

Submission to the Productivity Commission's Inquiry into Childcare and Early Childhood Learning

Contact

Rohan Martin
Corporate Affairs Manager
McMillan Shakespeare Limited
Level 20, 360 Elizabeth Street
Melbourne, Vic, 3000
Ph: (03) 9097 3842

Date

25 March 2014



HOLDEN
Leasing



The McMillan Shakespeare Group of Companies

McMillan Shakespeare Group

Submission to the Productivity Commission's Inquiry into Childcare and Early Childhood Learning

Overview

This submission is to the Productivity Commission's Inquiry into Childcare and Early Childhood Learning which was requested by the Federal Treasurer and announced by the Federal Government on 17 November 2013.¹

The McMillan Shakespeare Group (MMSG) has a longstanding interest in the provision and sponsorship of childcare by employers arising from our position as Australia's largest provider of salary sacrifice program and design. Employer-provided or sponsored childcare is a regular discussion topic with our clients. We have also undertaken work in this area. For example, in 2007 MMSG signed a memorandum of understanding with the NSW Government to design and administer programs to deliver access to childcare for all NSW public service employees.

Our submission responds to the Treasurer's request that the Commission report on and make recommendations about (among other things) options for enhancing the choices available to Australian families as to how they receive childcare support, including subsidies, rebates and tax deductions, and the role and potential for employer-provided childcare.² In particular, MMSG's submission seeks to do the following:

- Examine how the transfer system's support of childcare can be improved to augment and provide more effective childcare choices to Australian families without wholesale removal and replacement of workable elements of the current support mechanisms.
- Simplify the administration of childcare.
- Remove the disincentive for women to return to work currently due to the transfer system penalties imposed on income derivation and the consequent tax impacts.
- Encourage greater employer involvement in childcare through direct investment in infrastructure, administration of tax deduction-linked childcare payments, and education of employees as to childcare benefit entitlements.

We make the general observation that the stakeholder with the most to gain in terms of lifting workforce participation is the employer. Any reform that encourages employers

¹ Tony Abbott, Prime Minister, Sussan Ley, Federal Assistant Minister for Education, and Joe Hockey, Federal Treasurer, *Government announces Productivity Commission inquiry to focus on more flexible, accessible and affordable child care*, Joint Media Release, Canberra, 17 November 2013.

² Joe Hockey, Federal Treasurer, *Terms of Reference – Child Care and Early Childhood Learning*, 17 November 2013, as reproduced in Productivity Commission, *Childcare and Early Childhood Learning – Productivity Commission Issues Paper*, Canberra, December 2013, at pp iv and v. (In this submission, the term "childcare" is used instead of the Government's reference to "child care".)

to become more economically and structurally involved with the childcare system would be a significant benefit, not just in terms of relevant employees with young children and their increased workforce participation but also in relation to meeting increased demands for childcare places within the general community.

Recommendations in summary

MMSG submits that the following reforms will enhance the childcare choices available to Australian families, improve the level of participation of women in the workforce, and parents generally, whilst at the same time provide greater encouragement for employers to provide childcare benefits to their employees:

CCB/CCR – see page 16

- The two-tiered system be combined into a single-benefit system
- The amount of the combined benefit be staggered according to single/family income

Income tax/FBT – see page 18

- ***Principal recommendation*** - Allow parents the option of claiming an income tax deduction under the *Income Tax Assessment Act 1997* (the ITAA 1997) for childcare fees in lieu of claiming a combined CCB/CCR entitlement.
- ***Alternate recommendation*** - Amend s 47(2) of the *Fringe Benefits Tax Assessment Act 1986* (the FBT Act) to lower the barriers against employers joining together to provide FBT-exempt childcare facilities to employees.

The transfer system and childcare

The transfer system as it relates to childcare support mainly consists of the means tested Child Care Benefit (CCB) and the non-means tested Child Care Rebate (CCR). Although both essentially fund the same things, their basis of eligibility, calculation and level and mode of payment are different. Although the CCB and the CCR reporting and payment processes are reasonably efficient and the payments do provide real support to many Australian parents, they are not easily understood and, particularly in the case of the CCR, difficult to access.

Rather than provoking non-distortionary childcare choices by parents, the transfer system now dominates their cost support and has led to an environment which does not adequately motivate women to enter or re-enter the workforce after childbirth. This has resulted in ongoing under-utilisation of valuable human capital.

The transfer system has also developed to the point where it actively provides a disincentive to any parent other than those on high incomes to incur childcare costs on a before-tax basis. This is indicative of the disconnect between transfer system entitlements and the financial outcomes for parents receiving indirect or direct childcare support from their employers. The variables are so pronounced as to prevent any childcare decision-making by a 'parent employee' using a model of consistent or universal principles.

Our submission discusses in detail those issues with the transfer system as it impacts childcare costs and makes recommendations designed to overcome them. This is based on detailed modelling and analysis carried out by PricewaterhouseCoopers (PwC) on behalf of MMSG for the purposes of this submission.

The fringe benefits tax system and childcare

The fringe benefits tax (FBT) system's support of childcare is inefficient and distortionary. Rather than provide cost-efficient incentives, the FBT exemptions for employer-provided childcare and employer-sponsored childcare are outdated, overly restrictive, and beset with uncertainty. These problems lead many employers to either not engage with childcare support or not be willing to incur the costs of compliance in obtaining exemption status, preferring instead to incur the FBT liability which is typically not passed onto employees.

Quantitative market research performed by Sweeney Research on behalf of MMSG for

"We have a childcare facility close to our head office and staff see a great benefit."

Source: Verbatim response, Sweeney Research

the sole purpose of this submission also largely confirms anecdotal evidence that despite many employers viewing assisted childcare for their employees as an important factor in retaining staff and being perceived as an 'employer of choice', the hurdles to qualify for FBT exemption are too high for all but the very largest companies in Australia.

Our submission reveals the outcomes of the Sweeney Research Report and examines the major issues concerning FBT and childcare. Our recommendations on this issue are designed to encourage more employers to provide assisted childcare to their employees.

Need for coherent connections between transfer system and tax system

Overlaying the issues involving the transfer system support of childcare and the separate issues involving the tax system and childcare is the fact that there are no coherent connections between the two systems as they relate to childcare. Moreover, the limits of one do not connect to the limits of the other.³ This is an obstacle to achieving sustainable outcomes from the Inquiry because the concept of the "family unit" for the purposes of the transfer system is not the same as the tax system's version. As noted by Stewart,⁴ this "is one reason why it is important to consider tax and transfer systems together."

