

## Family taxation

### Personal income taxation

- 3.1 Australia levies income tax on the basis of individual income, even though some modest offsets are available to recognise that income may be shared between family members.<sup>1</sup>
- 3.2 In 2003-04, the most recent figures available, Australian personal taxpayers paid over \$95 billion in income tax.<sup>2</sup> The most tax was paid by people in the peak income earning and peak reproductive ages, that is between 25 and 54.<sup>3</sup> Men continue to have higher taxable incomes than women, reflecting labour force participation patterns and the high incidence of women in part time work. In 2003-04, for example, the average taxable income for men was \$42,921, and the average taxable income for women was \$28,428.<sup>4</sup>
- 3.3 Tax rates for individuals for the 2006-07 income year are outlined in table 3.1. In tax cuts announced in the 2006-07 Budget, the highest marginal tax rate was reduced from 47 per cent to 45 per cent and the threshold for the that bracket rose from \$95,001 to \$150,001 on 1 July 2006.

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1 Dwyer T, 'The taxation of shared family incomes', *Perspectives on tax reform* (2004), no 2, Centre for Independent Studies Policy Monograph no 61, p 4.  
2 Australian Taxation Office, *Taxation statistics 2003-04* (2006), p 10.  
3 Australian Taxation Office, *Taxation statistics 2003-04* (2006), p 11.  
4 Australian Taxation Office, *Taxation statistics 2003-04* (2006), p 12.

Table 3.1 Personal income tax thresholds for 2006-07

Taxable income	Tax rate
\$1 – \$6,000	Nil
\$6,001 – \$25,000	15 cents for each \$1 over \$6,000
\$25,001– \$75,000	\$2,850 + 30 cents for each \$1 over \$25,000
\$75,001 – \$150,000	\$17,850 + 40 cents for each \$1 over \$75,000
\$150,000 and over	\$47,850 + 45 cents for each \$1 over \$150,000

Source: Australian Taxation Office website, viewed on 30 August 2006 at <http://www.ato.gov.au/individuals/content.asp?doc=/content/33969.htm&pc=001/002/031/005&mnu=1180&mfp=001/002&st=&cy=1>

## Taxation measures relevant to families and carers

- 3.4 Alongside the benefit payments system, the tax system is an important delivery method for family and carers' assistance.<sup>5</sup> Social tax expenditures by the Australian Government (the value of foregone tax revenue) in 2003-04 were estimated at \$20.6 billion. Of this, nearly three quarters of the expenditure was directed at older people. Seventeen and a half per cent was for families and children, and the remainder was for other social expenditures. Almost all of the estimated expenditure on families and children (86.5 per cent) was due to the exemption of Family Tax Benefit from income tax.<sup>6</sup>
- 3.5 The Treasury's *Tax expenditures statement* (2005) states that social security and welfare tax expenditures are estimated to increase within the reporting period of 2002-03 to 2008-09, as outlined below.<sup>7</sup>

5 Hill E, 'Howard's "choice": The ideology and politics of work and family policy 1996-2006', p 3, viewed on 8 August 2006 at <http://www.australianreview.net/digest/2006/02/hill.html>.

6 Australian Institute of Health and Welfare, *Welfare expenditure Australia 2003-04* (2006), Health and Welfare Expenditure Series no 27, Cat No HWE 34, pp 25-26. See Chapter 2, table 2.8 for a summary of which Government payments are taxable and which are exempt.

7 The Treasury defines tax expenditure as a tax concession that provides a benefit to a specified activity or class of taxpayer. A tax expenditure can be provided in many forms, including a tax exemption, tax deduction, tax offset, concessional tax rate or deferral of a tax liability. *Tax expenditures statement* (2005), p 2.

Table 3.2 Aggregate tax expenditures for the social security and welfare function

Estimates (\$m)		Projections (\$m)			
2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
22,962	23,909	25,444	26,845	28,597	30,313

Source: *The Treasury, Tax Expenditures Statement (2005)*, p 12.

