian companies, asked the Treasurer to remove both the business premises and the child care facility limitation to the exemption.⁵¹

- 7.64 The committee has received correspondence from Shell Australia Ltd expressing full support for the reforms proposed by Deloitte and their partners.⁵² Other major representative business groups, such as the Business Council of Australia and the Australian Chamber of Commerce and Industry, have spoken in support of fringe benefits tax reform for child care.⁵³
- 7.65 Health insurance and health care corporate BUPA Australia have said to the committee that child care is poorly supported by the existing fringe benefits tax legislation. The expense and logistical problems posed by operating a child care facility were the reasons why they chose not to provide salary sacrificing arrangements to their staff.⁵⁴
- 7.66 As a further example, Monash University has written to the committee to:
- ...express general concern about the restrictions imposed by fringe benefits tax on an individual organisation's capacity to enable staff to benefit from salary packaging...
- Monash University would encourage the implementation of suggested amendments which would enable a shared provision of child care, for example as a partnership between the University and other employers in the local community. This could be of benefit both to our staff and to the strengthening of our relationships with other local organisations.⁵⁵
- 7.67 The committee believes that this interest in child care by employers is encouraging, and that ideas such as this one show promise. It is contradictory to the best interests of government, business and workers that employers continue to decide against child care assistance due to tax penalties.

51 Deloitte et al., 'Submission to the Federal Treasurer: Exemption of child care from fringe benefits tax' (2005).

52 Shell Australia Ltd, correspondence, dated 27 September 2006.

53 Ker P, 'Family still "women's business"', *The Age*, 11 April 2006, p 9; Australian Chamber of Commerce and Industry, supplementary sub 153, p 7.

54 BUPA Australia, correspondence, dated 27 September 2006.

55 Monash University, correspondence, dated 27 September 2006.

7.68 Employers who are already offering salary sacrificing for child care have reported that the administrative burden on the business is minimal. The Commonwealth Scientific and Industrial Research Organisation told the committee:

We allow salary sacrifice directly from our pay system, and that is administratively efficient for us. In a sense, it is no different from allowing people to make deductions to a bank or anywhere that takes electronic funds transfers. So it is pretty efficient and it is not administratively burdensome for us.⁵⁶

The Department of Foreign Affairs and Trade agreed:

We are the same: salary sacrificing is not an administrative burden at all. In terms of the child care centre, we have a staff member who has, as part of their responsibilities, the management of the contract and a liaison role with the child care centre, but I would not consider it to be at all onerous. In fact, it is relatively easy. There is an issue in terms of being able to get staff back to work a little quicker, so it is an easy trade-off.⁵⁷

Tax deductibility for child care

7.69 In this section, the committee will explore a solution that could be available simultaneously with increased salary sacrificing; i.e., a tax deduction for work-related child care.

7.70 A single father of four children, Paul Richards, forwarded to the committee a letter he received from the Treasurer in response to his question about whether child care could be made tax deductible. In this person's case, his fly-in fly-out job necessitated overnight care, so he could not use long day care or access any financial assistance that would enable him to work. The Treasurer wrote:

Expenses of a predominantly private or domestic nature, such as child care expenses, do not qualify for deductions.

If individuals were able to access deductions for child care, the benefit received would reflect their marginal tax rate,

56 Smith W, transcript, 11 October 2006, p 11.

57 Williams P, transcript, 11 October 2006, p 11.

resulting in different treatment of individuals contingent on their income. The individuals who would benefit most would, of course, be on the top marginal tax rate. Individuals without a tax liability would not be able to benefit from deductions.⁵⁸