The fact that the Inquiry is dealing with childcare and early childhood learning and that the Government's belief that a "more flexible and responsive childcare system will lift

³ For example, and as noted by the Henry Review, "while CCB and CCR are conditional on child care being provided by regulated providers for quality assurance purposes, these important conditions do not apply for FBT purposes." Australia's Future Tax System Review (the Henry Review), *Australia's Future Tax System: Final Report*, Canberra, December 2009, Part 2, Chapter F4-2.

⁴ Miranda Stewart, "Domesticating Tax Reform: The Family in Australian Tax and Transfer Law (1999) 21(3) *Sydney Law Review* 453.

workforce participation”, only serves to reinforce this need, which is addressed by our submission.⁵

Market research into employers and childcare

The extent to which employers are providing benefits cannot be easily ascertained. This is due in part to the ATO not requiring employers to particularise on annual FBT return forms which, if any, fringe benefits they provided during the relevant period were exempt from FBT. In addition, it is not clear how many employers are providing childcare services or support *regardless* of whether or not such benefits are covered by an FBT exemption.

We note however that the Commission is seeking information on the nature of childcare services or assistance provided by employers and issues encountered in supporting employee use of childcare services.⁶

Some of Australia’s largest companies promote the fact that they provide childcare facilities for their employees, for example Telstra, Qantas, and Optus. These facilities are mostly for the exclusive use of employees, however CSL, for example, operate a facility that is also available to the public. Some other companies do not provide childcare facilities directly, but instead choose to provide financial assistance to eligible employees towards their childcare costs, for example ANZ Bank.

MMSG commissioned Sweeney Research to undertake quantitative market research aimed at gaining an understanding of the extent that other, smaller, organisations provide childcare facilities or assistance to their employees, and the reasons why they do so (and in respect of organisations that do not provide such assistance – the reasons why not).

Sweeney Research is one of the largest Australian-owned research consultancies, with over 40 years of experience in conducting quantitative and qualitative research within the Australian economy. The firm conducts research for many of Australia’s largest organisations, including more than 20 of the ASX Top 100 listed companies.

On behalf of MMSG, Sweeney conducted telephone interviews with the HR leadership of 100 large organisations for this submission, ie those most likely to have given serious consideration to options for employee childcare. Eighty percent of responding organisations employed over 500 staff and 95% employed more than 200 staff.⁷

⁵ Tony Abbott, Prime Minister, Sussan Ley, Federal Assistant Minister for Education, and Joe Hockey, Federal Treasurer, fn 1.

⁶ Productivity Commission, *Childcare and Early Childhood Learning – Productivity Commission Issues Paper*, Canberra, December 2013, at p 17.

⁷ Twenty two percent of responding organisation were listed on the ASX Top 300, and 10% on the ASX Top 100. The responding organisations were spread across more than 10 industry sectors, and Sweeney estimated that, combined, they had more than 200,000 employees.

Key findings

The key findings of the Sweeney research were as follows:

- Whilst employees' childcare is a significant issue for large scale employers, only 13% of those surveyed had established arrangements to respond to this need. The remaining 87% of employers do not provide any form of childcare support or services for their employees.
- In relation to the 87% of employers not providing any form of childcare support to employees, when asked to identify the main barrier to providing their own childcare facilities, the two leading reasons were 'insufficient employee demand to justify a facility' and 'costs to the organisation'. Other main barriers included:
 - Unable to comply with FBT exemption
 - Legal liability associated with operation of a facility
 - Lack of suitable space
 - Cost of insurance
 - Not perceived as core business.
- Two-thirds of those 87 employers not providing any form of childcare support attached importance to being unable to obtain FBT exemption as a barrier to providing childcare facilities.
- Five percent of employers provided their own childcare facility, and a further 2% provide a facility shared with other employers. The leading motive of those 7 employers for providing this form of support was the desire to be 'an employer of choice'. Other motives were as follows (in decreasing order of importance):
 - To keep or attract valued staff
 - To enhance employee engagement
 - To retain high levels of focus at work
 - To meet the operational requirements of the business
 - Response to employee demand
 - To increase efficiency.
- Various perceived employee benefits of providing childcare facilities were identified by those 7 employers as follows (in decreasing order of importance):
 - Ability to check on their child
 - Accessibility and convenience
 - Ease of communication with carers
 - Reinforces employer's support of employees with families
 - Lower cost of childcare
 - Access to a high quality facility
 - Closer, feels safer
 - High quality learning and development
 - Access for breastfeeding.

- Of the 7 employers providing either exclusive or shared childcare facilities for their employees, 2 had obtained FBT exemption for their childcare facility, 2 had not obtained FBT exemption, and 3 'did not know'.⁸
- Of those 7 employers, 5 recovered their costs from employees, at varying levels between 30% and 100%. Three of those 5 employers allowed their employees to salary sacrifice the recovery of childcare costs.
- The other 6% of employers providing childcare support did so by funding places in 3rd party childcare centres or by providing financial assistance to employees making their own childcare arrangements. To be 'an employer of choice' was also a leading motive for employers providing this form of support, but slightly less important than responding to employee demand.

Conclusions on employers and childcare

Several key conclusions can be drawn from the Sweeney Research about employers and childcare:

- Anecdotal information that the level of engagement of employers in Australia with their employees' childcare needs is very low was confirmed.
- With only 13% of surveyed organisations providing some form of childcare support, it can arguably be assumed an even smaller percentage of small to medium-sized organisations do so.
- Whilst only a small number of organisations interviewed by Sweeney Research identified the inability to obtain FBT exemption as the *main* barrier to providing childcare facilities, other verbatim responses, such as "we are not big enough" and "we are spread across a lot of sites", indicate a level of frustration at the *current* limited parameters of the FBT concessions.
- That perception of the limits of the FBT concession is reinforced by one of the main barriers identified by the 87% of employers not providing any form of childcare support – insufficient demand to justify a facility.

As we discuss on pages 18 to 21, both our principal and alternate recommendations seek to remove those barriers by opening up the scope for employers to be involved in childcare – by virtue of the FBT 'otherwise deductible rule' (principal recommendation) or by virtue of allowing several employers to join together to provide childcare facilities and otherwise not be subject to the strict 'control' requirements (alternate recommendation).

⁸ Whilst care was taken in selecting the appropriate person in each organisation to be interviewed, there was always the risk that knowledge or awareness held by that person of the organisation's FBT status as regards childcare facilities being provided as a benefit would be insufficient to obtain a yes/no response. However, if it is accepted that FBT exemption would be the exception rather than the norm, then it could be surmised that the 3 employers whose representatives 'did not know' were not exempt.

