



Paper
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*An examination of child care tax transfer
reform proposals*

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"AND THE COW JUMPED OVER THE MOON..."
– AN EXAMINATION OF CHILD CARE TAX TRANSFER REFORM PROPOSALS

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I INTRODUCTION

Child care policy has been labelled “the barbecue stopper” of public policy¹. For many years parents – usually mothers – have been juggling the competing demands of what is in the best interests of their children in terms of personal growth, development and care with the financial and parental needs of the family.

This juggling act is mirrored in public policy, as the government seeks to provide quality care for children, at a cost that is affordable to both parents and society. A further dimension is added to the debate as child care has a major impact on the decisions that families, particularly mothers, make in relation to workforce participation. In order to maintain productivity growth levels at a rate that will support the Australian economy, workforce participation rates need to continue to grow. As official unemployment levels are currently low, the largest source of untapped participation is married women, although their participation rates are increasing². Access to affordable and appropriate child care is a significant barrier to workforce participation by mothers.

The Women’s Electoral Lobby and other feminist, economic and employer organisations argue that child care is a prerequisite for many women to be able to work, and this needs to be recognised through appropriate funding for women using child care:

“ WEL urges governments to support the provision of accessible, quality child-care and respite care on an equitable basis, the costs of which should be shared by parents, governments, employers and other stakeholders. ³”

Between October 2006 and March 2007 three major reports were released that made recommendations in relation to how the tax-transfer system could better support mothers returning to work:

1. The Taskforce on Care Costs is an alliance of business, government and non-government organisations with an interest in care costs. It commenced work in November 1993, publishing its final report: *Where to Now? 2006 Final Report*⁴ on 16 October 2006 (TOCC Report).
2. In December 2006 the House of Representatives Standing Committee on Family and Human Services tabled its report: *Balancing Work and Family: Report on the Inquiry into Balancing Work and Family*⁵ (FHS Committee Report). The terms of reference of the inquiry empowered the committee to:

1 Attributed to John Howard in July 2002

2 ABS Labour Force Australia Cat No 6202.0 March 2007 p 6

3 WEL National Policies, <http://www.wel.org.au> at 19 March 2007

4 The Taskforce on Care Costs : *Where to Now? 2006 Final Report*
http://www.tocc.org.au/media/TOCC_2006_Final_Report_16_Oct_2006.pdf

5 House of Representatives Standing Committee on Family and Human Services: *Balancing Work and Family: Report on the Inquiry into Balancing Work and Family* Commonwealth of Australia 2006

"inquire into and report on how the Australian Government can better help families balance their work and family responsibilities. The Committee is particularly interested in:

- The financial, career and social disincentives to starting families;
- Making it easier for parents who so wish to return to the paid workforce; and
- The impact of taxation and other matters on families in the choices they make in balancing work and family life."⁶

While many of the recommendations relate to the collection and dissemination of information by relevant government agencies, a number of the more controversial recommendations dealt specifically with tax/transfer issues in relation to child care.

3. Most recently, on 6 March 2007 the Human Rights and Equal Opportunity Commission published its report: "It's About Time: Men, Women, Work and Family" Final Paper 2007⁷ (HREOC Report). The issue of child care is included as part of a study of work/life balance in Australian households, with HREOC making a number of recommendations in relation to the tax and welfare systems in relation to families and child care.

The relevant recommendations of each report have been reproduced as Appendix 1 to this paper.

It would be satisfying to report that a consensus was reached in how to best support mothers returning to the workforce. However, although the same core problems were identified, each of the reports has recommended a different approach to resolve the problems.

- The FHS Committee recommended (by majority) that child care fees be made tax deductible.
- TOCC recommended that care costs should be subsidised to a maximum of 50% of costs, or \$10,000 pa per household.
- HREOC recommended further examination of a combination of universal benefits and an earned income tax credit (EITC).
- The FHS Committee and TOCC both recommended a relaxation of the distinction between approved care and registered care.
- The FHS Committee and TOCC each obtained estimates as to the impact of the proposal, although different models were used. FHS engaged Econtech to estimate the budget effects of proposed alternative child care arrangements⁸. TOCC commissioned microsimulation modelling from the Melbourne Institute of Applied

6 Adopted by the committee 9 Feb 2005; n 5 page xxi

7 Human Rights and Equal Opportunity Commission "It's About Time: Men, Women, Work and Family" Final Paper 2007 Human Rights and Equal Opportunities Commission, 2007

8 Note 5, appendix E

Economic and Social Research, University of Melbourne, concerning the impact of Government expenditure and revenue, and the impact on workforce participation.⁹

- The one common recommendation was that the current fringe benefits tax exemption should be extended to allow parents to access salary sacrifice arrangements in respect of off-site child care.

In this paper I will examine the current tax-transfer system of payments in relation to child care. I will then analyse the different proposals that have been made, with particular reference to the distributional equity of each. Each of the reports also considered, to a greater or lesser extent, care of other relatives and dependants; however analysis of this aspect is beyond the scope of this paper.

II CURRENT SYSTEM

The current system of assisting with child care costs is a combination of tax rebates and transfer benefits.

1 Transfer benefit – Child Care Benefit (CCB)

The primary form of assistance with child care costs is the child care benefit (CCB), which is a subsidy for the cost of child care. The CCB is payable through the Family Assistance Office (FAO). It can be claimed as a direct payment to the child care provider, or as a reimbursement to the parent.

The rate of CCB payable depends on a number of variables. The variables include¹⁰:

- Whether the child is in registered care or approved care. This distinction relates to the whether the carer meets prescribed accreditation standards.
- How many hours a week the child is in care. All families are entitled to 24 hours care a week, with no work test applied. There is a general maximum of 50 hours subject to both (or the sole) parents meeting a work/study test. This may be waived if additional hours are required in special circumstances; for example a shift worker, or a family that has extensive travel to and from work.
- The standard hourly rate. This currently is a maximum \$2.96 for approved care, reducing to a minimum of \$0.497. Registered care paid at the minimum rate.
- The number of children in care. At the maximum rates, if the parent has two children in care, the hourly rate increases to \$3.09 each; and \$3.21 each for three children.
- The age of the children. The rate payable per hour for a school age child is 85% of the rate payable for a pre school age child.

⁹ Note 4 refer Chapter 5

¹⁰ A New Tax System (Family Assistance) Act 1999 - Schedule 2

- Family income levels. If family income does not exceed \$34,310 the maximum rate is payable. Minimum rates only are payable if family income exceeds \$98,348 for one child; \$106,629 for two children and \$121,130 for three children.
- There is a shading in formula that applies between the minimum and maximum income levels. This formula is one of the most complex that I have seen, as it takes into account not only the family income and the number of children, but also incorporates loadings as the number of children increases.¹¹

The major policy goals that are reflected in this system, as set out by EPAC in 1996, are:

- A child and family-focused child care system;
- Affordable, high quality care should be available to all children and families;
- The system should be flexible enough to respond to changing needs; and
- Quality child care should be delivered at the best possible price¹².