- 7.71 The committee accepts that tax deductibility for child care, if applied as the sole form of government assistance for child care, would not be advantageous for people with a low or nil tax liability. This problem has been considered seriously by the committee and is addressed later in this chapter.
- 7.72 But there is a logical inconsistency in the Government's policy position on tax deductibility for child care. Public servants in the Treasurer's own department can salary sacrifice for child care, as can employees of the Australian Taxation Office. Through the fringe benefits tax exemption, an elite number of Australian employees are permitted to deduct the cost of child fees from their pre-tax income. They enjoy, in fact, tax deductibility for child care. The Australian Taxation Office, in evidence, confirmed that while the mechanisms were different, the monetary outcomes of salary sacrificing for child care and a tax deduction for child care were exactly the same.⁵⁹
- 7.73 The public service has a role as a model employer, and the committee congratulates the agencies offering salary sacrificing for child care for taking leadership.⁶⁰ But the Government's obligation is to make sure that other workers can also access these benefits. The self-employed and those working for small businesses need equity in their child care choices. Why should a tax deduction not also be available to those who do not have a workplace offering on-site child care?
- 7.74 The policy idea of tax deductibility for child care is not new. Since the 1970s, governments have repeatedly rejected calls to make child care costs a tax deduction. In 1980, for example, the Women Members Group of the Australian Society of Accountants made a submission to the Federal Treasurer urging that tax deductions for child care expenses be made available to working mothers and single fathers. The group claimed that:

58 Annexure B to Richards P, sub 170, p 1.

59 D'Ascenzo M, Commissioner of Taxation, and Chooi A, transcript, 29 November 2006, p 8.

60 Australian Government agencies offering salary sacrificing for child care are detailed in figure 7.3.

... such a system, by decreasing the net cost of going out of work, would encourage more women to earn taxable income, thereby increasing tax revenue. It also argued that welfare payments would be reduced and employment created as a result of increased demand for child care places, and that facilitating women's return to the workforce after the birth of their children would result in a better return from public investment in the education and training of women.⁶¹

These arguments still resonate.

Child Care Tax Rebate

- 7.75 The Child Care Tax Rebate, announced in the 2004-05 Budget, acknowledges for the first time the vital role that taxation plays in women's ability to work. It is not means-tested and provides vertical equity for child care costs across the income scale, while targeted assistance remains in the form of the means-tested Child Care Benefit.
- 7.76 It could, however, go further in stimulating workforce participation outcomes. Unlike a tax deduction for a work-related expense, the Child Care Tax Rebate is not strongly linked to workforce participation and does not make explicit recognition of child care as an essential cost of working.⁶²
- 7.77 The rebate is capped at \$4,000, which may not be sufficient for families dependent on formal care, particularly if they are living in the inner metropolitan areas of cities like Sydney. Additionally, as the committee explored in the previous chapter, the Child Care Tax Rebate is only payable for approved care, meaning that many families miss out.
- 7.78 The following section will examine arguments for and against making child care expenses tax deductible.

61 Cass B and Brennan B, 'Taxing women: The politics of gender in the tax/transfer system', *eJournal of tax research* (2003), University of New South Wales, vol 1, no 1, p 48.

62 There is a child care benefit test for the Child Care Tax Rebate, but it is not stringent. The then Assistant Treasurer the Hon Mal Brough MP moved in 2005 to ensure that parents who worked less than 15 hours a week would continue to have access to the rebate provided that they participated in work, training or study at some time during the week. Hon Brough MP, Assistant Treasurer, 'Child care rebate assured in tax changes', media release, 7 December 2005.

Essential cost of working

7.79 Despite the rejection of a number of attempts by Australian taxpayers to claim child care expenses as a deduction, the courts and the Federal Commissioner of Taxation have accepted that in many cases child care expenditure is necessary for a person to be able to work. In fact, they have been generally sympathetic to taxpayers. Justice Mason noted in 1972 that:

The [child care] expenditure was incurred for the purpose of earning assessable income and it was an essential prerequisite of the derivation of that income.⁶³

7.80 Similarly, Chief Justice Bowen and Justices Toohey and Lockhart acknowledged in 1984 that:

It may be accepted that the placing of [the taxpayer's] child in a kindergarten (and the incurring of expenses thereby) was a prerequisite to the taxpayer's employment. It was not suggested that any other course was open to her if she was to take on any of the three jobs in question.⁶⁴

7.81 This is consistent with evidence received by the committee that for many parents, child care is an unavoidable cost incurred in taking paid work. It is often calculated against potential increased income when a parent decides whether to return to the workforce. The committee received many impassioned comments on the necessity of child care to the working parent:

As a civilized society we should be ready to accept that if parents are to work they need child care - not all families are fortunate to have relatives to take care of the children or earn enough (a minimum of A\$60k in Sydney), to pay for quality child care. It should be deductible for families.⁶⁵

Child care is absolutely essential to me being able to be employed, so why is it not tax deductible? Why is my briefcase, my computer, my corporate clothes, my study expenses etc all tax deductible, whereas child care is not? Child care costs me 150 per cent more than my mortgage

63 *Lodge v FC of T* 1972.