Transfer and tax systems' support of childcare – current issues

As raised in the [Overview](#), there are a number of current issues associated with the transfer and tax systems' support of childcare. Some of these issues overlap, but as the following discussions demonstrate, they all combine to produce inefficient and inconsistent outcomes for parents seeking quality childcare options.

Child Care Benefit and Child Care Rebate – confusing, complex and a disincentive

In February 2012 the previous Federal Government estimated that “up to 100,000 Australian families” may have been eligible for CCB or CCR payments but were not claiming their entitlements.⁹ This gap in potential claims was despite the fact that in 2008 the Government had increased the CCR from 30% to 50% of out-of-pocket childcare costs and the maximum amount of the rebate from \$4,354 to \$7,500 per year, and in 2011 had introduced the option of receiving CCR payments fortnightly instead of annually.

A possible reason for the maximum amount of potential CCB/CCR claims not being made can be attributed to the issues identified by the Henry Review in 2009. In its Final Report to the Treasurer, the Review labelled the calculation of the CCB as “particularly complicated” and the existence of the two childcare transfer payments and the way they interacted as adding to that complexity – for parents, providers and administrators.¹⁰

Several submissions to the Inquiry have also labelled the current transfer system relating to childcare as “complex”. For example, we note that Early Childhood Australia (ECA)¹¹ gave the following reasons for that complexity:

- There are differing work training study tests for the CCB and the CCR.
- Parents on different incomes are on different CCB rates.
- The CCB has multiple income thresholds.
- The rate of CCB and its thresholds are indexed.
- The CCR is applied to a percentage of costs.
- Parents are often not entitled to any amount of CCB but entitled to the full CCR amount.
- The CCR has a cap, which is indexed, whereas the CCB has an hourly cap.

⁹ Kate Ellis, Federal Minister for Early Childhood and Child Care, *100000 Australian families still missing out on child care assistance*, Media Release, Canberra, 6 February 2012. The Minister broke down the estimate on a State/Territory basis: NSW 40,000, Victoria 20,000, Queensland 24,000, South Australia 6,000, Western Australia 8,000, Tasmania 2,000, Northern Territory 600, and Australian Capital Territory 1,400. Whilst the Minister gave the total as 101,200, the amounts stated total 102,000. The estimates were based on the difference between the numbers of families using registered childcare and the numbers not claiming the CCR.

¹⁰ Henry Review, fn 3, Part 2, Chapter F4-2.

¹¹ Early Childhood Australia, *Early Childhood Education and Care: Creating Better Futures for Every Child and for the Nation – Early Childhood Australia's Submission to the Productivity Commission Inquiry on Child Care and Early Childhood Learning* (sic), February 2014, at p 46.

MMSG also notes that a study by the University of New South Wales' Social Policy Research Centre (the SPRC)¹² commissioned by ECA for the purposes of its submission to the Inquiry concluded that:

"The current combination of a capped, means-tested subsidy (Child Care Benefit) with a non-means-tested rebate (Child Care Rebate) ... is not only confusing for parents, its distributional impacts push and pull in different directions. CCB delivers maximum assistance to lower income families while CCR, being tied to actual fees paid, delivers the greatest benefits to families who pay the most for child care – families at the higher end of the income scale."

The SPRC also found that considerable confusion particularly surrounds the interaction between the CCB and CCR:

"The distinction between 'approved' and 'registered' care is also not well understood. The term 'approved' implies a service that meets government regulations and services. Parents are thus often surprised to discover that their preschool, for example, which meets all required quality standards, is not 'approved' for CCB because the Commonwealth requires approved services to be open for a minimum number of hours per day and weeks per year. While this may make sense from a bureaucratic and administrative perspective, it makes no sense to families."¹³

Notwithstanding the Government's estimate (discussed above) that 100,000 families are entitled to the CCR but are not claiming it, other families are receiving the rebate but without knowing why. These confusing outcomes arise despite the intrinsically fluid and efficient reporting and payment processes now in place. They arise because whilst CCR entitlement depends on whether or not the family is eligible for the CCB, that requirement is satisfied even if the entitlement to the CCB is at the zero rate of payment, but the CCR can only be paid if the family has applied for the CCB, in which case payment occurs automatically.

Primary carers have little incentive to resume work

The disconnect between the transfer system and the tax system in relation to childcare support results in primary carers of young children having little incentive to return to work.

Analysis by PwC for the purposes of this submission demonstrates that a couple deriving Average Weekly Ordinary Time Earnings incurs incrementally less gains in disposable income for every extra half day worked by the primary care giver and increased effective tax rates up to 68.24%, as per the following table:

¹² Deborah Brennan and Elizabeth Adamson, (2014) *Financing the Future: An equitable and sustainable approach to early childhood education and care*, SPRC Report 01/14, Social Policy Research Centre, UNSW, at p 2.

¹³ Deborah Brennan and Elizabeth Adamson, fn 12, at p 15.

Effective tax rates for couple earning AWOTE

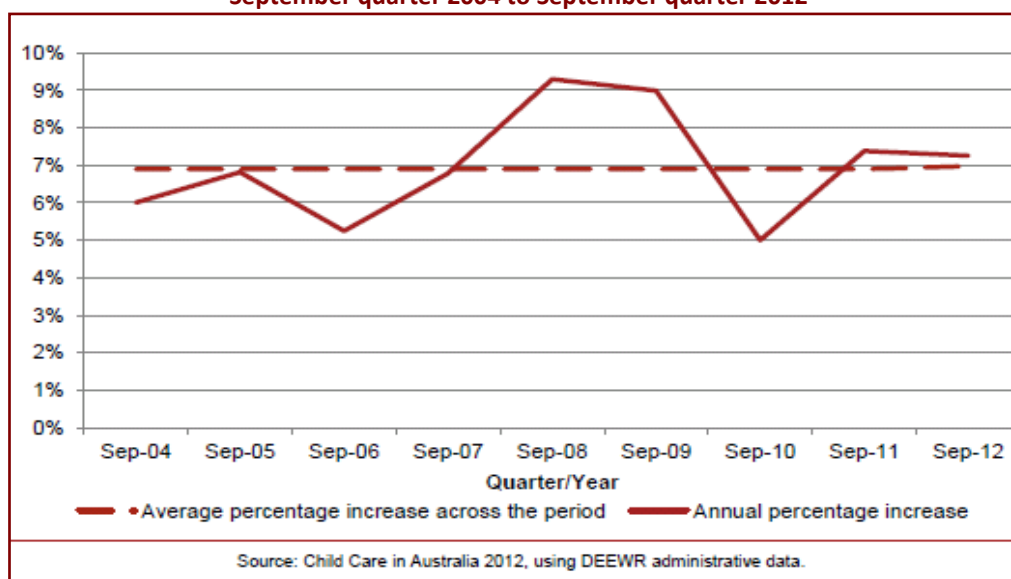
Days worked/ child care used per week	Family Market Income	Primary carer earnings	Current situation		
			Current Disposable Income after Child Care Costs	Gain in disposable income from working an extra half day	Effective participation tax rate
0	74,724	-	64,381	6,317	15.47%
0.5	82,196	7,472	70,698	5,204	30.35%
1	89,669	14,945	75,902	3,124	58.20%
1.5	97,141	22,417	79,026	2,719	63.62%
2	104,614	29,890	81,744	4,890	34.55%
2.5	112,086	37,362	86,635	3,854	48.42%
3	119,558	44,834	90,489	3,755	49.75%
3.5	127,031	52,307	94,244	3,437	54.00%
4	134,503	59,779	97,681	2,373	68.24%
4.5	141,976	67,252	100,054	2,588	65.37%
5	149,448	74,724	102,642		