The notable exclusion from this list, reflecting the shift in public debate, is to encourage mothers to participate in the workforce. In this respect the Australian system differs significantly from other systems, such as the UK tax credit, that are primarily designed to encourage mothers to return to work. This is the driver for the attention that the system is currently receiving, as employers and policy makers seek to increase the labour participation rate.

The policy objective that all children should have access to quality care is implemented through the differentiation between types of care, and the funding levels payable in relation to each. It also accounts for the otherwise anomalous allowance of funding for up to 24 hours approved care per week without a work/study test.

“Quality child care may deliver benefits to the community additional to those received by individual families. Of particular relevance here is the role of quality child care in promoting early child development and socialisation.....government financial support which encourages the use of child care may improve efficiency as well as equity.”¹³

Means testing access to the CCB contributes to the progressivity of the tax transfer system. However, it also increases effective marginal tax rates (EMTR's), as CCB is progressively withdrawn as income increases. High EMTR's discourage mothers from re-entering the full time workforce. As the mother increases her working hours, in addition to marginal tax rates on the income earned, and the withdrawal of FTBs, families face increasing child care costs and a simultaneous reduction in the subsidy.

11 Note 10 Clause 11

12 See Future Child Care Provision in Australia Taskforce Final Report Economic Planning Advisory Commission, Nov 1996 at p 39

13 Note 12 at p31

2 Tax Rebate – Child Care tax rebate (CCTR)

Given the structure of CCB payments, most working families using formal care pay more for child care than the available benefit¹⁴. In order to alleviate out of pocket expenses, the Child Care Tax Rebate¹⁵ (CCTR) was introduced with effect from 1 July 2004, meeting an election commitment made by the Howard government. The rebate is available under the following conditions:

- The rebate is claimed only through the tax system, and is not a refundable offset; ie it is limited to the amount of tax payable by the claimant. Any excess can, however be transferred to the claimant's spouse;
- The rebate is 30% of the amount paid net of any child care benefit, to a maximum of \$4,000 per child;
- The care must be approved care;
- The claimant must pass the work/study test, and the claim is limited to the number of hours for which the claimant would be entitled to CCB;
- The rebate is claimable in the tax return for the year following the year in which the expenses were paid.

The major problem with the CCTR is the time lag in payment of the rebate, which is effectively more than two years: child care paid in July 2004 could not be claimed before 30 June 2006; and under arrangements for the lodgement of income tax returns, actual lodgement of income tax returns could be well into 2007. This is an administrative matter that results from the interrelationship between the CCB and the CCTR. As claimants have a period of 12 months to claim any outstanding CCB, the legislation provides that a determination must have been made in respect of the CCB entitlement before the rebate can be claimed¹⁶, and this cannot be determined before the period to claim the CCB has expired. Further, as the rebate is a non-refundable offset, the entitlement cannot be calculated accurately until lodgement of the income tax return allows calculation of the net tax payable.

It is worth noting that as at 30 November 2006 approximately 40% of parents who were eligible for the rebate had not yet claimed that rebate¹⁷. The Australian Taxation Office is matching data received in relation to the CCB to income tax returns, and automatically refunding the rebate. However, this process relies on the accuracy of the data held by the FAO.

This is obviously a major concern for families that are required to meet their child care costs on an ongoing basis. Some commercial child care providers enter into payment arrangements under which a parent can partially defer payment of the fees, pending refund

14 ABS Child Care Cat No 4402.0, June 2005, Table 9

15 Subdivision 61-IA Income Tax Assessment Act 1997

16 s.61-480(2) ITAA 97

17 Evidence given by Mr Colin Walker to the House of Representatives Committee on Family and Human Services, Hansard, 29 November 2006

of the tax rebate. However this is not a satisfactory solution. The HREOC recommendations address this, recommending that fortnightly reductions in tax be available though PAYG estimates.¹⁸

3 Family Tax Benefit

The Family Tax Benefit (FTB) is not directly related to child care expenses, but it also impacts on the decision as to whether, or when, a mother will return to the workforce. Family Tax Benefit Part A (FTBA) is designed to compensate families for the cost of raising children. Family Tax Benefit Part B (FTBB) is an additional amount that is available to families that are on substantially a single income. The policy driver for FTB is the policy of choice, allowing families to choose the extent to which the parents participate in the workforce. Generally the policies of the Howard government have been to facilitate the traditional family model, with a breadwinner and a homemaker raising children¹⁹. In such a world, there is less need for formal child care.

This is not a true representation of today's workforce, or economic needs. The 2002 Intergenerational Report²⁰ has highlighted the need for increased participation in the workforce; and women are increasingly returning to the workforce after having children. The dominant family model in Australia now is one where the primary earner works full time, while the secondary earner works part time²¹. The most recent statistics show that currently over 70% of all part time workers are women²².

The biggest criticism of the FTB is the disincentive effect on two income families. The taper rates apply separately to the two components of the FTB at levels of 20% and 30% respectively, discouraging the secondary earner from rejoining the workforce, or from moving from part time to full time work²³. However, the impact of the withdrawal rates of the FTB is not on the wealthiest families, due to the compounding effect of the withdrawal of FTBA and FTBB concurrently as spouse income increases family income. While the current system has improved vertical equity, reducing EMTR's for most families, it is families in the 4th, 5th and 6th decile that now face the highest EMTR's²⁴.

While improved child care is the biggest need for women already in the workforce, the design of the FTB is a major limitation on encouraging women back into the workforce.

18 Note 7, Recommendation 26, at p xxi

19 Hill, E (2006)

20 Budget Paper No 5, 2002-03 Budget; Commonwealth of Australia 2002

21 ABS Australian Labour Market Statistics Cat No 6105.0 Jan 2007, Table 1.2

22 Note 21, Table 1.1

23 Harding, A., Q. N. Vu, et al. (2006). Trends in Effective Marginal Tax Rates 1996-97 to 2006-07.

AMP.NATSEM Income and Health Report Issue 14.

24 Note 23 Figure 6.

4 Tax deductibility – Lodge case

Under Australian income tax law there has been no availability of deductions for child care as a cost of work. In Lodge's case²⁵ Ms Lodge worked from home as a legal costs clerk in order to care for her child, but found that she needed to place her child in day care in order to complete that work satisfactorily. The High Court held that the cost, while work related, was of a character that precluded tax deductibility:

"the expenditure was incurred for the purpose of earning assessable income, and it was an essential prerequisite of the derivation of that income. Nevertheless its character as nursery fees for the appellant's child was neither relevant nor incidental to the preparation of bills of cost, the activities or operations by which the appellant gained or produced assessable income."²⁶

This decision was confirmed in Martin's case²⁷. Although the taxpayer tried to show (inconclusively) that the child care was a condition of employment, it was seen by the Full Federal Court as being a precondition of employment, and as such not deductible.