## Child Care Tax Rebate

- 3.6 The Child Care Tax Rebate was announced in 2004 and applies to child care costs incurred since 1 July 2004. It is legislated in the *Income Tax Assessment Act 1997*.
- 3.7 To receive the rebate, families must already be eligible to receive the Child Care Benefit, and they must be using approved child care. The rebate is not available for fees for registered child care. This means that parents using some family day care, limited in-home carers (nannies), private preschools and some other types of care have the Child Care Benefit as their only form of assistance with child care costs.
- 3.8 Child Care Tax Rebate provides a 30 per cent tax rebate for out of pocket child care costs, up to a maximum of \$4000 per child per annum. Out of pocket expenses are total child care fees for approved care, less the Child Care Benefit entitlement. The \$4,000 cap will be indexed in line with CPI.<sup>8</sup>
- 3.9 The rebate reduces tax liability by up to \$4,000, and must be claimed in the tax return for the year after the child care expenses were paid. Taxpayers with insufficient tax liability to absorb the whole rebate do not receive a payment for the remaining amount of the rebate. They can, however, transfer any unused amount to their spouse.

## Tax offsets

- 3.10 Tax offsets, also known as tax rebates, directly reduce the amount of tax that a taxpayer must remit to the Australian Taxation Office. In contrast to a tax deduction, which is subtracted from a person's taxable income, tax offsets are subtracted from a person's tax liability.
- 3.11 This means that while the dollar value of a tax deduction will depend on the taxpayer's marginal income tax rate, the dollar value of a tax

<sup>8</sup> Parliamentary Library, *Bills Digest: Tax Laws Amendment (2005 Measures No. 4) Bill 2005*, no 22, 2005.

offset will be constant to taxpayers across all income ranges, except for those with insufficient tax liability to absorb the benefit.

- 3.12 In addition to the Child Care Tax Rebate, the government offers a range of tax offsets to give tax relief for personal circumstances. These are available to families and carers who have maintained their spouse or another family member in the previous financial year, or who have maintained a housekeeper for running a household and caring for dependants. They include:
- Dependent Spouse Tax Offset;
  - Dependent Parent or Spouse's Parent Tax Offset;
  - Invalid Relative Tax Offset;
  - Child-Housekeeper Tax Offset (for the taxpayer's dependent child, adopted child or stepchild who keeps house for him or her full time, in limited circumstances); and
  - Housekeeper Tax Offset (for a person who works full time keeping house for the taxpayer and caring for dependants, in limited circumstances).<sup>9</sup>
- 3.13 The maximum values of these offsets and their eligibility conditions are outlined below.
- 3.14 These offsets are not refundable; that is, they can only reduce a person's tax liability to zero.
- 3.15 In the year 2003-04, 337,914 taxpayers claimed a tax offset for a dependent spouse, for a value of \$396 million. In the same year, 13,508 taxpayers claimed a tax offset for a dependent parent, parent-in-law, or invalid relative, for a value of \$17 million.<sup>10</sup>

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9 Australian Taxation Office website, viewed on 6 September 2006 at [http://www.ato.gov.au/individuals/pathway.asp?pc=001/002/004&mfp=001/002&mnu=6557#001\\_002\\_004](http://www.ato.gov.au/individuals/pathway.asp?pc=001/002/004&mfp=001/002&mnu=6557#001_002_004).

