Goodstart Early Learning

Response to Tax Discussion Paper

5 June 2015

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1. Introduction

One of the best investments Government can make to boost productivity in the short, medium and long term is in early learning and care. Early learning can deliver a threefold return to the nation through increased workforce participation and tax revenue from women, building human capital to produce a more productive future workforce and addressing vulnerabilities and disadvantage through early intervention.

Goodstart agrees that the tax system needs to support improvements in productivity and encourage workforce participation, however, we would also argue that it is equally important to provide an adequate safety-net that supports participation in quality early learning for all children.

We commend the Government's $3.2B investment in a new childcare subsidy that will help make childcare more affordable for working families from 1 July 2017. We are also keen to continue to work with the Government to ensure that the package provides additional support to vulnerable children with additional needs and to ensure as many children as possible can benefit from two days per week of quality early learning.

In this short submission we address relevant questions from the discussion paper and also note some important principles to consider in the development of the Taxation Green Paper and the interactions with the Federation Green Paper.

We would welcome the opportunity to discuss any of the aspects of this submission.

2. Implications for Labour Supply – the Tax Transfer System

Relevant Discussion Paper Questions:
9. To what extent does taxation affect people's workforce participation decisions?
10. To what extent are the interactions between the tax and transfer system straightforward for the people who deal with both systems?

Tax Transfer System and Workforce Participation

Analysis of OECD countries between 1979 and 2002 showed financial incentives and disincentives determined by tax policies, as well as other factors such as unemployment, education and childcare policies, had a substantial impact on women's labour force participation.[1] Australia's tax and transfer system creates a number of distortions that work against participation in paid work. This is particularly acute for secondary income earners, usually women. At the most basic level, paid work is taxed, while work in the home, leisure, and other activities are not. Beyond this, the means-tested structure of family payments (for example, the Family Tax Benefit and others) and the Low Income Tax Offset mean secondary earners choosing to work or to work more can face high effective marginal tax rates and effective tax rates—well above the highest statutory marginal rate. The financial disincentives seem then, to be strongest for lower income earners. For example, when considering percentage changes in net family income for a family with two children in childcare:

- **Absolute incentives are very low in some circumstances.** For a family at the $40,000 per earner income level, the financial incentive for a secondary earner to move from three to

[1] Schwarz, P. (2012) 'Tax disincentives and female employment in OECD countries', *Journal of European Social Policy*. 22(17).

four working days per week is an increase in household income of around 2 per cent. This small benefit comes at the cost of reduced leisure time and time spent with children.

- **Incentives differ significantly by income.** For a secondary earner at the $150,000 level, the financial incentive to work an extra day never drops below 6 per cent; for secondary earners at the $40,000 or $70,000 levels, the incentive can drop as low as 2 per cent.

The new childcare subsidy announced in the 2015-16 Budget should go some way to addressing the impacts of the cost of childcare for these families. However, when considering broad reforms to the tax transfer system the net impacts are important for particular cohorts that are known to be very sensitive to changes in financial incentives created by the tax transfer system and those cohorts that are least able to change their employment status. Particular cohorts should include:

- Low and middle income sole parent families
- Non-working parents (usually mothers) in sole income low and middle income families
- Parents with disabilities or parents who are carers
- Low income working families with insecure work (ie families where at least one parent is engaged in casual work or has a marginal attachment to the labour market).

The tax transfer system can inadvertently create new barriers to work and increase welfare dependency for some of these vulnerable groups, particularly when considered in the context of a softening labour market. Reforms should be designed to minimise these risks.

Childcare subsidies and workforce participation

One of the major reasons for government involvement in early learning and care subsidies is the role it plays in supporting workforce participation among mothers of young children. Paid employment generates a range of benefits for parents and children, including higher income, greater savings, and the enjoyment and fulfilment derived from work. At the economy-wide level, workforce participation is an important driver of economic growth and activity.

Childcare affordability impacts women's decisions about returning to work and how much they will work. Consequently, the Australian Government makes a significant investment in childcare subsidies and it is one of the simplest levers to adjust within the tax transfer system to address financial disincentives to work. OECD analysis suggests that a 1% change in net childcare prices (ie out of pocket costs) leads to an inverse change in the employment rate of 0.06% and the effect is stronger for low income women.[2]

We commend the Government for committing to improve childcare affordability for working families. When the new childcare reforms commence in July 2017, we expect they will significantly improve the financial incentives for both mothers to return to work and for those already working to work more hours.