An alternative approach was more successful in Coleman's case²⁸. Senator Coleman relied on the concessional deduction provisions (subsequently re-enacted as a rebate) to claim a tax deduction for the cost of a housekeeper engaged to care for herself, her husband and her five year old son while she fulfilled her parliamentary duties. Such a deduction was only available to married persons in special circumstances. The majority of the Board of Review found that special circumstances existed:

"In our opinion the extremely busy public life of the taxpayer and the need to maintain through the housekeeper a continuity of stable home life for the taxpayer's son constituted special circumstances because of which it is just to allow the deduction."²⁹

However these cases did not change the Commissioner's practice of limiting special circumstances to circumstances where the person is not co-habiting with their spouse, and was effectively a sole parent³⁰, and when the FTB was introduced in 2000, the opportunity to claim a housekeeper rebate in special circumstances disappeared, as the provision was repealed and subsumed into the FTB system. It should also be noted that the rebate was capped at a level that was substantially less than the cost of employing a housekeeper.

The introduction of child care subsidies progressively from 1984 recognised that child care is a cost of working, although it is not recognised as such in the taxation system.

"As I have said, it is a work related deduction, like many others. The government will always have the right and retain the right to make adjustments to any of those

25 Lodge v FC of T High Court 72 ATC 4174

26 Mason J at p 4176

27 Martin v FCT 84 ATC 4513

28Case J70: Ruth Nancy Coleman v FC of T (public hearing) 77 ATC 579

29 RK Todd & LC Voumard at p 583

30 ATO ID 2002/281

deductions. We at least recognise that, in order to work, women and families need decent child care, decent income support, a proper industrial relations environment and appropriate deductions for the cost of their employment, amongst which I would number that particular allowance.”³¹

Child care subsidies have been retained in various forms since their introduction in 1984. These child care subsidies were not originally means tested as they were seen as an entry cost to the workforce. Two years later, from opposition, the former minister stated:

“In the same way, for instance, that the tools of trade are tax deductible, so women requiring decent child care in order to work should have it recognised as a non means tested cost of employment. Means testing the child care cash rebate has signalled that the government believes that women’s work related expenses are to be treated differently to men’s, despite the observation by the Minister responsible for women’s interests that child care is a genuine work related expense.”³²

There are clearly two competing principles at work here: should child care be regarded as a cost of employment, or is it an equity measure that should be more available to those who need assistance with the cost of child care?

Given that the courts have consistently found that the cost of child care is not deductible under the general deduction provisions of the ITAA, a statutory deduction would need to be legislated to allow tax deductibility. This is one of the proposals of the FHS Report.

5 Fringe Benefits Tax System

There is an exception to the proviso that child care is not tax deductible. Under the Fringe Benefits Assessment Act 1986, certain child care is an exempt fringe benefit:

“47(2) [Recreational facilities, child care facilities]

Where:

(a) a residual benefit provided to a current employee in respect of his or her employment consists of:

(i) the provision, or use, of a recreational facility; or

(ii) the care of children of the employee in a child care facility; and

(b) the recreational facility or child care facility, as the case may be, is located on business premises of:

(i) the employer; or

(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.”

31 Hon Dr Carmen Lawrence, Minister for Human Services & Health Hansard 7/2/1995 at p 584

32 Hon Dr Carmen Lawrence: Public Policy and the Status of Women in Society Proceedings of International Conference: Expanding Choices for Women ed J M Barker Curtin University 1997, p 5

There is very little legislative history to this provision. It was incorporated in the FBTAA as first enacted, although it originally only applied to benefits available on a day on which the employee worked³³. The administrative history, however, shows a lack of coherent policy application.

The 1985 Draft White Paper³⁴, which advocated the introduction of the Fringe Benefits Tax, was silent on the issue of exemptions from FBT for child care – although very few exemptions were canvassed in the report. It does, however, address tax deductibility for child care costs:

“6.41 The Government nevertheless has accepted that it should bear some of the costs of child care. It considers that such assistance is more appropriately provided directly through the expenditure side of the budget, rather than as a tax concession.”³⁵

This does raise the question as to why a concession was granted under the FBTAA, which was drafted following the tax summit at which the 1985 proposals were discussed.

It is commonly understood that the child care exemption was included in the legislation to encourage employers to provide child care for employees, however this statement cannot be supported from the contemporary documentation. EPAC traced this understanding to a media statement by the Treasurer in February 1996 to that effect³⁶.

The FHS report goes further, stating that:

“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.”³⁷

The exemptions and concessions available under the FBTAA can be grouped into the following categories.

Work related exemptions: this category includes items that are required for the employee to satisfactorily perform their duties, whether provided by the employer or the employee. Private usage of such items would be incidental to business use. This includes items such as:

- Laptop computers
- Mobile phones and PDA’s
- Newspapers and subscriptions
- The “otherwise deductible rule” decreases the taxable value of expense payment or property fringe benefits

33 Amended by Taxation Laws Amendment (Fringe Benefits and Substantiation) Act 1987 (assent 18/12/1987)

34 Reform of the Australian tax system : draft white paper, June 1985. Australian Govt. Pub. Service, 1985.

35 Note 34 at p 66

36 Note 12 at p 116

37 Note 5 at p 233

- Cars, although not fully exempt, are within this category, as the statutory formula reflects the assumption that business travel will increase the total travel in a car, and therefore the statutory percentage declines;

Industrial exemptions: This group of exemptions reflects the responsibility of employers to provide appropriate working conditions, although in some instances it goes beyond the minimum requirements of industrial law. It includes:

- In-house health care facilities
- Live-in residential care workers
- Relocation expenses
- Remote area housing
- Superannuation is a somewhat anomalous exemption, but this can be justified on the grounds that in order to encourage participation in superannuation, taxation concessions were already in place.

Minor Benefits: The final category includes items that would require excessive record keeping, or are not measurable. This includes items such as:

- Property consumed on a working day on the employer's premises
- Minor, infrequent and irregular use of a car
- Benefits with a notional value less than \$100
- Moderate staff discounts are supported through the calculation of the taxable value.

Child care does not really fit comfortably into any of these categories. Although it could be argued that it is a work related expense, this argument was specifically rejected by the Government in continuing to deny tax deductibility. If it was regarded as an appropriate industrial issue, the exemption should have extended beyond the employer's premises. Its inclusion with recreational facilities in s. 47(2) FBTAA suggests that it was regarded as a minor or incidental benefit that would have involved a relatively small cost to the employer per employee. This is, of course, clearly not the case.

However this FBT concession is very rarely utilised. The main reason for this is the requirement that the child care be operated on the employer's (or related company's) business premises. Prior to 1996 this test was interpreted liberally by the ATO, which gave a number of private rulings facilitating such arrangements:

"In this context, the provision of benefits to employees in the form of child care would be an important factor in recruiting, retaining and otherwise rewarding employees. Activities undertaken in connection with the provision of those benefits to employees would be 'business operations' of the employer who carried on the business or carried out the profit making undertaking. Thus, if that employer used his/her premises for operating a child care facility on the premises, the operations would be regarded as 'business operations'. The consequences of this view is that the provision of facilities

such as child care, recreational, car parking or health care for employees would be an activity falling within 'business operations.'³⁸

However, this ruling was withdrawn in 1999, to be replaced by a more restrictive interpretation. The ATO determined that where a third party operated child care facilities on premises owned by the employer, it could not be said to be on the employer's business premises:

"52. In some arrangements an employer, as one of many employers, merely pays a fee to a service provider for the child care services that have been provided at particular premises, with only limited rights to terminate the arrangement. In these situations, questions arise as to whether the employer has a sufficient right to possession of the premises to satisfy the requirement that the premises be premises *of* the employer.