64 *Martin v FC of T* 1984.

65 Carroll G, sub 40, p 3.

costs, and this is... only for 3 days per week for two children.⁶⁶

Child care is a work-related expense for the vast majority of parents, and thus should be tax-deductible for working parents.⁶⁷

If something as obscure as a handbag or a briefcase is deemed to be a necessary tax-deductible cost of employment, I struggle to see how child care costs for a working parent could sensibly be interpreted otherwise.⁶⁸

In my book, child care has to be considered a work related expense... If you are paying child care, taxable income is a grossly exaggerated figure as opposed to what you are actually taking home. I pay \$6,000 per annum in child care. If that \$6,000 was taken off my taxable income I would get tax breaks and far more assistance. I find it really strange.⁶⁹

Deductibility for individuals with child care expenses for work-related reasons acknowledges that today there is a nexus between child care expenses and income: some of us with children cannot work unless our children are looked after. Without child care, we would not be working.⁷⁰

Nexus between child care and income

- 7.82 The courts have held that the essential nature of child care is not sufficient to qualify for a deduction under section 8-1 of the *Income Tax Assessment Act 1997*. As outlined in chapter three, allowable deductions must be 'incurred in gaining or producing the taxpayer's assessable income'. That is, they must arise directly from the nature of the activity whereby a person earns an income.
- 7.83 It is possible that many of the deductions presently allowable as business expenses have a less direct relationship to work activity than, say, a plumber or carpenter to his tools. In a well-known Canadian case, *Symes v The Queen 1993*, a married woman working full time in a Toronto law firm attempted to claim deductions for the

66 Fulton P, sub 38, p 1.

67 Name suppressed, sub 95, p 2.

68 Carr B, Women Lawyers Association of NSW, transcript, 13 March 2006, p 57.

69 Fenney-Walch B, transcript, 11 April 2006, p 16.

70 Jacobsen S, 'Child care is taxing', *Law Institute Journal* (2005), vol 79, no 12, p 83.

cost of employing a nanny. Justice L'Heureux-Dubé, a Supreme Court judge who dissented from the final decision, wrote:

One must ask whether the many business deductions available, for cars, for club dues and fees, for lavish entertainment and the wining and dining of clients and customers, and for substantial charitable donations, are so obviously business expenses rather than personal ones.⁷¹

- 7.84 In Australia, where boardroom lunches and magazine subscriptions are tax-deductible, but child care is not, there is a similar confusion about what constitutes a legitimate expense of doing business.

'Private and domestic' expense

- 7.85 Further to the fact that a deductible expense must be incurred in gaining or producing income, there is a disqualification in the *Income Tax Assessment Act 1997* of deductible expenses that are private or domestic:

You cannot deduct a loss or outgoing under this section to the extent that... it is a loss or outgoing of a private or domestic nature.

- 7.86 For over 30 years it has been a principle of Australian tax law that child care costs are essentially expenses of a private nature. In a society dominated by a traditional breadwinner model, this assumption was unchallenged. At the time of Justice Mason's decision in 1972, which created precedent for the taxation treatment of child care in Australia thereafter, the average participation rate for women was only 37.1 per cent.⁷² The concept prevailed of the breadwinner husband earning income to provide for the family, supported by a wife at home performing the 'private' tasks of housekeeping and caring for children.
- 7.87 Increasingly, however, the sole breadwinner division of labour resembles fewer and fewer Australian households. Women's still-growing participation in the workforce means that there can no longer be an assumption that a worker has someone at home to perform the 'private' tasks that support their ability to work. Parents of both genders now move more fluidly between the spheres of public

71 *Symes v the Queen* 1994 [Canada], L'Heureux-Dubé J, dissenting report, p 81.