Improving childcare affordability is a sound investment. Our own research of over 3,000 parents shows that if childcare issues were addressed 41% of those currently working part-time would look to work more hours, as would 33% of parents not working at all.

Although no detailed modelling has been released, it appears that the additional $3.2B of additional investment will significantly improve the effective marginal tax rates faced by secondary income earners looking to return to work through:

- a higher effective subsidy rate for low and middle income earners
- removing the annual cap on subsidies for families with incomes below $185,000

2 Gong, X. & Breunig, R. (2012) 'Estimating net child care price elasticities of partnered women with pre-school children using a discrete structural labour supply-child care model', Treasury Working Paper

- maintaining assistance and creating an incentive to work full-time or 4 days for secondary income earners in very high income families with a new annual cap of $10,000.

We also welcome the Government's commitment to ensure that children from very low income families can retain some access to early learning by providing 12 hours of subsidy per week for children from families with incomes below $65,000.

In designing the new system it will be important to consider the following matters to ensure as many parents as possible are encouraged to work where they can:

- ensure that it is easy for families to calculate and claim their childcare subsidies
- ensure the system does not create new barriers to casual and seasonal workers who may not be able to secure guaranteed minimum hours each week
- ensure families with changing work patterns do not incur debts
- ensure a wide range of participation, including volunteering is recognised as activity.

Goodstart looks forward to working with the Government to implement the reforms.

3. Fringe Benefit Taxes

Relevant Discussion Paper Questions:
16. To what extent does our fringe benefits tax system strike the right balance between simplicity and fairness? What could be done to improve this?

Abolishing FBT exemptions for childcare has been recommended by several inquiries as a way to address the inequity of providing more tax-payer funded assistance for childcare to very high income earners through salary sacrificing. In principle, we support removing inequities in the system, however abolishing the FBT exemptions would also have the unintended consequence of making staff discounts for childcare liable for FBT which would have a serious negative impact on the ECEC sector. Goodstart believes that it would be better to have a slightly more complex system for FBT that ensures fairness and equity for low income earners rather than making across-the-board changes that disproportionately impact low and middle income earners who benefit from the FBT system now.

For example, recent changes to FBT proposed by the Productivity Commission in its final report would inadvertently render most staff discounts on childcare liable for FBT. Staff discounts for childcare are reasonably common across the sector, both for-profit and not-for-profit, and provide a vital workplace incentive. Within Goodstart, 3,660 of our 13,000 staff enjoy access to staff discounts. The concession is important to the staff, as it allows educators to work in the same centre as their children, improving their work and family balance. The practice also builds commitment of educators to their centre, contributing to lower staff turnover. In what is acknowledged as a low-wage sector, this is an important and valuable incentive to staff. A full explanation of the issues and complexities around possible changes to FBT are outlined in **Attachment A**.

Such a move would have a serious negative impact on the ECEC workforce. Goodstart notes the Not-for-profit Sector Tax Concession Working Group report to Treasury in May 2013[3] recommended a comprehensive approach to the review of FBT concessions for not-for-profit organisations. It would seem sensible that any reform of FBT concessions should be part of a broader package of reforms for the entire not-for-profit sector that have careful consideration to ensure there are no unintended consequences for low and middle income earners.

3 http://www.treasury.gov.au/~/media/Treasury/Access%20to%20Information/Disclosure%20Log/2014/1447/Downloads/PDF/NFP%20Sector%20WG%20Final%20Report.ashx

4. Tax Concessions for the NFP Sector

Relevant Discussion Paper Questions:
47. Are the current tax arrangements for the NFP sector appropriate? Why or why not?
48. To what extent do the tax arrangements for the NFP sector raise particular concerns about competitive advantage compared to the tax arrangements for for-profit organisations?
50. What, if any, changes could be made to the current tax arrangements for the NFP sector that would enable the sector to deliver benefits to the Australian community more efficiently or effectively?

Goodstart is for-purpose, not-for-profit and is one of the nation's largest social enterprises. The tax system and concessions for the NFP sector are critical to ensuring there is adequate support for a strong and effective community sector to support vulnerable children, families and individuals.