Those financial outcomes for parents deciding to return to work are derived from the resulting loss of CCB and CCR entitlements combined with the marginal tax rates applying to the extra income derived, and the increase in childcare costs for each extra half-day worked.

The CCR and the cost of childcare

According to the analysis performed by PwC for this submission, childcare fees have recently been growing “significantly faster” than inflation or even average wages, as shown in the following graph:

**Average and annual percentage change to long day care hourly fees,
September quarter 2004 to September quarter 2012**



PwC has attributed some of the cause of this spike in price growth to the increase in the rate of the CCR from 30% to 50% in 2008, along with the proportional rise in the cap on the entitlement.

The unfortunate cost outcome of this effect is that, again according to PwC's analysis:

"Families receiving a nil rate of [CCB] and paying the average child care price in certain jurisdictions, such as NSW and the ACT, will have reached their maximum entitlement of [CCR] when utilising only four days of care per week. This means that certain families would not be eligible for any additional child care assistance if they were to increase their workforce participation (and subsequent childcare needs) from four to five days per week."

Of course, those families paying *more* than the average child care price reach their maximum CCR entitlement *before* four days per week.

FBT-exempt childcare benefits

There are two separate statutory exemptions from FBT for benefits provided to employees by their employers that are related to childcare, subs 47(2) and subs 47(8) of the FBT Act. Both exemptions have major practical issues for employers which are discussed below.

Subsection 47(2) – provision of childcare facility

The broad purpose of subs 47(2) is to exempt from FBT childcare facilities provided by employers for employees. The overriding practical requirement of FBT exemption employer-provided childcare is that the facility must be "located on the business premises of the employer".

That requirement has led to the perception that employers providing "off-site" childcare facilities are not entitled to the FBT exemption. It is our understanding that some employers have decided not to provide "off-site" childcare facilities for this reason. In turn, we note that several submissions to the Inquiry have recommended that subs 47(2) be amended to allow "off-site" childcare facilities to be exempt from FBT as a means of encouraging more employers to provide more childcare support to employees.¹⁴ MMSG also notes that allowing FBT-exempt off-site childcare facilities has the support of the Federal Government.¹⁵

¹⁴ For example, Kate Ellis, Shadow Minister for Early Childhood, *Submission to the Productivity Commission's Inquiry into Childcare and Early Childhood Learning*, 3 February 2014 (Submission No. 145): "In considering new ways to improve access to and affordability of childcare, we urge the Commission to consider incentives for employers to provide childcare services, and ways that Government can make it easier for employers to provide such support. For example, we ask the Commission to look at ways of extending the Fringe Benefits Tax concession currently received by employers who provide childcare on site to employees, to employers who provide childcare off-site."

¹⁵ Sussan Ley, Assistant Member for Education, as quoted by Joanna Mather, "Ley eyes childcare tax perks" *Australian Financial Review*, 31 January 2014, at p 5: "One of the terms of reference in our review is employer-provided childcare and I think we can do more there because the benefit that you gain through the tax system is only if it is on-site and all employers can't do that."

However, we believe it is unnecessary for the Inquiry to examine extending subs 47(2) to allow “off-site” childcare facilities. *This is because such facilities have always been exempt from FBT under subs 47(2).*

The Federal Court made that clear in its 1998 decision in *Esso*.¹⁶ Moreover, the ATO has been routinely making private rulings granting exempt status for “off-site” childcare facilities.¹⁷

We contend that the *real* issues with the subs 47(2) exemption is that many employers have either struggled to convince the ATO they control the childcare facility they are providing or have been unable to provide childcare facilities jointly with other employers.

Control of childcare facilities

The problem for employers in not being accepted as being in control of their childcare facility arises when a third-party professional childcare operator is engaged to manage the facility. To be granted FBT-exempt status, the employer needs to ensure they comply with stringent requirements demonstrating control when establishing relevant management agreements and site rental agreements, as prescribed by the ATO in Taxation Ruling TR 2000/4, and supply to the ATO all relevant documents and contracts for the ATO’s consideration of any private ruling seeking confirmation of FBT exemption status.¹⁸

Regardless of whether their childcare facility is “on-site” or “off-site”, many employers have failed to obtain FBT-exempt status because the ATO is not convinced they control the facility.¹⁹

Joint venture childcare facilities

The *Esso* case involved a joint venture of three arms-length employers providing a single “off-site” childcare facility. The Federal Court held that *Esso* was entitled to the exemption because the fact that the premises were also leased by Lend Lease and BP for the same purpose did not have the consequence that the premises were not business premises of each of the three employers.²⁰

However, in any instance of more than one employer joining together to provide the one childcare facility, the Court warned that “the issue of whether premises are premises of a particular person involves questions of fact and degree”.²¹ At some point, multiple employers would fail to gain exemption, and any joint venture of more than employers risks not gaining exemption.

¹⁶ *Esso Australia Ltd v FCT* [1998] FCA 1253. Merkel J stated: “Common sense would dictate that in many instances basic requirements for child care facilities may be such that it is inappropriate for the facilities to be located upon the same premises where the other business operations of an employer are conducted.”

¹⁷ See, for example, Private Rulings Nos. 4539, 17951, 44253, 53462, and 60984.

¹⁸ Commissioner of Taxation, *Taxation Ruling TR 2000/4: Fringe benefits tax: meaning of ‘business premises’*, Canberra, 1 March 2000, See, for example, paras 55-60 and 70.

¹⁹ See, for example, Private Rulings Nos. 26780, 40870, 54253, 58801, and 65809.