72 Australian Bureau of Statistics, *Census of population and housing* (1971), cited in *Australian social trends, 2003* (2003), Cat No 4102.0, p 134.

and private labour: from the kitchen to the workplace; and from the child care centre to the home office. It is unsurprising that there are continuing tensions in our income tax law about what expenses are legitimately 'work-related'.

7.88 Justice L'Heureux-Dubé in the Canadian case offers a thoughtful interpretation of the public/private divide:

In my view, it is important to look closely at the dichotomy of business as opposed to personal expenses. If we survey the experience of many men, it is apparent why it may seem intuitively obvious to some of them that child care is clearly within the personal realm. This conclusion may, in many ways, reflect many men's experience of child care responsibilities.

In fact, the evidence before the Court indicates that, for most men, the responsibility of children does not impact on the number of hours they work, nor does it affect their ability to work. Further, very few men indicated that they made any work-related decision on the basis of child-raising responsibilities.

The same simply cannot be said for women. For women, business and family life are not so distinct and, in many ways, any such distinction is completely unreal, since a woman's ability to even participate in the workforce may be completely contingent on her ability to acquire child care. The decision to retain child care is an inextricable part of the decision to work, in business or otherwise.⁷³

7.89 In the case mentioned above, a majority of 5-2 in the Supreme Court of Canada held that child care expenses were not deductible. The decision was split along gender lines; the five men sitting on the case found that the expenses were not deductible, whilst the two women sitting on the case found the opposite.⁷⁴

7.90 The presiding chief justice, while not in the end able to justify a work-related deduction under the law, nevertheless found the case a challenging one. He noted that the traditional characterisation of child

73 *Symes v the Queen* 1993 [Canada], L'Heureux-Dubé J, dissenting report.

74 Young C, 'Taxing times for women: Feminism confronts tax policy', *Sydney law review* (1999), vol 19, viewed on 13 October 2006 at <http://www.austlii.edu.au/au/journals/SydLRev/1999/19.html>.

care expenses as private in nature pre-dated significant numbers of women of child-bearing age entering the workforce:

Proper analysis of this question demands that the relationship between child care expenses and business income be examined more critically.⁷⁵

- 7.91 In his judgement he invoked the legal principle that if expenses arose from personal circumstances rather than business circumstances, then the expense was personal and non-deductible.

There are obvious tautologies within this approach. 'Personal expenses' are said to arise from 'personal circumstances' and 'business expenses' are said to arise from 'business circumstances'. But, how is one to locate a particular expense within the business/personal dichotomy?

- 7.92 As an example of this difficulty, Chief Justice Lamer cited an earlier case from the Canadian Federal Court, where the presiding judge had concluded that a taxpayer had used good business and commercial judgement in using child care to enable her to take paid work. 'The decision', he had said:

... was acceptable according to business principles which include the development of intellectual capital, the improvement of productivity, the provision of services to clients and making available the resource which she sells, namely her time.⁷⁶

- 7.93 In concluding his judgement, he took the step of saying that the law should be changed to take account of the evidence the court had heard.

We propose to permit deduction of the child care expenses that face many working parents today. The problem of adequately caring for children when both parents are working, or when there is only one parent in the family and she or he is working, is both a personal and a social one. We consider it desirable on social as well as economic grounds to permit a tax deduction for child care expenses, under carefully controlled terms [i.e. for work-related child care only].⁷⁷

75 *Symes v the Queen 1994* [Canada].

76 Federal Court, Trial Division 1989 3 FC 59 (Cullen J) [Canada], cited in *Symes v the Queen 1994* [Canada].

77 *Symes v the Queen 1994* [Canada].