10 Australian Taxation Office, *Taxation statistics 2003-04* (2006), p 19.

Table 3.3 Tax offsets for dependent family members and carers

	Maximum offset	Eligibility
Dependent Spouse Tax Offset	\$1,610	Dependant's separate net income cannot exceed \$282 per year; or \$6,721 for partial offset.  The taxpayer or the dependant must not be eligible for Family Tax Benefit Part B.
Dependent Parent or Spouse's Parent Tax Offset	\$1,448 for each dependant	Dependant's separate net income cannot exceed \$285 per year; or \$6,073 for partial offset.
Invalid Relative Tax Offset	\$725	Dependant's separate net income cannot exceed \$285 per year; or \$3,181 for partial offset.
Child-Housekeeper Tax Offset	\$1,610 (or \$1,930 if the claimant has another eligible dependent child or student)	Child-housekeeper is defined as the taxpayer's child, adopted child or stepchild who kept house for them full time. A child who is a full time student or a full time employee is not considered to keep house full time.  The child-housekeeper must be maintained by the taxpayer.  The child-housekeeper's separate net income must be less than \$282; or \$6,721 for partial offset.  The taxpayer must not be eligible for Family Tax Benefit Part B or Dependent Spouse Tax Offset.
Housekeeper Tax Offset	\$1,610 (or \$1,930 if the claimant has another eligible dependent child or student)	A housekeeper is a person who worked full time keeping house for the taxpayer and cared for a dependant child of theirs, a dependent invalid relative, or the taxpayer's spouse who was receipt of a disability support pension.  The taxpayer must not be eligible for Family Tax Benefit Part B, Dependent Spouse Tax Offset, or Child-Housekeeper Tax Offset.

Source: Australian Taxation Office website, viewed on 6 September 2006 at <http://www.ato.gov.au/individuals/pathway.asp?pc=001/002/004/009&cy=1>.

## Effective marginal tax rates

- 3.16 The committee received evidence on the way in which effective marginal tax rates were making it difficult for low to middle income earners to choose to participate in the paid workforce.
- 3.17 'Effective marginal tax rates' refer to the interaction of the tax and welfare systems where a person either wishes to enter the workforce or increase their hours. As welfare benefits are withdrawn (due to means testing) and income tax increases (due to higher income earned and progressive taxation scales<sup>11</sup>), the net increase in income can be

11 All current income tax brackets and marginal rates are detailed in chapter three.

modest for the time spent in work. Some families face the loss of as much as 80 cents for each additional dollar earned.<sup>12</sup>

3.18 As the Department of Employment and Workplace Relations told the committee, the problem of effective marginal tax rates for parents ‘speaks to the generosity of the family payment system’. As chapter two outlined, family payments are contributing an increasing proportion of income to low to middle income Australian families.<sup>13</sup>

3.19 The Department noted that Welfare to Work acknowledges effective marginal tax rates by not requiring parents to accept a job offer if they can demonstrate that they will be less than \$25 per week better off. This financial suitability test takes account of income tax and benefit withdrawal as well as child care and transport costs.<sup>14</sup>

3.20 The interaction of the tax and welfare systems can generate significant disincentives to workforce participation. For example, a mother of five told the committee:

When I was still married, I successfully applied for a position as a medical receptionist. I then found, after I put my children in child care and lost my Parenting Payment and our income tax was adjusted, I was going to take home \$10.00 per week, after I paid for petrol, car maintenance and clothing, I was going to be worse off.<sup>15</sup>

3.21 The National Council of Single Mothers and their Children submitted to the committee comments from a single mother interviewed for a research project in South Australia in the late 1990s:

I was earning maybe one hundred and fifty extra but I had to cut it down to part time and it just wasn’t worth it. Housing Trust put your rent up. Social Security takes away money and I was about five dollars better off (Bonny, 28, 3 children).<sup>16</sup>

3.22 A calculation on today’s taxation rates and family payments suggests that a single mother with two children below school age would be better off working three days a week on average weekly earnings, but

12 St Vincent de Paul Society, sub 145, p 10.

13 Morehead A, transcript, 31 May 2006, p 18.

14 Morehead A, Department of Employment and Workplace Relations, transcript, 31 May 2006, pp 12-13.

15 Bentley S, sub 43, p 1.

16 McInnes E, *Public policy and private lives: Single mothers, social policy and gendered violence* (2001), thesis for Doctor of Philosophy, FUSA, Bedford Park, cited in National Council of Single Mothers and their Children, sub 108, p 9.

only slightly. After putting her children in long day care for three days a week and paying gap costs after Child Care Benefit, she would be approximately \$140 a week better off.<sup>17</sup> This calculation does not allow, however, for impacts on public housing subsidies or Rent Assistance; nor does it allow for the potential withdrawal of benefits such as the Health Care Card.