²⁰ *Esso Australia Ltd v FCT* [1998] FCA 1253, at p 9.

²¹ *Esso Australia Ltd v FCT* [1998] FCA 1253, at p 9.

The reality of employer-provided childcare facilities

The practical outcome of the subs 47(2) exemption is that it is only available to employers of sufficient size to justify establishing a childcare facility on their own. Most employers simply do not have the critical mass of employee need to do so. In addition, satisfying the 'control' aspect of any facility simply in order to obtain FBT exemption can become a deterrent to any employer not wishing to be exposed to the risk and regulatory compliance regime inherent with any childcare facility when the conduct of such a facility is not within the scope of their core business operations.

Subsection 47(8) – priority of childcare access contributions

The purpose of subs 47(8) is to bestow FBT-exempt status on contributions made by employers to approved programs to obtain priority of access for children of employees at a childcare facility. Unfortunately, a Federal Parliamentary inquiry in 2006 found that employers were not using the exemption because it was poorly understood and complicated, as evidenced by a survey conducted of 599 employers which found that not a single employer had taken advantage of it.²²

Even the ATO has acknowledged that it is a difficult process for any employer to be certain a contribution for priority access is exempt from FBT under subs 47(8).²³

FBT-exempt childcare benefits - summary

In summary, the exemption from FBT of certain childcare benefits is often misunderstood, and for good reason. This includes misunderstanding the limits of the exemptions.

The requirements for FBT exemption are also in practice not easily complied with due to inherent uncertainties, thus obliging employers to seek certainty as to their particular exempt status by the costly (and at times unsuccessful) process of seeking favourable private rulings from the ATO.

In particular, and as has already been noted, the subs 47(2) exemption for childcare facilities is in practice not available to most Australian employers. This has been the case for some period of time. The only other FBT concession, provided by subs 47(8), is simply not being utilised because of its inherent complexity.

As a consequence, and despite calls for it to be reinvigorated, the FBT system's support of childcare has been left languishing for two decades.

²² Parliament of the Commonwealth of Australia, House of Representatives Standing Committee on Family and Human Services, *Balancing Work and Family – Report on the Inquiry into balancing work and family*, Canberra, December 2016, at p 83, para [3.48]. The Committee also stated, at para [3.47], that subs 47(8) had been expanded in 1993 to act as an alternative to subs 47(2) for private sector employers who only required a small number of dedicated places for their employees.

²³ Commissioner of Taxation, *ATO Interpretative Decision ATO ID 2012/58: Fringe Benefits Tax: Exempt Benefits: priority of access to a child care service*, Canberra, 20 June 2012. As per subparas 47(8)(a)(v)-(viii) of the FBT Act, the employer has to determine that the relevant childcare service had a certificate of approval issued pursuant to s 195 of the *A New Tax System (Family Assistance) (Administration) Act 1999* that covered both the time of the employer's contribution and the time that priority of access was granted to the employee's child.

Salary sacrificing and the CCR

As we noted earlier, in 2008 the Government had increased the CCR from 30% to 50% of out-of-pocket childcare costs and the maximum amount of the rebate from \$4,354 to \$7,500 per year. This prompted the Henry Review in 2009 to conclude that:

- The FBT exemption provided a greater level of assistance only for families with very high child care costs on either the top marginal tax rate or second top marginal tax rate.
- The FBT exemption for child care provided a higher rate of assistance for taxpayers earning over \$180,000 and incurring child care costs over \$16,727 (\$64.33 per day in full-time care).
- Taxpayers with incomes lower than \$180,000 would have needed to be incurring costs in excess of \$19,691 to receive a higher rate of assistance from the FBT exemption although that figure is accurate only for those taxpayers with incomes close to \$180,000 because as a taxpayer's income begins to fall below \$180,000, any benefit from the FBT exemption falls exponentially due to lower marginal tax rates and higher entitlement to the means tested CCB.

MMSG agrees that the increase in the CCR in 2008 meant that it was *potentially* no longer viable for employees earning a high income to salary sacrifice their childcare costs. However, in our view the Henry Review was incorrect to equate salary sacrificing as being only permissible in respect of childcare being provided by the employer and only if that childcare constituted an exempt fringe benefit.

This is because the ATO also accepts salary sacrificing arrangements for childcare that is *not* provided by the employer, and this is on the assumption that the employer pays a childcare liability incurred by the parent and is thus subject to FBT as it represents an expense payment fringe benefit.²⁴ In fact, the ATO's policy on acceptable salary sacrificing arrangements is predicated on the assumption they relate to expense payment fringe benefits and not on residual benefits as required under s 47(2).²⁵

Thus, the net result of a parent salary sacrificing the costs of childcare provided by their employer will either be:

- a) the employer is exempt from FBT but the employee is not entitled to the CCB/CCR; or
- b) the employer is not exempt from FBT but the employee is entitled to the CCB/CCR.

The determining factor as to which outcome will apply in any given situation will usually be the exact terms of the particular salary sacrifice arrangement as to whether or not the parent retains the liability to the childcare fees. The employer's FBT status flows from the same thing. MMSG submits that apart from being confusing for parents, it is

²⁴ See, for example, Edited Version of Private Ruling Authorisation Number 46314 and Edited Version of Private Ruling Authorisation Number 1011314748023.

²⁵ Commissioner of Taxation, *Taxation Ruling TR 2001/10: Income Tax: fringe benefits tax and superannuation guarantee: salary sacrifice arrangements*, Canberra, 10 October 2001, at paras 19-20.

not justifiable to elevate differing outcomes under the transfer system and the tax system in this manner.

In addition, it would appear that the Henry Review based its conclusions on the unstated assumption that employers only provide childcare facilities to employees *on a full-cost recovery basis*, but as the earlier discussion under the heading [Market research into employers and childcare](#) demonstrates, this is simply not the case.

Tipping point

Despite the issues arising from the Henry Review equating salary sacrificing with exempt employer-provided childcare, the income level of \$180,000 referred to by the Review relates to a ‘tipping point’. This is the point at which the net cash outcome of a choice to salary sacrifice the cost of childcare becomes greater than a choice to pay for childcare out of after-tax salary instead and claim entitlements to the CCB/CCR. The figure of \$180,000 cited by the Henry Review is assumed to relate to a single parent income, but again this was unstated.