7.94 Australian courts have been less forthright in airing ambiguities in this question of child care expenses. In his judgement of 1972, Justice Mason noted some tensions in the legislation, although he did not speculate on how they had arisen, and how the distinction of 'work-related' and 'private' expenses might have been made more complex by the fact that the appellant was a single working mother:⁷⁸

I express no opinion on the question whether an expenditure which is incurred in gaining or producing assessable income may nevertheless be of a 'private' or 'domestic' nature.

7.95 Justice French, in his judgement for *Hyde v FC of T 1988*, went further:

It is evidently the fact, and is accepted by the Commissioner, that the taxpayer's expenditure on child minding was necessary to enable him to undertake the employment from which he derived his assessable income... One can accept that the taxpayer may well feel some sense of grievance at the fact that the expenditure cannot be claimed as a deduction, but as the courts have said on occasions before today, the answer to that grievance will not be found in the courts but in changing the law and that is a matter for the legislature.⁷⁹

7.96 The committee notes that the courts have, in previous cases, changed their minds on their interpretation of the law and have reversed long-entrenched policy positions. An example is *Ha and Hammond v NSW 1997* in the High Court of Australia, which overturned previous findings on the definition of excise duties and led to the dismantling of state taxes on fuel, alcohol and tobacco worth billions of dollars.

7.97 The best solution, however, is for legislators to take responsibility for clarifying the status of child care, and acknowledge it as an expense legitimately and necessarily incurred in the 'business' of earning an income. The courts have invited the legislature to take this course of action, and the committee believes that it should be undertaken.

Benefits of a tax deduction for child care

7.98 Offering families a tax deduction would acknowledge child care as a legitimate cost of working, and would align government expenditure in this area more closely with workforce participation outcomes. This is consistent with OECD recommendations that Australia's child care

78 *Lodge v FC of T 1972*.

79 *Hyde v FC of T 1988*.

assistance be made more conditional on employment.⁸⁰ By giving a benefit proportional to the marginal tax rate of the worker, a tax deduction would actually give an incentive for increased participation in the workforce, as it would reward parents by returning to them some of their own hard-earned income which would otherwise go to government revenue.

7.99 Certainly, the individuals who gave evidence to the committee in favour of a tax deduction saw government expenditure on child care not as a welfare payment but as an investment for workforce participation. Many parents, and especially mothers, are keen to use their skills, experience and talent in society at large:

I am asking... that you give long and hard consideration as to how the tax system can help families with their child care costs. Why can you not consider making child care (and that includes nannies) tax deductible? Can't you see that meaningful support like that will enable an army of qualified, enthusiastic and capable women to return to the workforce?⁸¹

It would make a big difference to us as a family if child care costs could be claimed as a tax deduction. Child care costs are a work related expense. I would not have to use child care if I did not have to work. I do not mind paying tax as I believe we all need to contribute to pay for the community and social structure that we have, however, I believe that as child care is primarily used to support working parents it should be seen as an expense incurred because of work and treated as such by our tax system.⁸²

The Tax Office's narrow view of the modern world is shameful. This is the 21st century where woman are encouraged to not only be parents but also to have careers and contribute to the economy. It is the century of flexible hours, globalisation and virtual offices. It is the century where Australian women are constantly being encouraged to not only have children to help address the ageing population crisis but also publicly admonished if they don't return to work...

80 OECD, *Economic survey of Australia 2006* (2006), p 11; see also Jaumotte F, 'Labour force participation of women: Empirical evidence on the role of policy and other determinants in OECD countries' (2003), *OECD Economic studies*, no. 37, p 88.

81 MacDonald E, sub 154, p 2.

82 Langham J, sub 171, p 2.

I would encourage the committee to embrace the 21st century and understand the dilemma facing working women and families who employ nannies and allow these to be legitimate tax deductions. In doing this they may also encourage more women to return to work, either for organisations or to start their own business, thereby contributing even further to the Australian economy.⁸³

7.100 Similarly, a single father wrote to the committee:

These last 12 years I have been raising four children and I work at every opportunity I can. There are a few reasons I don't work now mostly related to raising my kids. One thing which would be of a great help to me and most probably others was if employing a live in nanny could be regarded as a legitimate work-related tax deduction.⁸⁴

7.101 The South Australian Premier's Council for Women also made a submission to the inquiry urging that a tax deduction for child care would offset the costs of working for parents, and would be an incentive in encouraging their participation in the workforce.⁸⁵

7.102 The comments above, of course, also incorporate a plea for flexibility in the type of child care costs considered as legitimate deductions. The committee considers that if such a deduction were to be implemented, it should include in-home care, consistent with its findings from chapter six about the need to recognise a more flexible range of child care options to suit contemporary workers.