3.23 Effective marginal tax rates caused by the interaction of the tax and welfare systems can also be compounded by additional costs of working. The St Vincent de Paul Society noted that:

Some of the other difficulties of returning to work for a parent are seemingly insignificant but become large for individuals trying to get back into the daily routine of work and socially reacting with people in a new environment. These include:

- clothing;
- meals may cost more than those in the home;
- donations/charges for work-related functions/events.<sup>18</sup>

3.24 In the hypothetical situation considered above, of a single parent returning to work for three days a week, the small amount of additional income earned may be further eroded by expenses such as uniforms or corporate attire, transport and parking.

3.25 Even for those whose family incomes preclude them from receiving any significant amount of family assistance, the decision to return to the paid workforce or to increase hours must be compared against the additional costs of working. Child Care Queensland wrote:

Families regularly tell us that it is not worth their while financially for both parents to work on a full time basis and place their children in care five days per week. Families are trying to balance their optimum earning point in relation to their income and costs incurred in obtaining that income. Child

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17 This figure was arrived at using family benefit calculators available on the websites of Centrelink and the Family Assistance Office, and the Australian Taxation Office's basic calculator. Payments taken into account were Parenting Payment, Family Tax Benefit Parts A and B and Child Care Benefit, together with gap costs of child care at \$50 per day per child. Average weekly earnings of \$839.50 for August 2006 were reduced by 40 per cent to account for average lower earnings for women and for those working part time. Australian Bureau of Statistics, *Average weekly earnings, Australia, August 2006* (2006), Cat No 6302.0, p 1.

18 St Vincent de Paul Society, sub 145, p 9.

care costs, travel and taxation are all mentioned as a deterrent to full time employment.<sup>19</sup>

- 3.26 Professor Barbara Pocock, of the University of South Australia, told the committee that:

We need to have arrangements that facilitate transitions between jobs, between care and work, into retirement and so on. I feel, and I think the literature suggests, that lumpy policies – policies that create barriers between transitions like high effective marginal tax rates or the lack of, for example, paid leave – are very problematic. They impede transitions rather than facilitate them.<sup>20</sup>

## **Fringe benefits tax exemption for employer-provided child care**

- 3.27 Fringe benefits tax (FBT), introduced in 1986, was designed to improve public confidence in the fairness of the tax system. Specifically, it was intended to stop people avoiding income tax by converting their salary to non-cash benefits. The Australian Taxation Office defines a fringe benefit as a benefit provided in respect of employment, including any right, privilege, service or facility, provided in place of or in addition to salary or wages.<sup>21</sup> For example, cars made available for the private use of an employee, low interest employee loans and free or discounted air travel are fringe benefits.<sup>22</sup>
- 3.28 The current rate of tax on fringe benefits is 46.5 per cent, equal to the highest marginal tax rate applicable to individuals, including the Medicare Levy of 1.5 per cent. This applies to benefits with a value of over \$1000, soon to be \$2000, provided in an FBT year (1 April to 31 March).<sup>23</sup>
- 3.29 A feature of Australia's fringe benefits tax system is that liability rests with the employer, whether they are sole traders, partnerships, trusts,

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19 Child Care Queensland, sub 198, p 2.

20 Pocock B, transcript, 24 May 2006, p 2.

21 Australian Taxation Office, *Taxation statistics 2003-04* (2006), p 130.

22 Australian Taxation Office, *Taxation statistics 2003-04* (2006), p 130.

23 The Government has announced that from 1 April 2007, the fringe benefits reporting exclusion threshold will increase from \$1,000 to \$2,000.



corporations or government bodies.<sup>24</sup> Since 1994, however, employers have been able to claim tax deductions on the grossed-up rate of benefits provided to employees. In this way, companies are able to offset some of their fringe benefits tax liability against their company income tax.

- 3.30 There are a number of exemptions to fringe benefits tax; that is, some specified benefits can be provided to employees without incurring the tax. An exemption for 'in-house child care facilities for the dependants of employees' was part of the original legislative package.<sup>25</sup> Under section 47(2) of the *Fringe Benefits Tax Act 1986*, employer-provided child care is exempt from fringe benefits tax where child care is provided for children of employees in a facility on business premises. As outlined by the Act:

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 maybe, 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.

