



## THE TAX INSTITUTE

3 February 2014

Dr Wendy Craik AM  
Presiding Commissioner  
Child care and Early Childhood Learning Inquiry  
Productivity Commission  
GPO Box 1428  
CANBERRA CITY ACT 2600

(via email: [childcare@pc.gov.au](mailto:childcare@pc.gov.au))

Dear Dr Craik

### **Child care and tax deductibility**

The Tax Institute is pleased to present our submission to the Productivity Commission's inquiry into future options for child care and early childhood learning, with a focus on developing a system that supports workforce participation and addresses children's learning and development needs. Our submission is particularly focussed on the following part of the inquiry's Terms of Reference:

4) Options for enhancing the choices available to Australian families as to how they receive child care support, so that this can occur in the manner most suitable to their individual family circumstances. Mechanisms to be considered include subsidies, rebates and tax deductions, to improve the accessibility, flexibility and affordability of child care for families facing diverse individual circumstances.

### **Overview**

The Tax Institute has long called for a sustained commitment to tax reform for the benefit of all Australians. The tax system should be efficient, equitable and simple and should encourage savings and investment and workforce participation.

There are many women who would participate in the workforce except for the unavailability of child care. In many cases these individuals would earn higher wages than the wages of the child care workers. Therefore, a tax concession to subsidise the cost of child care should provide a positive benefit to the Australian economy by generating tax revenue in the form of income tax on wages.

Two options for improving access to child care through the tax system would be to allow a tax deduction for child care costs and to use a refundable tax credit or cash grant.

## Issue in detail

Australian families are increasingly balancing work and family responsibilities and there is a direct relationship between the price of child care and whether women return to the workforce.

Studies show that, in economic terms, the labour supply behaviour of women with young children responds negatively to child care price. This means that, as the price of child care increases, there is a corresponding decrease in the number of hours that women are in paid employment. This indicates that, for parents who need to use child care to work, child care is a cost of employment. Despite the longer term benefits of returning to work, in the short term, the costs of child care significantly reduce the value of doing so.

In order to encourage female work force participation and promote children's development, the Australian Government currently offers two main child care payments: a means tested Child Care Benefit and a non-means tested Child Care Rebate.

### *Summary of the Henry Review findings in relation to the current system*

The *Henry Tax Review* of 2009 ('**The Henry Review**') found that the current system of child care assistance recognises that parents and children in different circumstances will require different amounts of assistance. It concluded that the amount of child care assistance should be higher at low income levels and means tested as income increases, but that a base level of assistance should be provided across the income spectrum to facilitate participation.

Under the current tax law, a tax deduction is not available for a loss or outgoing of a private or domestic nature irrespective of whether that expenditure is necessary in order to earn income. As a result, child care costs are deemed private expenditure which is not deductible, although they are, in most cases, essential because of a taxpayer's employment.

Accordingly, the current system offers a combined means tested benefit payment and a non-means tested rebate payment, and the tax system rules out the deductibility of child care expenses.

The Henry Review acknowledged that our current system is confusing, with high effective marginal tax rates adversely influencing taxpayer behaviour. Means-testing access to child care payments contributes to high effective marginal tax rates. It encourages lower income earners back into the work-force with the presumption that higher income earners will return to work irrespective of the concession.

*Allowing tax deductions for child care costs would remove a major disincentive preventing women from returning to work*

Tax deductions for the costs of child care, if appropriately targeted, would encourage highly educated women who bear the primary responsibility for domestic duties to return to work. Tax deductions should only be available to reduce the tax on income from employment or self-conducted business income so that they are unequivocally tied to enhancing productivity. That is, there is no point giving a subsidy to reduce the tax on investment income. As such, we do not support subsidising the child care expenses of a parent who is still at home earning bank interest or share dividends.

The advantage of making child care costs tax deductible is that it relies on market forces (rather than Government intervention) to determine work force participation and to allow legitimate costs of work force participation to be appropriately deducted from income. Tax deductibility would assist in eliminating existing positive incentives for primary carers to stay out of the workforce, yielding a variety of benefits for individual families as well as the nation.

Tax-deductibility of child care costs therefore deserves careful consideration and study. We accept that any such scheme would need to be supplemented with means-tested access to the child care rebate, to ensure that women in lower marginal tax brackets who cannot benefit as greatly from deductibility of child care are also appropriately supported.

Some level of means-tested support may well be necessary as some low income families will require additional assistance. However, this assistance should be in addition to a wider consideration of deductibility of child care costs.

*Alternatively, the government could allow a refundable tax credit or cash grant*

The main argument against making child care costs tax deductible is that it tends to favour higher wage earners. Viewed through the productivity lens this might be seen as an advantage, because it provides the greatest encouragement to the most productive workers. Nevertheless, many in the community would regard it as undesirable to make the tax system less progressive. A refundable tax credit or cash grant would avoid this outcome. Therefore, if the Productivity Commission is not prepared to endorse tax deductibility it should consider making available a refundable tax credit or cash grant.

**Conclusions**

Adopting either tax deductibility or tax credits/cash grants would provide a direct benefit for the nation by increasing productivity and generating tax revenue for the government in the form of income tax on wages.

We acknowledge that, in addition to subsidising costs of child care, it is essential to ensure that sufficient child care places are available. Workplace flexibility allowing part-time employment is also necessary, but these issues fall outside of the Tax Institute's area of expertise.

We look forward to engaging with you further in relation to this important issue.

Yours sincerely

**Michael Flynn CTA**  
President