The tipping point’s relevance is that the perception prevails that parents earning incomes above it obtain “a greater level of assistance” than the CCR by virtue of salary sacrificing the full cost of employer-provided FBT-exempt childcare, but that this group of taxpayers is small.²⁶

Modelling performed for MMSG by PwC for the purposes of this submission suggests the following alternate income ‘tipping points’:

Tipping points for family and single incomes

Family Type	Tipping Point
Couple Family, 70:30 income split, children aged 2 and 8, one child in care	\$144,000
Couple Family, 70:30 income split, children aged 2 and 4, both children in care	\$134,000
Single parent, children aged 2 and 8, one child in care	\$140,000
Single parent, children aged 2 and 4, both children in care	\$130,000

Those thresholds were based by PwC on childcare usage of 5 days per week (50 hours per week), 48 weeks per year at costs slightly above the average cost in NSW of \$8.50 per hour.

However, metropolitan childcare costs, particularly in Sydney, can be in the range of \$120 to \$160 per day per child and more, depending on the suburb and the provider, and therefore the gap between the maximum CCR amount of \$7,500 and total childcare costs is increasing for a lot of parents.²⁷

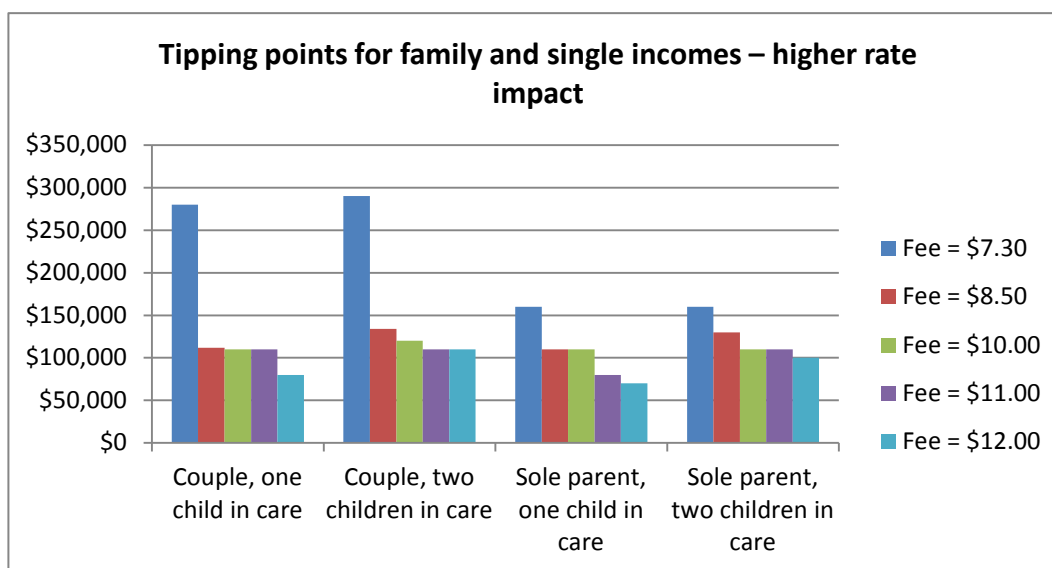
Fees for childcare are edging towards \$170 per day.”

Source: *Sydney Morning Herald*, 9 February 2014

²⁶ See, for example, Deborah Brennan and Elizabeth Adamson, fn 12, at p 15.

²⁷ For example, Goodstart Early Learning’s fees as at 1 January 2014 included \$137 per day at Bondi Junction, \$128 per day at North Sydney, and \$122 per day at West Pymble); whilst Only About Children’s fees range from \$150-\$160 per day at many of their Sydney centres including Cammeray, Mosman, and the Sydney CBD. See also Dr Madeleine Mattarozzi Laming, President, Australian Federation of Graduate Women, *Submission to the Productivity Commission’s Inquiry into Childcare*

Thus, PwC's modelling shows the tipping points for such high levels of childcare fees are between \$75,000 and \$100,000:



Most employees do not salary sacrifice their child care costs, either preferring to incur them on an after-tax basis given the maximum CCR amount potentially payable or because their employer is not providing childcare facilities on a salary-sacrifice basis. More likely, however, as the following discussions demonstrate, the employer is simply not providing childcare facilities or support of any kind.

Recommendations in detail

The focus of MMSG's submission is the role played by the transfer system and the tax system in the support of childcare in Australia, and the dysfunctional connections between the two. The discussions above highlight specific issues that inhibit childcare support and therefore participation by parents.

The recommendations made by MMSG and discussed below are designed to overcome those problems. They are neither novel nor new, and indeed are variously supported by other organisations and reviews, including other submissions to the Inquiry. Above all, MMSG's recommendations are intended to enhance the childcare choices available to Australian families, improve the level of participation of women in the workforce, and parents generally, whilst at the same time provide greater encouragement for employers to provide childcare benefits to their employees.

Merge CCB and CCR

MMSG recommends that the CCB and the CCR be merged or replaced with a single support payment. This will overcome the complexities and confusion surrounding the two existing transfer payments discussed earlier in our submission, be administratively

and *Early Childhood Learning*, date unknown, (Submission No. 417): "The ... [CCR] ... provides for up to \$7,500 per year in child care costs, but child care fees are in excess of \$120 a day per child, ie \$38,800 for a full-time working year of 48 weeks in most metropolitan centres"; Alexandra Smith and Amy McNeillage, "Private schools cheaper than childcare", *The Sydney Morning Herald*, 9 February 2014.

easier to process, monitor and control, and make transfer entitlements more accessible to those parents currently entitled to receive benefits but not currently claiming them.

A merged CCB/CCR system would be better targeted to support families in need, mainly disadvantaged families and families deriving low incomes. A single support payment would be more accessible and streamlined, and thus more efficiently directed, both in terms of funds and timing.

This proposal was originally recommended by the Henry Review.²⁸ As concluded by the SPRC on behalf of ECA's submission to the Inquiry, a single support payment such as envisaged by the Henry Review

"would improve the simplicity and transparency of funding for parents and providers alike. It would end the anomaly where parents who rely predominantly on CCB are constrained by an *hourly* cap ... while higher income families dependant on CCR face an *annual* cap and the majority of parents who rely on both CCB and CCR face a confusing mix of *both* annual and hourly caps."²⁹

MMSG also recommends that the amount of the combined benefit be staggered according to single/family income, with greater support being given to low income earners. This was also originally recommended by the Henry Review.³⁰

MMSG notes that apart from the support of ECA, the concept of a merged CCB/CCR payment has also been advocated by some of the largest operators of childcare centres in Australia. For example:

- **Goodstart Early Learning** recommended that all transfer payments in support of childcare be "combined into a single payment to make childcare assistance simpler and more transparent" and that whilst such assistance should be available to all families, more should be given to low- and middle-income families.³¹
- **Guardian Early Learning Group** recommended that the CCB and the CCR be merged into one benefit and that the administrative savings be re-allocated to increased parent funding.³²

²⁸ Henry Review, fn 3, Part 2, Chapter F4-1.