- 3.31 This exemption, in theory, allows employers to provide either a direct benefit to employees by purchasing child care outright, or to offer them child care as part of their salary sacrificing menu. Salary sacrificing, otherwise known as salary packaging, allows employees to forfeit a portion of their pre-tax income in return for their employer providing an agreed benefit. They do not pay income tax, therefore, for the portion of their income equivalent to the value of the benefit.
- 3.32 Many companies are interested in giving a child care salary sacrificing option to employees, as the cost of the child care is in fact partly borne

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24 Australian Taxation Office, *Taxation statistics 2003-04* (2006), p 130.

25 Hon P Keating MP, Treasurer, *Reform of the Australian taxation system* [White paper] (1985), p 35.

by the government through foregone income tax. In seeking the exemption from fringe benefits tax, however, there have been complexities in defining 'business premises' to the satisfaction of the courts and the Australian Taxation Office. This remains the restriction most difficult for employers to satisfy.

3.33 In 1996, Esso Australia Ltd applied for a private ruling on whether its salary sacrificing arrangements for child care were exempt from fringe benefits tax. Esso, together with two other unrelated companies, had leased premises and entered into an agreement with a child care provider to operate a centre and provide services for their employees.

3.34 The Commissioner of Taxation ruled that these premises could, for the purposes of the *Fringe Benefits Tax Act 1986*, qualify as a site of business operations:

'Business operations' arise only in the context of a business or a profit making undertaking. In this context, the provisions 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.<sup>26</sup>

This broad interpretation was later supported by Justice Merkel in the High Court with regards to the original legislative intent of the exemption.<sup>27</sup>

3.35 The Commissioner of Taxation did not, however, grant the exemption, because he considered that unless an employer had exclusive possession or sole occupancy rights to premises, they could not properly be regarded as business premises. Esso disagreed, arguing that there was no implication of exclusivity in the Act. It sought a review by the Administrative Appeals Tribunal, but was unsuccessful.<sup>28</sup>

3.36 In 1997, the Australian Taxation Office amended its public fringe benefits tax ruling cementing this principle and precluding joint venture agreements from qualifying for the exemption. The Federal

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

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

28 *Esso Australia Ltd v FC of T 1998 ATC 2085*.

Commissioner of Taxation did allow that companies could lease premises, in lieu of ownership, but deemed that the law did not allow for companies leasing premises cooperatively to receive the fringe benefits tax exemption.

Only one person can satisfy the 'business premises' test at any one time and that person is the person who has exclusive occupancy rights in respect of the premises.<sup>29</sup>

Consultancy group Families at Work suggest that this ruling resulted in the closing down of the joint venture child care arrangements of hundreds of Australian companies.<sup>30</sup> A Senate inquiry in 1998 into child care funding reported that:

Evidence received by the Committee indicated that the recent Australian Taxation Office decision has had several effects. Firstly, some centres, particularly in the Sydney and Melbourne CBD, have been forced to close. These centres... ensured a high utilisation through FBT exempt salary packaging of child care fees.

Secondly, the National Association of Community Based Children's Services (NACBCS) stated that some parents who were receiving the benefit of FBT exempt salary packaging of child care fees, no longer receive this benefit and have to pay the full cost of child care.

NACBCS argued that the ruling has 'reduced some of the child care places available, particularly those located close to city perimeters or in the city areas and some families can no longer afford the fees being charged by their services and have not been able to find affordable alternative child care arrangements'.<sup>31</sup>

3.37 Meanwhile, Esso lodged an appeal with the High Court which was upheld in 1998. Justice Merkel said that:

It seems to me that, under s 47(2), for the relevant business premises to be those of an employer, the employer must have a right to possession of the premises, at least to the extent

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29 Federal Commissioner of Taxation, Public Ruling TR 96/27 (withdrawn), 'Fringe benefits tax: meaning of "business premises"'.

30 Families at Work, *Tax and child care: A strategy to reform the fringe benefit tax treatment of employer funded child care* (2001), p 11.

31 Senate Community Affairs Committee, *Inquiry into child care funding* (1998), pp 123-24.

necessary to enable the conduct thereon of the relevant recreational or child care facility.