7.103 Also following on from the previous chapter, a tax deduction that included in-home care would further assist with the fight to legitimise the nanny industry and reduce the size of the black economy. Parents claiming tax deductions would need to provide the tax file numbers (TFNs) or Australian business numbers (ABNs) of their child care providers, and so would have a strong incentive to make sure that they are hiring a carer who is registered and qualified. Parent employers would withhold a small amount of withholding tax which they would then remit to the Australian Taxation Office.

83 Moulder A, attachment to The Elite Nanny Service, supplementary sub 157, p 4.

84 Richards P, sub 170, p 1.

85 South Australian Premier's Council for Women, sub 67, p 13.

Ensuring a fair distribution of assistance

- 7.104 The most common criticism of proposals to make child care tax deductible - or to expand salary sacrificing for child care - is that it will only benefit high income earners paying higher marginal rates of tax. The question is one that the committee has considered seriously.
- 7.105 Government policy has been to target family assistance for low to medium income earners, and over the last decade this has successfully raised the real disposable income levels of many families. Table 7.1 shows increases in real net tax thresholds for families since 1996-97; or rather, the level of private income at which income tax paid first exceeds cash benefits received. A dual income couple with two children, for example, are now earning over \$50,000 before they begin to pay any tax:

Table 7.1 Increases in real net tax thresholds for families, 1996-97 to 2006-07

Family type	Real net tax threshold		
	1996-97	2006-07	Per cent change
Sole parent	\$34,594	\$48,065	38.9
Single income couple with children	\$34,021	\$48,065	41.3
Dual income couple with children (75:25 split)	\$34,650	\$51,829	49.6
Dual income couple with children (60:40 split)	\$34,749	\$50,910	46.5
Dual income couple with children (67:33 split)	\$34,703	\$51,808	48.1

Source Budget paper no 1, 2006-07 Federal Budget, Statement 5: Revenue, Table B1, p 5-26. Dollar amounts are calculated in 2005-06 prices. Families are assumed to have two children – one aged three years and the other aged eight years. The numbers in brackets represent the wages of each working adult in the family, expressed as a proportion of average weekly ordinary time earnings for full time employees (AWOTE).

- 7.106 Given increasingly generous assistance to low and middle income families, the committee considers that there is a need to acknowledge higher income earners as the biggest contributors to income tax collected by the Australian Government. Their tax contribution funds, in part, the assistance received by many other families.

- 7.107 As Sinclair Davidson writes:

When rhetoric is swept aside and taxation data is examined more carefully, evidence shows that, contrary to popular belief, it is relatively high income earners who are paying the lion's share of personal income tax.⁸⁶

86 Davidson S, 'Who pays the lion's share of personal income tax? (2004)', *Perspectives on tax reform*, no 4, Centre for Independent Studies, p 1.