²⁹ Deborah Brennan and Elizabeth Adamson, fn 12, at p 4.

³⁰ Henry Review, fn 3, Part 2, Chapter F4-1: "To facilitate workforce participation and improve early childhood development, parents and children in different circumstances will require different amounts of assistance. For low-income families, assistance with the cost of child care plays a significant role in facilitating workforce participation, a key factor for some families in breaking out of the cycle of poverty. This suggests that relatively more assistance should be provided to families with lower incomes. Even at higher income levels, however, the tax and transfer system impacts on the benefits of working relative to the benefits of not working (including the choice to care for children at home). The current system includes a number of biases against paid work because of the taxation of wage income, the removal of benefits as income increases and the availability of government payments as a substitute for paid work. The combination of these objectives suggests 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."

³¹ Goodstart Early Learning, *Submission to the Productivity Commission Inquiry into Child Care and Early Childhood Learning*, 3 February 2014 (Submission No. 395), at p 90.

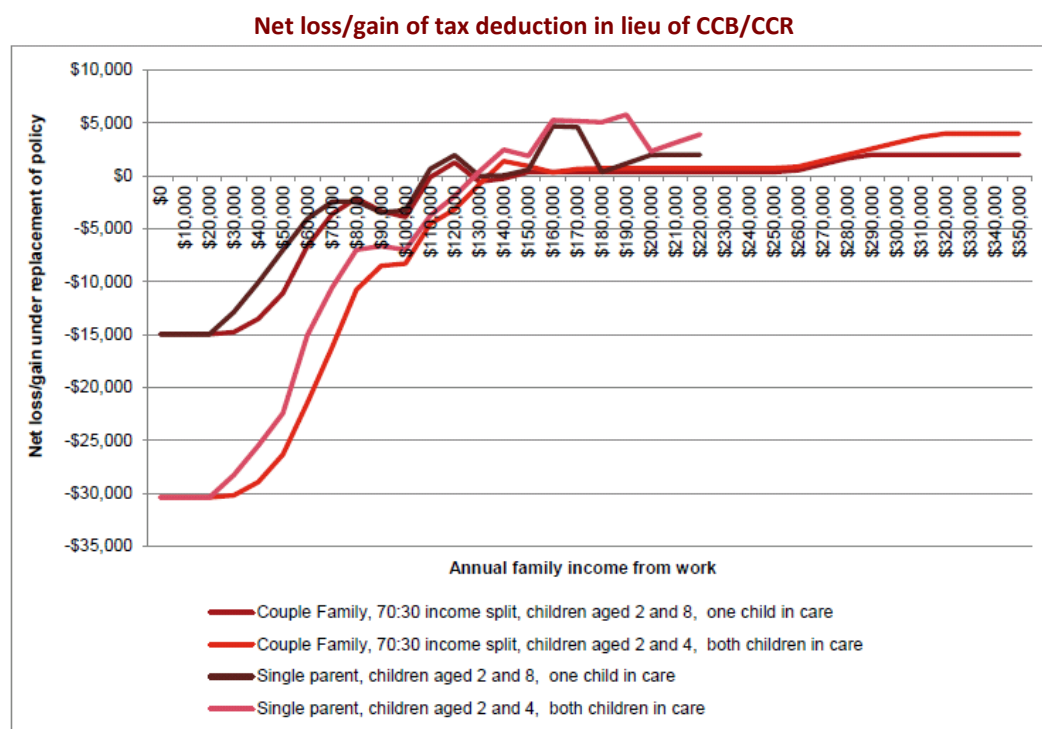
³² Guardian Early Learning Group, *Submission to the Productivity Commission Inquiry into Child Care and Early Childhood Learning*, 3 February 2014 (Submission No. 274), at p 3.

Option of tax deduction for childcare fees

MMSG recommends that parents be given the **option** of claiming an income tax deduction for childcare fees **or** claiming a combined CCB/CCR entitlement, and that consideration be given to extending deductibility to all forms of registered childcare, including home care arrangements.

Providing parents with the option of claiming a tax deduction in lieu of claiming a combined CCB/CCR entitlement has the direct benefit of enhancing their childcare choices. In particular, parents would be able to choose the type of Government support (ie transfer system or tax system) that best accommodates their financial circumstances and their specific childcare needs.

In the absence of reforms to the CCB/CCR system, those choices would to a large degree be influenced by the tipping points we discussed at page 15 and, as the modelling performed by PwC has demonstrated in the graph below, the net gains to parents earning incomes above those points and opting to claim tax deductions are at reasonable levels:



As far as we are aware, all arguments so far raised against allowing parents to claim an income tax deduction in respect of childcare costs have been targeting the suggestion that the tax system, via tax deductibility, *replace* the transfer system in supporting childcare.³³

³³ See, for example, Guardian Early Learning Group, fn 32, at p 4, and Henry Review, fn 3, Part 2, Chapter F4-1: "Providing assistance as a tax deduction would not always assist low-income families, as many are not taxpayers ... For low-income families, assistance therefore needs to be provided as a transfer payment."

However, MMSG is **not** recommending replacing the current CCB/CCR system with an entitlement to an income tax deduction, but is instead recommending that parents be given the *option* of claiming *either* the (merged) CCB/CCR *or* an income tax deduction in respect of a child's childcare costs.

By creating this option low income families, and to a lesser extent middle income families, will not be disadvantaged in terms of having no real income tax liabilities to be offset by a deduction. Reducing taxable income by claiming a tax deduction for childcare costs *prima facie* increases potential benefit entitlements, and thus should be in lieu of those benefits.

Administration considerations of tax deduction for childcare fees

Providing parents with the option of claiming an income tax deduction for childcare costs would also have the effect of invoking the 'otherwise deductible' rule for FBT purposes. This would essentially mean that employers would not be liable to FBT for any childcare payments made on behalf of employees who would otherwise have been entitled to claim an income tax deduction for those fees. This outcome would obviate all the current issues relating to employers seeking to come within the terms of subs 47(8) of the FBT Act (discussed above) and overcome a lot of the disincentive associated with subs 47(2) and the need for employers to have a critical mass of employees eligible for childcare support before being entitled to exemption under that provision.