If the employer has the requisite possessory entitlement in respect of the premises it does not appear to matter whether that entitlement is one of ownership, exclusive possession or non-exclusive possession.

In the present case, Esso is in possession of the leased premises for the purpose of the provision of the relevant child care facilities at those premises. I can see no reasons why Esso's possession must be exclusive.<sup>32</sup>

- 3.38 Following the outcome of the Esso case, the Commissioner of Taxation published a revised public ruling on the meaning of 'business premises' on 1 March 2000.<sup>33</sup> There remains the restriction that the employer must have 'the requisite possessory entitlement in respect of the premises'; that is, the employer must have control over and entitlement to the child care facility. It is not possible for an employer to receive the exemption if they would like, for example, to purchase child care places from a nearby long day care centre.
- 3.39 Continuing uncertainty surrounding the business premises test has meant that many employers have sought private rulings from the Commissioner of Taxation before investing in the lease or ownership of a child care facility for their employees. The committee has received evidence from several companies and Australian Government departments who have sought private rulings on the fringe benefits tax exemption for child care, and several who, at the time of writing, were preparing an application.
- 3.40 The committee has received evidence that employees of some large Australian companies, universities, hospitals and Australian Government departments are able to salary sacrifice their child care fees in an arrangement that is fringe benefits tax exempt. Further information on employers who offer salary sacrificing for child care can be found in chapter seven.
- 3.41 The value of the fringe benefits tax exemption for child care, or the number of employees taking advantage of it, is not known. This is because exempt benefits are not required to be reported to the

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

33 A draft version of the revised ruling was published by the Australian Taxation Office in August 1999 (TR 1999/D11).

Australian Taxation Office.<sup>34</sup> In modelling commissioned by the committee, consultants Econtech calculated that the cost of the fringe benefits tax exemption for child care fees is approximately \$14.08 million per year.<sup>35</sup> This figure was based on evidence gathered by the committee on private companies and public sector agencies currently offering salary sacrifice; evidence presented in submissions and public hearings; and available workplace surveys from recent years, which are detailed further in chapter seven.

- 3.42 The committee notes, in addition, that the Australian Taxation Office has no idea if there are employers offering salary sacrificing for child care that does not meet the requirements of the public ruling. In evidence, the Australian Taxation Office said that because fringe benefits were self-assessed by employers, it was possible that some employers were assuming compliance when this was not the case, and this information was not recorded as a 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.'<sup>36</sup>

### Interaction of salary sacrificing with other forms of assistance

- 3.43 Salary sacrificing for child care does have an impact on a parent's entitlement to other government subsidies for child care. Where employers provide exempt child care through a salary sacrifice agreement, employees are not eligible for Child Care Benefit or the Child Care Tax Rebate. This is because entitlement to the Child Care Benefit is dependent on a parent being liable for child care costs. Under a salary sacrificing agreement it is the employer who is contractually liable for child care costs.<sup>37</sup>
- 3.44 A parent can still claim Child Care Benefit and Child Care Tax Rebate for the costs of child care outside of the salary sacrificing agreement, but these costs are of course paid from their net (post-tax) income.

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34 D'Ascenzo M, Commissioner of Taxation, transcript, 29 November 2006, p 4; see also Walker C, Australian Taxation Office, transcript, 21 June 2006, p 21.

35 Econtech, Appendix E, p i.

36 D'Ascenzo M, transcript, 29 November 2006, p 4.

37 Department of Family and Community Services, 'Impact of salary sacrificing on Child Care Benefit,' *Child Care News* (2003), no 12, attachment no 2; see also the Tax Commissioner's private ruling 65073 (2006).