53. There are also questions as to whether the premises or any part of the premises are being used for the business operations of the employer. It may be that the activities actually taking place *on the premises* would more properly be described as business operations of the service provider. Consequently, the facts may give rise to the inference that the premises are not the 'business premises' of the employer."³⁹

Few employers are prepared to take the direct responsibility for the management of child care as a part of their business operations. Some reasons put forward for this include:

- the regulatory requirements to set up a child care centre on their premises are prohibitive;
- the normal business premises of the business do not provide a safe environment for a child care centre;
- there is insufficient demand for the service at a particular location; or
- the provision of child care is beyond the core business activities of the employer.

The ATO itself provides an example of the problems. The child care service that had been provided in fifteen tax office locations has been closed down. The FHS Committee questioned the Commissioner of Taxation as to why the centres had been closed:

"CHAIR—Why did you decide to close down the 15 child care centres?

Mr D'Ascenzo—I think that is an organisational issue of not wanting to be in that business, as you pointed out."⁴⁰

Note that employees in the public sector are able to take advantage of the related company criteria, which has enabled the ATO to maintain the exemption offered to its employees, even after closure of the centres in ATO premises, as long as there are places available in centres located in other government agencies.

38 TR 96/27: Fringe Benefits Tax: Meaning of Business Premises at para 41

39 TR 2000/4: Fringe Benefits Tax: Meaning of Business Premises (At 1 March 2000) at paras 52-53

40 Evidence given by the Commissioner of Taxation, note 17

The FHS Report has collated a list of the companies that are currently able to offer salary sacrifice arrangements in relation to child care⁴¹, and has identified only four major public corporations, in addition to a number of universities⁴² and Federal Government agencies⁴³ that are able to offer salary sacrifice arrangements in relation to child care.

III REFORM PROPOSALS

The reform proposals that have emerged from the three reports are:

- Extensions to eligible care types.
- Tax deductibility
- Extension of the fringe benefits tax exemption
- Capped transfer payment payable through a range of mechanisms
- Universal benefits
- Earned Income Tax Credits

1 Extensions to Eligible Care Types

Both the FHS Report and the TOCC Report recommend the extension of the approved care category to include types of care that would currently only be classified as registered care. By increasing the categories of care that qualify for relief, or upgrading the category of that relief, CTB entitlements will increase. However, as the CCTR is currently limited to approved child care, it will also provide a CCTR entitlement.

TOCC justifies this proposal on the basis that it will:

- Improve the quality of care outside the approved care sector;
- Reduce the cash economy; and
- Extend additional choice and flexibility to families⁴⁴.

Currently the accreditation principles are the key differentiation between the categories of care. The difference between registered child care and approved child care is that to be an approved child care provider, the organisation must meet certain accreditation standards. The Minister for Families, Community Services and Indigenous Affairs has appointed a committee to review these standards, and draft standards were released in January 2007⁴⁵, for a public review period that will close on 10 April. These standards, which will replace the standards that have applied since 1995, address four key quality areas, being:

41 Note 5 at 236

42 Universities may provide child care facilities for students, and make places available to staff.

43 Federal government agencies often offer schemes under the "related company" provision, as discussed above.

44 Note 4 at p 42

45 available at http://www.facs.gov.au/internet/facsinternet.nsf/child_care/child_care_system.htm

1. interactions
2. children's learning and experience
3. health and safety, and
4. quality management practices

A registered carer does not receive the same level of funding; but is not subject to the same degree of regulation in relation to their activities. They are required to register with the FAO, but are not required to meet the accreditation standards. Conversely, a parent using registered care is not able to claim the same level of assistance by way of the CCB. The current maximum weekly amount payable in respect of registered care is \$24. 85 per child as compared to a maximum of \$148 for the first child in approved care⁴⁶.

Approved carers encompass a wide range of care providers, including commercial, community and family based child care providers. Registered carers are individuals rather than organisations⁴⁷, and cannot be a registered carer if they are an approved carer⁴⁸. This type of care is provided by some group care providers, such as family day care, private pre-schools and kindergartens, but is largely made up of private arrangements, for example friends or relatives caring for the child in either their own home or the child's home. Nannies may register with the FAO as a registered carer.

The FHS report points out three major inconsistencies between registered and approved carers:

- The CCB payment per hour is considerably lower for registered care, being \$0.497 per hour "the equivalent of a postage stamp for each hour of care"⁴⁹;
- The CCTR is only available in relation to approved care; and
- Registered care is only funded for the time that the parents meet the work/study test.

The ABS child care data does not classify child care by the categories of registered and approved care, but uses the classifications of formal and informal care. Formal care is defined as "regulated care away from the child's home. The main types of formal care are before and/or after school care, long day care, family day care and occasional care."⁵⁰ In most cases formal care would be approved care; but not all informal caregivers would be registered carers with the FAO as this category includes unregulated care, whether paid or unpaid. In all, 45.8% of children under 12 used some form of child care; however significantly more children used informal care than those who used formal care⁵¹. Except for the lowest income group, this proportion does not vary significantly when mapped against the income of parents⁵².

46 rates as published on http://www.familyassist.gov.au/internet/fao/fao1.nsf/content/payments-ccb-how_much-less_32485.htm on 5 March 2007

47 s.209(1) A New Tax System (Family Assistance) (Administration) Act 1999

48 s.209(2) A New Tax System (Family Assistance) (Administration) Act 1999

49 above n 5

50 ABS Child Care Cat No 4402.0, June 2005, at p 61

51 Single parent families: 20% formal to 31% informal; two parent families: 25% formal to 42% informal.

note 50, table 3

52 note 50, tables 12 and 13

There are considerable financial incentives to parents to use approved carers. The required accreditation is currently available to Long Day Care Centres, Out of School Care Services and Family Day Care Schemes⁵³. Other types of care, such as occasional care or vacation care may be, but are not always, offered through an accredited service. Accreditation is not available in respect of individuals providing day care services in the family home, whether under a commercial arrangement or a family relationship, unless it meets the limited criteria under the funded "In-home Care Scheme". Access to funded in-home care is limited to families in circumstances where existing services are not available, or their needs cannot be met, for example due to shift work or disability⁵⁴. Funding for the In-Home Care Scheme is capped at 8,700 places, which adds a further limitation on the number of families receiving such assistance.