The option of claiming a tax deduction for childcare fees is sometimes criticised because it is perceived to be disadvantageous to parents in terms of cash flow. Transfer payments are made fortnightly whereas tax deductions are claimed annually. However, the ATO has a policy of allowing PAYG variations in these types of situations, thereby effectively allowing parents the benefit of a tax deduction with each salary or wage payment. Alternatively, employees can be allowed to salary sacrifice their childcare fees in lieu of a formal tax deduction – the PAYG effect is the same. Salary sacrifice arrangements are now common place in the Australian workplace. A number of employers administer their salary packaging arrangements in-house, whilst many others elect to outsource their administration arrangements to external providers.

Support for tax deduction for childcare fees

MMSG notes that the proposal to allow parents the option of claiming an income tax deduction for childcare fees in lieu of receiving transfer payments was first recommended in 2006 by the House of Representatives Standing Committee on Family and Human Services as one of the outcomes of its lengthy inquiry into balancing work and family.³⁴

We also note that tax deductibility of childcare fees has been advocated by the Tax Institute on two recent occasions. Firstly, in February 2013, the Institute submitted to the Treasurer that

“[Tax] deductibility of child-care deserves careful consideration and study, both from a feasibility perspective, as well as the potential resulting increase in the nation's productivity. Tax deductibility of child-care will allow greater use of the

³⁴ Parliament of the Commonwealth of Australia, House of Representatives Standing Committee on Family and Human Services, fn 22, Recommendations 16 and 17, at pp xxv and xxvi.

market over direct Government intervention and will provide direct benefits rather than child care system-dependent outcomes.”³⁵

The second occasion was the Tax Institute’s submission to the Inquiry, where it was argued that

“[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.”³⁶

We also note that the Tax Institute’s submission to the Inquiry that tax deductibility “would need to be supplemented with means-tested access to the [CCR], to ensure that women in lower marginal tax brackets who cannot benefit as greatly from deductibility of child care are also appropriately supported.”³⁷

Lastly, MMSG notes that The Institute of Chartered Accountants in Australia’s submission to the Inquiry stated:

“The Institute recommends the Inquiry considers the current financial assistance for childcare including ‘in-home care’ as well as considering other alternatives such as the possibility of making childcare tax deductible.”³⁸

Alternate recommendation – reform FBT exemptions

As an alternative to allowing parents the option of claiming an income tax deduction for childcare costs, MMSG recommends that subs 47(2) and subs 47(8) be substantively amended or replaced to lower the barriers against employers seeking to provide FBT-exempt childcare facilities or support to employees.

The 2006 inquiry by the House of Representatives Standing Committee on Family and Human Services recommended that FBT “be removed from all childcare, so that all or any childcare provision made by employers to assist employees is exempt, inclusive of salary sacrificing arrangements for child care.”³⁹ The recommendation had bipartisan political support, and this has continued to this day.⁴⁰ In this regard, MMSG supports the approach adopted by the Australian Chamber of Commerce and Industry in its

³⁵ The Tax Institute, *2013-14 Federal Budget Submission*, 13 February 2013.

³⁶ The Tax Institute, *Submission to the Productivity Commission Inquiry into Child Care and Early Childhood Learning*, 3 February 2014 (Submission No. 166), at p 3.

³⁷ The Tax Institute, fn 36.

³⁸ Institute of Chartered Accountants in Australia, *Submission to the Productivity Commission Inquiry into Child Care and Early Childhood Learning*, 3 February 2014 (Submission No. 369), at p 3.

³⁹ Parliament of the Commonwealth of Australia, House of Representatives Standing Committee on Family and Human Services, fn 22, Recommendations 16 and 17, at p xxv.

⁴⁰ The Labor members of the Committee agreed with the recommendation of the majority that the FBT exemptions be overhauled and extended: Parliament of the Commonwealth of Australia, House of Representatives Standing Committee on Family and Human Services, fn 22, at pp 301-2. See also Kate Ellis, Shadow Minister for Early Childhood, fn 14.

submission to the Inquiry that all childcare paid for by employers should be exempt from FBT.⁴¹

MMSG also notes that the Australian Industry Group's submission to the Inquiry recommended that consideration be given to extending the FBT exemption to allow more joint venture employer childcare facilities.⁴² We support that recommendation as it would serve to lower the barriers against employers seeking to assist employees with childcare.

Specifically, MMSG believes that if a specified number of employers, for example five, located in the same area wished to join together to mutually provide a childcare facility for their employees, each of those employers should be entitled to an FBT exemption. Such an amendment should by necessity dispense with the current 'control' requirement and thus allow joint venture facilities to be managed and operated by professional childcare operators.

Summary

The McMillan Shakespeare Group's submission to the Productivity Commission's Inquiry in childcare and early childhood learning focused on the Treasurer's request that the Commission report on and make recommendations about (among other things):

- a) options for enhancing the choices available to Australian families as to how they receive childcare support, including subsidies, rebates and tax deductions; and
- b) the role and potential for employer-provided childcare.

To that end our submission discussed ongoing issues with the Child Care Benefit and the Child Care Rebate, the fringe benefits tax treatment of employer-supported childcare, and the lack of a cohesive relationship between the transfer system and the tax system as they relate to childcare.

Those discussions were supported by commissioned analysis and research conducted for this submission on behalf of MMSG by PwC and Sweeney Research.

Our recommendations to address identified issues were straightforward – merge the CCB and the CCR or replace them with a single benefit system, and grant Australian parents the option of claiming an income tax deduction in lieu of receiving transfer payments. If the latter was not accepted, we recommended that the FBT legislation be amended to remove the current impediments to employers seeking to provide childcare benefits to employees. Our recommendations are similar to those made by others both prior to the Inquiry and as part of it.

MMSG strongly believes that if enacted, our recommendations would encourage greater workforce participation and employer involvement with childcare.

⁴¹ Australian Chamber of Commerce and Industry, *Submission to the Productivity Commission Inquiry into Child Care and Early Childhood Learning*, February 2014 (Submission No. 324), at pp 9-10.

⁴² Australian Industry Group, *Submission to the Productivity Commission Inquiry into Child Care and Early Childhood Learning*, 3 February 2014 (Submission No. 295), at pp 11-12.

About the McMillan Shakespeare Group

The McMillan Shakespeare Group is Australia's largest salary package and novated lease provider, looking after in excess of 250,000 individual remuneration arrangements on behalf of over 1,200 organisations. We currently have approximately \$4 billion in remuneration benefits under management for the employees of many of Australia's largest public companies and a large range of Federal and State government departments and agencies, statutory authorities, local governments, public benevolent institutions, and public and private hospitals and aged-care operators. These employees are mostly on low and middle income levels. MMSG also controls and remits over \$1 billion per annum in superannuation contributions on behalf of its clients.