## Fringe benefits tax exemption for priority of access payments

3.45 There is a further exemption for child care under the *Fringe Benefits Tax Assessment Act 1986* that should be noted here. Under section 47(8), payments made by employers to child care providers to secure priority places for their employees are exempt:

If:

(a) a residual benefit provided in respect of the employment of an employee arose out of priority of access, for a child or children of the employee, to:

(i) a place that is an eligible child care centre for the purposes of any provision of the *Child Care Act 1972*; or

(ii) family day care provided before the commencement of item 1 of Schedule 10 to the *A New Tax System (Family Assistance) (Consequential and Related Measures) Act (No. 2) 1999*; or

(iii) care outside school hours provided before the commencement of item 1 of Schedule 10 to the *A New Tax System (Family Assistance) (Consequential and Related Measures) Act (No. 2) 1999*; or

(iv) care in school vacations provided before the commencement of item 1 of Schedule 10 to the *A New Tax System (Family Assistance) (Consequential and Related Measures) Act (No. 2) 1999*; or

(v) an approved centre based long day care service within the meaning of the *A New Tax System (Family Assistance) (Administration) Act 1999*; or

(vi) an approved family day care service within the meaning of the *A New Tax System (Family Assistance) (Administration) Act 1999*; or

(vii) an approved outside school hours care service within the meaning of the *A New Tax System (Family Assistance) (Administration) Act 1999*; or

(viii) an approved in-home care service within the meaning of the *A New Tax System (Family Assistance) (Administration) Act 1999*; and

(b) in order to obtain that priority of access, the employer of the employee, or an associate of the employer, made a contribution under a program administered by the Department of Health, Housing, Local Government and Community Services; the residual benefit is an exempt benefit.

- 3.46 When first introduced by Treasurer Paul Keating in 1986, this exemption included only payments made to long day care facilities; this was expanded in 1993 to include a far greater range of child care services than that permitted under the exemption in section 47(2). It now includes payments made to family day care providers, outside school hours care, in home, and vacation care, in addition to approved long day care.<sup>38</sup>
- 3.47 The exemption was intended to compensate for the drawbacks that were already obvious in the exemption under section 47(2). The then Treasurer said that:
- The program offers an alternative to the establishment of in-house child care facilities for those private sector employers who require a relatively small number of dedicated places.<sup>39</sup>
- 3.48 Available information, however, suggests that it is poorly exploited by employers. Deloitte describe this exemption as being complicated and poorly understood by employers. In a survey they conducted of 599 employers, not one had taken advantage of the exemption.
- 3.49 This was most likely because:
- priority access payments were not to be paid directly to the child care provider, but through an administratively complex arrangement with the relevant Commonwealth department; and
  - the exemption is limited to payments made in order to guarantee child care places, but does not exempt the actual child care fees.<sup>40</sup>

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38 House of Representatives *Hansard, Taxation Laws Amendment Bill (no. 2) 1993: Second Reading*, 5 May 1993, p 114.

39 Deloitte et al., 'Submission to the Federal Treasurer: Exemption of child care from fringe benefits tax' (2005), p 25.

40 Deloitte et al., 'Submission to the Federal Treasurer: Exemption of child care from fringe benefits tax' (2005), p 25.

## Tax deductibility status of child care

3.50 Within the Australian tax system, taxpayers can claim various deductions, such as for gifts, industry incentives and the costs of managing one's own tax affairs. The most common deductions are those claimed are for work-related expenses. For the financial year 2003-04, seven million personal taxpayers claimed \$11.1 billion in work-related expenses.<sup>41</sup>

3.51 This is made possible by section 8-1 of the *Income Tax Assessment Act 1997*, by which taxpayers can claim deductions for expenses that are 'incurred in gaining or producing assessable income':

### General deductions

- (1) You can *deduct* from your assessable income any loss or outgoing to the extent that:
  - (a) it is incurred in gaining or producing your assessable income; or
  - (b) it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.
- (2) However, you cannot deduct a loss or outgoing under this section to the extent that:
  - (a) it is a loss or outgoing of capital, or of a capital nature; or
  - (b) it is a loss or outgoing of a private or domestic nature; or
  - (c) it is incurred in relation to gaining or producing your exempt income or your non-assessable non-exempt income; or
  - (d) a provision of this Act prevents you from deducting it.