Assuming that the care is paid care, for example the employment of a nanny, the major fiscal impact of extending the definition of approved care would be on the CCTR rather than the CCB. The effect of means testing of the CCB is that where family income exceeds the maximum, \$98,348 for a single child or \$106,629 for two children, the hourly rate payable for registered care and approved care is the same. These figures are both below two times full time average weekly earnings⁵⁵. Most two parent families, with both parents working, would receive reduced rates of CCB, leaving a larger out of pocket gap to be claimed under the CCTR. The 2005 survey⁵⁶ showed that while some 15% of families with children in formal did not claim the CCB, the largest income group was those parents earning more than \$2,000pw⁵⁷. While figures are not available in relation to informal care, it could be expected that the major impact of extending the category of approved care would be to allow such parents to access the CCTR in respect of the out of pocket fees.

Proposals to extend approved care to registered carers would break the connection between the accreditation principles and funding of child care services. Under these proposals, funding would be based on whether there was an arms length relationship between the carer and the family. While there is some logic to the proposal, in that non-arms-length arrangements are frequently not purely financial⁵⁸, and market forces do not apply; the major problem with this proposal is that it opens up an unregulated market to non accredited carers. In the absence of the funding mechanism to enforce standards, another regulatory mechanism would need to be developed to achieve the TOCC goal of improving the quality of informal care.

53 Under the new accreditation scheme, these categories will be integrated.

54 FACSIA factsheet: [http://www.facsia.gov.au/internet/facsinternet.nsf/vIA/child care/ \\$file/in-home_facssheet.pdf](http://www.facsia.gov.au/internet/facsinternet.nsf/vIA/child%20care/$file/in-home_facssheet.pdf)

55 In Nov 2006 weekly: Weekly Full time Male Ordinary Time Earnings were \$1124.90; Full time Female Ordinary Time Earnings were \$941.20 Australian Bureau of Statistics Cat No 6302.0 released Feb 2007

56 Note 14

57 Note 50 table 14. There are no statistics available in relation to informal care.

58 38.9% of all families reported care costs of nil, after allowance of any CCB. Of these, 91.3% used informal care either solely or in combination with formal care. Note 50, Table 11.

The FHS Committee does deal with the quality issue in relation to its recommendation that nannies be approved care. The recommendation specifies the following requirements:

- child care studies to Certificate II level;
- a first aid certificate; and
- a current “working with children” police record check.

However these hurdles have been set very low. The Certificate II is a base level qualification, which is not widely accepted as a sufficient qualification. Queensland and NSW government regulations specify that Certificate III (or equivalent) is the minimum level required for the carer to be regarded as a “qualified assistant”⁵⁹, as is the case in Tasmania for newly registered home based carers⁶⁰.

The committee made this recommendation after hearing evidence that the use of nannies or other in-home care arrangements was not limited to higher income earners. Where there is more than one child involved, not only does the cost of child care increase, but the difficulty in finding appropriate places together also increases. In such circumstances the parent may find it more appropriate to pay the cost of a nanny.

Nanny care can take a number of different forms, depending on the employment agreement entered into. It ranges from highly qualified, specialised skills such as maternity nanny care, to “home help” which encompasses a range of household and child care duties. The Labor members of the committee tabled a minority report dissenting from this recommendation on the grounds of equity, in favour of an expansion of the In-Home Care Program:

“Should a taxpayer subsidy be available if the nanny is also acting as a housekeeper and doing housework? We don’t think so.

Rather than have the taxes of middle Australia pay for the private choices of high earning couples, the in-home care program should be expanded so that all families who need in-home care get it.”^{61 62}.

Coincidentally, on 13 December 2006, the week following the tabling of the FHS Report, the Minister for Families, Community Services and Indigenous Affairs released the Final Evaluation Report of the In-home Care Program, which had been prepared by external consultants in June 2005⁶³. The Minister’s press release states that:

59 s.112, Child Care Regulation 2003 (Qld) CI 52 Children’s Services Regulation 2004 (NSW)

60 Standard 2.1 http://www.child_care.tas.gov.au/publications/standards/home_based_care.

Note that in-home carers are not required to be formally qualified, but if the carer undertakes formal qualification, the minimum recommended is Certificate III:

Standard 2.1 http://www.child_care.tas.gov.au/publications/standards

61 Note 5 at p 300

62 The discussion is reminiscent of the “Nanny Debate” when the CCTR election commitment was made.

There was confusion within the coalition ranks, fuelled by opposition attacks, as to whether nannies would be eligible for the CCTR, until it was made clear that the CCTR would be restricted to approved care.

63 Final Evaluation Report: In-home Care June 2005 RPR Consulting for Dept of Family and Community Services

"As a result of a number of identified quality and compliance issues, the Government undertook an internal review of the program in 2003, followed by an external review in 2005 at which time a moratorium on IHC places was implemented pending any outcomes of the review. Currently the Australian Government funds over 8,700 places in the In-home Care program."^{64 65}

The external review found that the flexibility of the program was a clear benefit, particularly where more conventional child care was impractical. However choice was not seen as a feature of the program due to the severe restrictions placed on access. In fact the issue of choice appeared to be limited, depending on the knowledge that the parent had of the program, and the focus of the provider.

"IHC was originally developed as a response to parents with very specific needs that prevented them from accessing child care because of the child or parent's illness. As the eligibility criteria and places expanded, some providers lost this focus and increasingly found almost any parent 'eligible' under the program who could afford IHC."⁶⁶

The report also raised a number of quality control issues in relation to the program. It found that there were issues surrounding:

- Setting boundaries around child care to exclude other domestic duties;
- Continuity of care as carers required leave from time to time;
- The suitability of the home as a work environment for the carer; and
- The suitability of the home as a safe care environment.⁶⁷

These concerns would seem to indicate that any extension of CCB or CCTR to nannies would need to be structured to ensure that the benefit is limited to the legitimate child care component.

2 Income tax deductibility

The FHS report recommends that tax deductions be allowed in relation to child care. There is no cap proposed on the amount that can be claimed, as long as the care relates to a day that the parent(s) were working. While there is an intuitive logic to the proposal, as parents may be unable to work without the provision of child care, this proposal runs counter to the principles of vertical equity. Allowing tax deductions in relation to family arrangements returns to the arrangements criticised in 1975 in the Asprey Report, when it was said in relation to spousal deductions that:

64 Mal Brough, Minister for Families, Community Services and Indigenous Affairs, Media Release 13 December 2006 http://www.facs.gov.au/internet/Minister3.nsf/content/in_home_care_13dec06.htm

65 It is this cap in places that is referred to in the FHS Report, and is criticised by the minority report.

66 Note 63 at p x

67 Note 63 at p x

“However, in lower income ranges, where the marginal rate of tax is less, the tax saving from a deduction is correspondingly smaller. It is questionable whether the effective assistance should be so unequally distributed, and should be least where it will be of most, if never great, real assistance.”⁶⁸

Since 1975 family assistance has generally been provided by way of direct transfers, or tax rebates, rather than by way of deductions. Where income tax rates are progressive, clearly higher income earners would receive a greater tax deduction for child care payments. As a general principle of tax law and in the absence of a specific limitation, it is not for the Commissioner to determine the amount that a taxpayer chooses to pay in respect of an allowable deduction as long as the amount has been properly incurred⁶⁹. Therefore allowing a tax deduction for child care would subsidise higher income earning parents to a greater extent, in relation to the higher fees that they can afford to pay. This not only decreases vertical equity of the system, but has the potential to increase distortions in the supply of child care, as services respond to changes in market conditions and increase charges. There has already been research indicating that supply problems in relation to child care relate to the type of care that parents wish to access, rather than the total number of places in the system⁷⁰.