- 7.108 For the 2003-04 income year, the last year for which tax return data is available from the Australian Taxation Office, 50 per cent of personal income tax - or \$47.8 billion - was collected from the 14 per cent of taxpayers who were in the top marginal bracket.⁸⁷ While this distribution may have been flattened somewhat by structural tax cuts announced in the 2006-07 Budget, there is no doubt that tax paid by higher income earners represents a proportionally significant contribution to government revenue.
- 7.109 Higher income earners who pay the most tax can only receive any real assistance for child care by way of salary sacrificing, which as this chapter shows, is limited to the elite echelons of the public service and employees of a handful of large corporations.
- 7.110 Giving workers a tax concession for child care expenses would acknowledge the economic contribution made by personal income tax dollars, and give back to these workers some of what they have earned through their own exertions. It acknowledges that in a competitive global economy, Australia cannot afford to lose some of its most highly-educated and highly-skilled workers to parenthood or caring responsibilities.
- 7.111 Furthermore, the committee believes that tax measures for child care may be useful to employees across a broad range of income strata. Professor Peter McDonald of the Australian National University argued that, combined with policy initiatives to ensure a basic level of equity of benefit, salary sacrificing was not necessarily discriminatory:
- Salary sacrificing could be extended to right across the range of incomes. I think it could be beneficial to those on lower incomes as well.⁸⁸
- 7.112 Similarly, Aegis Consulting told the committee that being able to pay for child care with pre-tax income, either through salary sacrificing or a tax deduction, would be expected to make it attractive for many more women to want to participate in the workforce:
- We would not lose all those women in that bracket between about \$20,000 and \$50,000 per year, who are sitting at home because it is not worth going to work.⁸⁹

87 The Treasury, *Pocket brief on Australia's tax system* (2006), viewed 10 August 2006 at <http://www.treasury.gov.au/contentitem.asp?NavId=002&ContentID=866>.

88 McDonald P, transcript, 15 February 2006, p 2.

89 Tranent A, transcript, 22 July 2005, p 23.

- 7.113 Modelling shows, however, that some families would not receive a benefit from a tax deduction for child care which is superior to the current system of Child Care Benefit and Child Care Tax Rebate.
- 7.114 Accordingly, the committee recommends that the Child Care Benefit and Child Care Tax Rebate be retained. A choice should be afforded to working parents to opt for the Child Care Benefit and Child Care Tax Rebate, or to claim work-related child care costs as a tax deduction, either by way of a claim through their annual income tax return or by salary sacrificing.
- 7.115 In this way, no-one will receive any less than they do presently, but those who are producing more will benefit to a greater extent by keeping some of their own earned income.
- 7.116 Ultimately, under the committee's proposed model, families will have the responsibility of choosing which form of assistance best suits their needs. Parents who have provided evidence to the committee have a high degree of awareness of what they think their options should be. These families want to exercise choice about how they organise their work and family life.

Recommendation 16

- 7.117 **The existing Child Care Benefit and Child Care Tax Rebate be retained.**

A choice should be afforded to working parents to opt for the Child Care Benefit and Child Care Tax Rebate, or to claim work-related child care costs as a tax deduction, either by way of a claim through their annual income tax return or by salary sacrificing.

Recommendation 17

- 7.118 **The *Income Tax Assessment Act 1997* be amended to allow child care expenses incurred for the purposes of earning assessable income to be a tax deduction in the hands of the parent taxpayer who incurs the expenses.**

A tax deduction shall only be claimed for the days of work on which the taxpayer can demonstrate that the care was necessary in order for them to work.

A tax deduction between parents in a couple family shall be apportioned between them in proportion to income earned by each.

Any unused portion of the tax deduction shall not be transferable between spouses.

Where a taxpayer elects to claim a tax deduction for child care expenses, Child Care Benefit and the Child Care Tax Rebate shall not be payable.

Where a taxpayer elects to claim the Child Care Benefit and Child Care Tax Rebate, a tax deduction shall not be available.

Note for implementation

- 7.119 An unintended side effect of introducing tax deductibility for child care costs would be flow-through effects for the Family Tax Benefit and Child Care Benefit income tests. Any reduction in taxable income reduces the income base used to test these payments. In order to prevent distortion, the tax deduction would be disregarded for the purposes of Family Tax Benefit and Child Care Benefit income tests. These income tests are already based on Adjusted Taxable Income (ATI), rather than actual taxable income, for exactly this reason. Adjusted Taxable Income takes into account things such as deductible child maintenance expenditure, tax-free pensions or benefits, and net rental property losses, so that families do not receive more or less than they were intended to receive through inflation or deflation of their taxable income.⁹⁰

Conclusion

- 7.120 In the preliminary stages of drafting this report, the committee commissioned Econtech, a modelling firm, to cost proposed changes to child care support. The first model put to Econtech was to replace the Child Care Tax Rebate with a general tax deduction and to make all employer-provided child care exempt from fringe benefits tax. Econtech calculated the net cost to the Australian Government of this proposal at \$218.5 million annually (in addition to current outlays). However, Econtech also found that low income earners would decrease the number of hours they worked under this new system

⁹⁰ Australian Government, *Family Assistance Guide* (2006), version 1.82, section 3.2.1, viewed on 24 November 2006 at http://www.facs.gov.au/guides_acts/fag/faguide-3/faguide-3.2/faguide-3.2.1.html.

and would be worse off.⁹¹ Accordingly, the committee has not put this proposal forward as a recommendation.