3.52 The Australian Taxation Office reported that, for the financial year 2003-04:

Clothing was the most common work-related expense claimed, with 4.7 million taxpayers claiming around \$1.1 billion worth of clothing (uniform) expenses. However,

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41 Australian Taxation Office, *Taxations statistics 2003-04* (2006), p 14.



in value terms, motor vehicle expenses accounted for the largest share (40%) of total work-related expenses claimed, with the average claim valued at \$1,965.<sup>42</sup>

- 3.53 Other valid work-related deductions include expenses for union fees; overtime meals; seminars, conferences and workshops; self-education; tools and equipment; computers and software; books, journals and trade magazines; and telephone and home office equipment.<sup>43</sup>
- 3.54 Taxpayers cannot, however, claim child care as a work-related deduction. This has been the subject of sporadic debate since the 1970s, when women began participating in the paid workforce in significant numbers.<sup>44</sup>
- 3.55 In *Lodge v Federal Commissioner of Taxation 1972*, a single mother's appeal against the Commissioner of Taxation's ruling was dismissed. The taxpayer had attempted to claim 'nursery fees' for the care of her infant daughter whilst she worked as a law cost clerk. Without placing her child in care, the appellant argued, it was impossible for her to work and earn a sufficient income.
- 3.56 The High Court accepted the argument that child care in this case was an essential prerequisite to the earning of income. It found, however, that the expenditure was not of a nature that would allow it to be deductible under the Act.
- The expenditure was incurred for the purpose of earning 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.<sup>45</sup>
- 3.57 Justice Mason also expressed a view, that, notwithstanding the judgement in the paragraph above, that expenses for child care were of a 'private and domestic nature'. They could thus be dismissed under the exceptions to allowable deductions in the Act.

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42 Australian Taxation Office, *Taxation statistics 2003-04* (2006), p 15.

43 Australian Taxation Office website, viewed on 31 August 2006 at <http://www.ato.gov.au/individuals/content.asp?doc=/content/18839.htm&pc=001/002/013/008/001&mnu=1220&mfp=001/002&st=&cy=1>.

44 Strategic Research Unit, Department of Research and Information, Law Institute of Victoria, *Tax deductibility of child care: Discussion paper* (2000), p 4.

45 *Lodge v FC of T 1972 ATC 4174*.

- 3.58 The Federal Court also confronted this issue in *Martin v Federal Commissioner of Taxation 1984*, and *Hyde v Federal Commissioner of Taxation 1988*.<sup>46</sup> In both cases, the presiding Justices again acknowledged that the expenditure on child care was necessary in order for the taxpayers to work. In both cases, however, it was ruled that the taxpayers were not entitled to deductions because the character of the expenditure meant that it was not incurred in the actual production of income.

## **Goods and Services Tax (GST) treatment of child care**

- 3.59 Goods and Services Tax (GST), introduced on 1 July 2000, is a tax of 10 per cent on the supply of most goods and services and other taxable supplies in Australia.<sup>47</sup> Along with other types of supplies such as rent, wages, fresh food, exports, water, and most education and health services, eligible child care is not subject to GST.<sup>48</sup>
- 3.60 Under section 38 of the *A New Tax System (Goods and Services Tax) 1999*, the exemption from GST applies to approved child care and any care provided by a registered carer. Long day care, family day care, occasional care, outside school hours care, and vacation care are therefore GST-free.
- 3.61 GST treatment is not so straightforward for in-home (nanny) care. In-home care is GST-free where:
- the care is provided by an approved in-home care provider under the Australian Government's program for families in special circumstances;<sup>49</sup> or
  - the carer is registered with the Family Assistance Office; or
  - the carer is employed directly by a family, as GST is not payable on wages.
- 3.62 Where an unregistered nanny is employed by an agency, however, and parents pay the agency a fee for service, that supply of child care is not GST-free. Agencies with a turnover of more than \$50,000 per

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46 *Martin v FC of T 84 ATC 4513* and *Hyde v FC of T 1988 ATC 4748*.

47 Australian Taxation Office, *Taxation statistics 2003-04* (2006), p 149.

48 Australian Taxation Office, *Taxation statistics 2003-04* (2006), p 151.

49 Further information on the In-Home Care program can be found in chapter six.

annum must be registered with the Australian Taxation Office for GST purposes.<sup>50</sup>

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50 D'Ascenzo M and Chooi A, Australian Taxation Office, transcript, 29 November 2006, pp 21-22.