The proposal recommends that the deduction is shared between parents in proportion to their income. Again, there is a flawed logic to this proposal, which results in a reduction in equity: as both parents are working, thus necessitating the child care, the cost could be regarded as a cost that relates to the joint household income. However, given the usual pattern of child care requirements, based on the father working full time while the mother works part time⁷¹, this allocation will ensure that the greater the difference between the wages of the parents, the more will be returned through the tax system, as shown in the following examples:

	Father's income	Mother's income	Total Income	Tax Benefit ⁷² . (Child care fees = \$10,000)
Family A	84,000	36,000	120,000	7,000 x 41.5% + 3,000 x 31.5% = \$3,850
Family B	60,000	60,000	120,000	6,000 x 31.5% + 6,000 x 31.5% = \$3,150

While this arrangement would be preferable to allowing parents to nominate the parent to be allocated the deduction, it is unlikely to encourage the secondary income earner to participate more in the workforce.

68 Asprey, K. C. (1975) at p 164
 69 Ronpibon Tin NL v FCT (1949) CLR 47
 70 Davidoff, I; (2007)
 71 Note 50, table 21
 72 calculation at 2007 rates.

This proposal does partially address the lengthy delay in accessing the CCTR as the deduction would normally be available on lodging an income tax return for the year. As previously discussed, while the CCB is payable immediately, in many cases this is a relatively small amount. The more substantial CCTR component is deferred for up to two years. There is also the possibility that the parent(s) may be able to lodge a variation in relation to PAYG tax deductions, thus matching the timing of the refund more closely to the date of payment.

In circumstances where a family is better off under the existing CCB/CCTR arrangements, they may elect to continue on that basis. This would protect the lowest income earners in two respects:

- The CCB component would still be payable as a direct subsidy to the child care provider – although the CCTR component is deferred.
- Where the marginal rate of tax of a parent falls below 30%, the CCTR would still be payable at that rate. Note, however, that as the current rebate is transferable but not refundable, the marginal rate of tax of the other parent would need to be at least 30% to be fully utilised.

However, the proposal for tax deductibility of child care fees has not been well received on the basis of the negative impact on the distributional equity of the system. It was rejected by the Labor members of the committee in the dissenting report⁷³; by the Prime Minister and cabinet⁷⁴, and by commentators and academics⁷⁵.

The modelling included in the report does, in itself, indicate that the report will not address the problem of the low labour force participation rate of married women. The modelling, by Econtech, is heavily qualified; however it shows the following outcomes based on tax deductibility of child care and fringe benefits tax exemption:

- Couple families and single parent families with an EMRT < 30% will pay more for child care, while families with an EMRT > 30% will pay less for child care. Note that this would be ameliorated by allowing families the choice of staying with the current system.
- If one parent in a two parent family is working, child care would become cheaper. However this is considered unlikely to increase participation.
- Families not currently using care would only be likely to increase participation in the workforce if the only working parent (or the sole) parent is in the EMRT > 30%.
- In taking account of EMRT's, the modelling takes account of marginal tax rates including the medicare levy and the low income rebate. It does not appear to take into account the effect that changes in income would have on the FTB. Increased hours of work would reduce entitlements, but conversely deductibility of child care

73 Note 61

74 Reported 24 December 2006

75 see Brennan, D; Burke, J; Pocock, B; quoted in Long, S: Child care tax deduction plan panned: ABC Transcript 8 Dec 2006; Apps, quoted in Cronin D: Child Care Tax Plan Disastrous: Canberra Times 9 December 2006

expenses would reduce taxable income, which would cause a consequential rise in FTB payments. This effect on EMTR's has not been taken into account.

3 Fringe Benefits Tax Exemption

This is the only recommendation that was uniformly endorsed by all three reports.

However, there is a clear inconsistency between the income tax treatment of child care and the fringe benefits tax treatment. As salary sacrificing arrangements have become more prevalent, there is a direct impact of the exemption on tax revenue. Unlike the other industrial issues exemptions, child care is an item that would not be traditionally borne by the employer, nor is it tax deductible, therefore it is particularly attractive as a salary packaging arrangement. To some extent this is reduced by the denial of the CCB and CCTR where a salary packaging arrangement is entered into, but there are still advantages from salary packaging:

- Salary packaging gives immediate access to the tax concession through reductions in PAYG tax, instead of the employee having to wait for up to two years for the CCTR;
- Salary packaging gives the employee a benefit equivalent to their marginal tax rate, whereas the CCB/CCTR combination will give a maximum of 30% rebate.

The problem is that while it is not consistent to allow salary sacrificing arrangements in relation to a non-deductible expense; it is equally inequitable to allow an exemption in certain, very restrictive, circumstances while denying it to the majority of employees. This problem was identified by EPAC over a decade ago, when it recommended the abolition of the exemption:

"In terms of their effects, salary sacrifice arrangements are little different from direct tax deductibility. Thus TOCC remains of the view that FBT exemptions supporting salary sacrifice arrangements for employer sponsored or provided child care are inappropriate.

TOCC rejects the view that salary sacrifice arrangements are a cheaper way of generating child care than direct subsidies, and that therefore the associated inequities should be accepted. As noted in the interim Report, the cost of support for places via FBT exemptions is typically higher than for places supported through the means tested Child Care Assistance scheme."⁷⁶

The TOCC proposal differs from the other proposals as the salary sacrifice arrangement is an optional delivery mechanism for a capped subsidy. Arrangements could be constructed under which the government contribution to child care costs is delivered through an arrangement involving the employer. Such a scheme for child care provided on or off site could be constructed under a scheme similar to the Employee Contribution Method arrangements for motor vehicles, under which part of the cost is managed through salary

76 Note 12, p 122.

sacrifice; in the case of child care this could be up to the capped limit of foregone tax; with the balance reimbursed to the employer by the employee from after tax income.

While the mathematics of such an arrangement is unlikely to be in the best financial interests of parents on a marginal tax rate that is lower than the fringe benefits tax rate, there may still be advantages when compared to the alternative delivery methods, including:

- the reimbursement may be more timely; or
- the employer may be able to negotiate attractive rates with a care provider.

However, in modelling the FHS report, Econtech estimates that the effect of salary sacrificing in respect of an employee on a package of \$65,000, and paying \$10,000 in child care fees, is in fact minimal. The effect of the CCB/CCTR is that the cost of child care is lower when paid directly to an off-site child care centre, than when salary sacrificing is available. However there does not appear to be any adjustment for the time lag until payment.

4 Subsidies

The main recommendation of TOCC was that carers should be entitled to a subsidy of 50% of care costs, capped at \$10,000.