- 7.121 Following this analysis, Econtech was asked to model the cost of a second proposal, which is reproduced in the recommendations of this report. However, Econtech modelled a slightly different proposal due to time constraints and the fact that the cost data published in the Australian Bureau of Statistics' Child Care Survey is net of Child Care Benefit (rather than showing both the amount of Child Care Benefit received and what the child care provider initially charged).
- 7.122 The second proposal modelled by Econtech was the same as the recommendations in this report, except that the tax deduction had some elements of the Child Care Tax Rebate, for example it was applied to a family's child care costs net of the Child Care Benefit. Although this is slightly different to the recommendations in this report, the committee is confident that the estimates provide a useful indication of the costs of its proposals. Econtech estimated that this second proposal would have a net cost to the Australian Government of \$262 million annually.⁹²
- 7.123 In the context of other government programs, such as Family Tax Benefit Part A (\$12.3 billion annually), Family Tax Benefit Part B (\$4.1 billion annually) and the Child Care Benefit (\$1.6 billion annually), spending \$262 million annually to improve flexibility in child care delivery is good value for money. The committee's proposals are affordable and the committee believes a significant number of Australians would be better off if they were implemented without delay.
- 7.124 The cost to revenue identified should be regarded as an investment to stimulate greater full time female participation, particularly targeting tertiary-qualified mothers to rejoin the full time workforce. As the committee's research has shown, the majority of today's university graduates are women, and the choices they make about work and family will make a difference to our national prosperity. These women will make up an increasing proportion of the workforce in the future, with total women graduates in the workforce likely to outnumber male graduates in the decades to come.⁹³

91 Econtech, Appendix E, p 20.

92 Econtech, Appendix E, p 23.

93 Trends in human capital distribution are detailed in chapter one.

- 7.125 In light of the Access Economics report at Appendix D, showing potential gains of increased female participation in full time work of between 2.9 and 4.4 per cent of national income, it is in the national interest to implement the recommendations made.

Additional comments by the Hon Alan Cadman MP

- 7.126 A crucial principle established in this report is that all parents should be able to claim some tax relief for sharing their incomes with their young dependent children. Greater emphasis and higher allowances should be given to children under the age of five, even though older children on balance 'cost more', as parents can more easily manage their work/home responsibilities once children reach school age.
- 7.127 The present Child Care Rebate is limited to \$4,000 for formal child care. Child care needs to be extended to as wide a range of services as possible. The rebate currently limits the type of child care. By providing support through the Family Tax Benefit, choices can be expanded and the options of using grandparents, relatives, in-home care and other types of child care become accessible. An increase to the Family Tax Benefit (Part A) by \$4,700 for each child under five would give families the opportunity of choosing the type of child care which is best suits them, and counteracts high effective marginal tax rates. No longer would it be a matter for the goodwill or generosity of the employer or the family making a decision to salary sacrifice.
- 7.128 Expensive child care is not available to everybody, nor do all parents endorse the use of centre-based care as the best means of caring for their young children. The registration of informal care will help reduce the prospect of abuse but continue to give parents choice. Once a real choice is available for parents, then work participation and family satisfaction both increase.
- 7.129 These changes would cost approximately \$1.7 billion but with other options escalating in cost, together with the complex administration involved, it provides a realistic and practical alternative to some of the proposals put forward by those giving evidence to this committee. Under this proposal, recommendations 14 and 15 would become superfluous as families would have additional resources, by way of the Family Tax Benefit (Part A), to use on the child care of their choice.