The current CCB/CCTR arrangements result in payments that vary depending on a range of variables:

- Lower income families are entitled to higher CCB payments
- Higher income families are entitled to reduced CCB payments, to a minimum of \$0.497
- All families are entitled to the CCTR rebate of 30% of net costs, but not refundable if the family tax payable is less than the entitlement.

The CCB payments are subsidies, with the rate established by the family circumstances, while the CCTR is based on 30% of the difference. This combination improves the progressivity of the system:

Family Income	Child care fees	CCB ⁷⁷	CCTR	Current Benefit	Proposed
< \$34,310 (one child)	10,000	\$7,104	\$869	\$7,973 79.73%	\$7,973 79.73%
< \$34,310 (Two children)	15,000	\$14,208	\$238	\$14,446 96.3%	\$14,446 96.3%
> \$98,348 (one child)	10,000	\$1,193	\$2,642	\$3,835 38.35%	5,000 50%
> \$106,629 (two child)	15,000	\$2,386	\$3,784	\$6,170 41.13%	7,500 50%

The approach recommended by TOCC would reduce the progressivity of the system. While TOCC recommends that the existing arrangements be available to families that would become worse off under the new arrangements, middle and higher income families would benefit disproportionately under the new arrangements.

This proposal could also have the effect of driving up the cost of child care, particularly in services or locations that cater to higher income families. Currently, once the CCB threshold has been reached, the effective marginal cost to parents is 70% of the fee. Under this proposal, that cost drops to 50%. Although the intention of the proposal is to make child care more affordable, thus increasing labour participation rates, increased demand combined with more affordability and limited places are likely to result in price increases.

While the cap of \$10,000 reimbursement; ie \$20,000 in care costs; should place a ceiling on the market, it is still considerably more than a family with one or two children in care would be able to receive under the current system. If a family with one child currently receiving the minimum CCB paid \$20,000 in care costs, the current entitlement would be \$6,835. The proposed subsidy of \$10,000 would be nearly 50% more than the current scheme.

As well as low income families, those with more than two children in care may find the new arrangements less attractive than the existing arrangements, as the CCTR cap is \$4,000 per child, compared with a proposed household threshold of \$10,000.

The recommendation that there be three methods of delivery would address the issues of delayed payment, and the asymmetry of the FBT exemption. As the entitlement is not based on income, the problem of reconciling income to entitlements before paying the rebate, would disappear. Payments could, therefore, be made as the parent is required to make payments to the supplier.

77 based on 50 hrs pw for 48 weeks

5 Universal Benefits

The HREOC⁷⁸ report suggests a combination of universal benefits, more progressive tax rates and earned income tax credits as another approach. There is less detail in this proposal, which recommends that the government examines these options.

The proposal to return to a universal benefit in relation to children is revisiting the child endowment/family allowance type of payment as it existed before means testing was applied in the late 1980's⁷⁹. Clearly in this scenario it is anticipated that increased marginal tax rates at higher levels would offset the regressive impact of the universal benefit, although HREOC did not incorporate any economic modelling of this proposal.

A universal benefit focuses on horizontal equity: all families are entitled to recognition of the additional costs that are incurred by families with children. This is a controversial proposition in Australia, as seen in the periodic attacks in the FTBB, which takes no account of family income. Introduction of a means test takes into account distributional issues to recognise that although some families need assistance with the cost of raising children, families that are better off do not require assistance – a test of vertical equity. The means test as applied in Australia is not used to gain access to the benefit, thus restricting it to those in need; but it is an affluence test, applied to limit access by high income earners who are not perceived to need assistance. This is a much more politically acceptable message in Australia.

6 Earned Income Tax Credits (EITC's)

The second element of the HREOC proposal is the application of earned income tax credits (EITC's) and work tests to determine the entitlement to FTB and CCB. There is no detail of the proposal in the report, as it recommends that the government investigate such a credit. EITC's are designed to address the interface between the tax and the welfare system, and to provide incentives to people to work. An earned income tax credit replaces welfare transfers in favour of tax credits. These tax credits are generally non refundable credits; ie where a taxpayer does not earn sufficient income to pay tax, the surplus is not refundable. Proposals for an EITC in Australia have been debated since an open letter from "the Five Economists"⁸⁰ to the Prime Minister in 1998. Similar proposals have been mooted by the ALP in recent Federal election campaigns⁸¹.

The key to such proposals is to encourage people to work by firstly increasing the credit available as one moves into the workforce, and increases participation; then the credit decreases as income increases. This should give highest levels of support to the working poor. The child care Benefit in the UK is payable on a similar basis. There is no child care benefit payable unless the mother is working at least 15 hours a week. At that point very generous hourly rates are payable, which progressively decline as income increases.

⁷⁸ Note 18

⁷⁹ Means testing of Family Allowance, was introduced in 1986 for students and 1987 for all children.

⁸⁰ Professors Peter Dawkins, John Freebairn, Ross Garnaut, Michael Keating and Chris Richardson

⁸¹ Referred to as the Family Tax Credit in 1998, and the Tax and Family Benefits Package in 2004.

Such schemes do increase the progressivity of the tax system, however they rely extensively on the withdrawal rates of benefits to do this. This is one of the major disincentive effects when mothers participate in the workforce. Withdrawal rates add to marginal tax rates when determining whether to undertake additional hours of work. Higher EMTR's result in a disincentive effect in relation to the hours worked by the second income earner in the family⁸². Although EITC's may have a role to play in moving individuals into the workforce, disincentives arise when trying to increase the hours worked by that individual.

IV ASSESSMENT OF THE PROPOSALS

The main problems that have been consistently identified by the reviews are:

1. Affordability, as related to the demand for places and high out of pocket costs as CCB is withdrawn.
2. Appropriate places are not available, resulting in long waiting lists and inappropriate placements.
3. The lengthy delay for the payment of the CCTR creates a cash flow problem for parents.
4. The disincentive effect of high EMTR's, which affect the labour participation rates of mothers in the workforce.
5. The current system is too complex for most families to negotiate, leaving them reliant on advice from the FAO,
6. Redistributive effects, in ensuring that families receive assistance according to their needs
7. Maintaining the quality of child care through ensuring the capabilities of carers.

The following matrix assesses the impact of each of the proposals:

	TOCC	FHS Committee	HREOC
Affordability	Has the potential to increase the cost of care as the proposed subsidy is greater than the existing rebate for middle and higher earners.	Has the potential to increase the cost of care as the limit to the deductible amount is referable to the income of each parent.	Insufficient detail to assess.
Availability of places	As demand for care increases, places will become scarce or more expensive.	As demand for care increases, places will become scarce or more expensive. More flexibility in approved care categories may assist.	Insufficient detail to assess.

82 Apps,P (2001)

Timeliness	Subsidies will match more closely the timing of payments as there will be no requirement to match annual income with entitlements. Families remaining on the current system will face the same delays. Salary Sacrifice arrangements allow wage adjustments to pay for care, net of benefits.	Tax deductions will be reflected on an annual basis as taxpayers lodge annual income tax returns. Delays will be up to one year. Families remaining on the current system will face the same delays. Salary Sacrifice arrangements will allow wage adjustments to pay for care, net of benefits.	PAYG adjustments will allow families to access estimated entitlements through payroll. Salary Sacrifice arrangements will allow wage adjustments to pay for care, net of benefits.
Participation Rates	Modelling ⁸³ indicates an increase in participation rates of 3.5% for sole parents, and 1% for women in couple households.	Modelling ⁸⁴ shows unlikely to increase participation rates of women not already in the workforce. The effect is most likely to be felt at low income levels where EMTR < 30%. Will entrench unequal earning of income within household.	EITC proposal will specifically encourage parents to participate in workforce. However when EITC withdrawal levels are reached, the disincentive effect of high EMTR's could discourage further participation.
Distributional Issues	Regressive. Means test removed. Will provide greater benefits to parents paying higher care costs, at 50% rate. Cap will limit excessive costs. Current benefit level preserved through election to remain in current system.	Highly regressive. Will provide greater benefits to parents paying higher care costs, at marginal tax rates. Current benefit level preserved through election to remain in current system.	Universal benefit is regressive. EITC is progressive in early stages, then regressive as withdrawn. It is possible that in combination the impact could be mitigated, but more details required.

⁸³ Note 4 at 31⁸⁴ Note 5 at 372, Table 2

Quality Care	The extension of approved care removes the accreditation links, although non accredited carers will be more visible.	The extension of approved care removes the accreditation links, although non accredited carers will be more visible. Nanny proposal could facilitate other forms of domestic work.	Extensive discussion, in Chapter 7, outside child care tax transfer proposals.
Complexity	Simpler than existing system, due largely to removal of means testing. But retention of option to use current system will mean additional complexity for low income earners in making the election.	Simpler than existing system. Entitlements split according to formula. Retention of option to use current system will mean additional complexity for low income earners in making the election	Universal benefits are usually easy to administer. EITC is more complex. Compliance burden shifted to lower income earners.

According to this analysis, each of the packages presented has a regressive impact on the equity of the system. While attempting to encourage workforce participation through increasing benefits to higher income earners, this is at the expense of the equity within the system. This may be because the reports have addressed child care independently of other elements of the family tax transfer system.

Such a trade-off may be acceptable if the efficiency gains through increased workforce participation were high enough. However, modelling presented by the authors of the FHS report indicates that the workforce participation effect would be limited at best. The TOCC report suggests a somewhat higher effect, principally among single mothers. The HREOC proposals would need to be fully detailed and modelled to assess the impact on the workforce.

None of the proposals adequately addresses the supply side of the equation. Part of the regressive impact is the likelihood that the cost of child care will rise. While it is still a matter of debate as to whether the shortage of child care places is a result of a lack of places or the personal choice of parents⁸⁵, proposals to change the classification of care types is unlikely to increase sufficiently the number of places in the system, as there will be a shift from informal to formal care.

While it is self evident that problems with the current funding of the child care system must be addressed, it is time to review our priorities in determining what we expect the system to deliver.

85 Note 70

If the primary goal is higher employment levels for women, then a full package of reform should include:

- Reforming other elements of the family tax transfer system to remove disincentives, specifically addressing EMTR's and FTBB;
- Maintaining progressivity of EMTR's of working mothers, after taking account of child care costs;
- Linking child care benefits more closely to work commitments; and
- Ensuring that alternative arrangements are made to address the benefits that children of non-working mothers obtain from access to quality child care.

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APPENDIX

*Recommendations of Family and Human Services Committee**6. Choice and Flexibility in Child Care:*

Recommendation 11: In-home (nanny) care be categorised as approved care, and thus attract payments and tax concessions extended to users of approved care, where providers are registered with the Family Assistance Office, and:
have or are at an advanced stage of attaining a minimum Certificate II qualification in child care, or an equivalent recognition of prior learning; and
have a current 'working with children' police record check; and
have a current first aid certification.

Recommendation 13: Paid care currently categorised as registered, including family day care, occasional care, outside school hours care, private preschools and inhome care; excluding care provided by grandparents, relatives or friends; be re-categorised as approved care, and thus attract payments and tax concessions extended to users of approved care.

Recommendation 14: The registered care category and associated rates of Child Care Benefit continue to apply for work-related care that is provided by grandparents, relatives or friends who are registered with the Family Assistance Office.

7. Tax Relief for Child Care:

Recommendation 15: 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.

Recommendation 16: 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: 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.

Recommendations of Taskforce On Child Care:

The two key recommendations of TOCC are as follows:

1. That the government introduce a 50% Care Costs Reimbursement for employees with caring responsibilities (for children, the elderly and people with a disability) to be capped at a net amount of \$10,000 of out of pocket expenses per household per annum....Recommendation 1 is intended to apply to employees as well as those who are studying or training.
2. The Government introduce three alternative delivery mechanisms for the 50% Care Costs Reimbursement, namely directly to the carer, to the care provider or via an employer (eg salary sacrifice).

A further two alternative recommendations were proposed:

3. The Government investigate the extension of the Child Care Tax Rebate for Approved and Registered Care to elderly and disability care.
4. The Government extend Child Care Benefit and Child Care Tax Rebate to fully cover Registered Care.

Relevant Recommendations of the HREOC Committee

Recommendation 25: That Family Tax Benefit Part B be modified to support couple families to share paid work and care and Australia move towards a system of progressive individual income tax in which child benefits are provided on a universal basis.

Recommendation 26: That the child care tax rebate be modified to make it also available to parents as a fortnightly payment in the same way as the Family Tax Benefit Part B. This would require the Australian Tax Office (ATO)/Family Assistance Office (FAO) to develop a reliable calculator to enable parents to estimate their annual child care costs and make a claim either through the FAO for fortnightly payments or through the ATO for the rebate at the end of the financial year and to reduce the risk of overpayments. Where an individual elects to receive the payment as a tax rebate, it should be able to be claimed as part of an individual's tax returns for the financial year for which they have submitted that tax return.

Recommendation 27: That the Australian Government examine the option of moving towards a system of earned income tax credits for working families which would encompass current Family Tax Benefit payments and the child care tax rebate. Such an examination should consider the circumstances of families where parents are not in paid work which may be eligible for a set proportion of the full level of tax credit support and a premium should be considered for children with specific needs, in particular disability.

Recommendation 28: That in recognition of increased difficulties facing many sole parents and the large number of children in sole parent households living in poverty, the Australian Government should further review incentives and special assistance to enable sole parents to undertake paid work. Options for reform include the introduction of an inwork emergency

fund to meet the cost of care related emergencies within the first 3 months of employment, a tax credit for sole parents entering the workforce for at least six months, and introducing a work related activity bonus on top of existing income support payments for sole parents with children aged under six years who engage in a work related activity.

Recommendation 30: That the Fringe Benefits Tax (FBT) exemption be expanded for all employers who subsidise dependent care through the establishment of a child care service either on or off their own premises or through subsidies/allowances paid towards employees' care costs (such as vacation care allowances, frail aged day programs, respite care and in-home support for people with disability).