The discussion paper notes that some concessions for the NFP sector may be inefficient and may be contributing to unintended consequences such as an uncompetitive advantage. Goodstart does not agree with this assessment and supports maintaining current concessions provided to the NFP sector.

As the discussion paper recognises, the not-for-profit sector delivers wide-ranging benefits to children, the community, the workforce, to governments, and the economy more broadly. We believe the value delivered by not-for-profits far outweighs the concessions provided.

Goodstart would not support proposals to remove existing exemptions and concessions that are critical to maintaining a strong not-for-profit sector and run contrary to long-established taxation and public policy decisions by the Commonwealth, state, and territory governments. The existing concessions are particularly important in the ECEC sector which operates in a mixed market in most local communities. In particular the recent Productivity Commission Inquiry noted that not-for-profit ECEC providers:

- are more likely to be assessed as meeting or exceeding national minimum quality standards than for-profit centres
- are more likely to provide nursery places for children under two years of age (which are in high demand but have a high delivery cost) than for-profit providers
- employ more qualified staff
- provide more places in outer regional and remote areas than for-profit providers within a network
- may cross-subsidise to support services in low-SEIFA areas or regional centres with low occupancy.[4]

As ECEC is a highly regulated low-margin business, a reduction in tax concessions provided to ECEC providers would probably need to be recouped through higher fees to families or through reductions in services.

Goodstart also supports updating of the categories for access to deductible gift recipient (DGR) status. The Productivity Commission and the Not-for-profit Sector Tax Concession Working Group report to Treasury in May 2013 recommended that DGR status should be extended to a broader group of NFPs, in recognition of the fact that NFPs are unable to raise equity other ways.[5]

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[4] Productivity Commission, Final Report, Childcare and Early Childhood Learning, 2014
[5] Productivity Commission, Research Report, Contribution of the Non-Profit Sector, 2010

Goodstart, which does not fit any of the current categories for DGR status but has an ambitious program to support social inclusion, would support this approach. At the very least, we would support a review of the 'education' categories for DGR status to include early childhood education and care. The current definitions have not been reviewed since 1999, and do not reflect current policy settings including the COAG level agreements on a national approach to early childhood education and care.

In terms of other possible changes, Goodstart considers that there is merit in the changes to meal and entertainment expenses announced in the 2015 Budget and we note that this change was also recommended by the Not-for-profit Sector Tax Working Group.

5. State Taxes, Payroll Tax and the GST

Relevant Discussion Paper Questions:
52. What are the relative priorities for state and local tax reform and why? In considering reform opportunities for particular state taxes, what are the broader considerations that need to be taken into account to balance equity, efficiency and transitional costs?

In general, Goodstart does not think the tax treatment of the ECEC sector should be a priority for reform. We believe the system for ECEC services is efficient at the moment, transition costs would potentially be very high and there are other higher priorities for reform for Government to consider.

Payroll Tax

The mixed market in ECEC presents significant challenges and reforms to 'level the playing field' through changes to payroll tax exemptions, as suggested by the recent Productivity Commission Inquiry would be likely to have serious unintended consequences.

In terms of possible reform options, it could be argued the least-distorting approach would be to extend payroll tax exemptions to *all* ECEC providers, both for-profit and not-for-profit. The current policy settings in relation to payroll tax are not nationally consistent, and only a small part of the ECEC sector currently pays payroll tax (privately owned operators owning more than one service). This approach would be consistent with the broader tax treatment of schools and preschools, recognising that since COAG endorsed the National Strategy on Early Childhood in 2009, the early years have been recognised as an important part of the national education effort. **Attachment B** provides further analysis about the ECEC sector and Payroll Tax.

GST

Childcare is currently GST exempt and given the early education benefits for children and direct Government investment via childcare subsidies, Goodstart believes this is appropriate. Broadening the base of the GST to include childcare would have several negative consequences;

- it would increase the cost of childcare for families, potentially increasing financial disincentives to work
- it would increase cost barriers for low income families to access early learning, potentially reducing the school readiness of their children
- it would also increase the cost to government as the key funder of childcare through the childcare subsidy system
- it would create new administrative complexity for services.

6. Reform of the Federation – revenue and investment

Quality early learning is one of the most efficient investments a Government can make. The latest *Going for Growth* report from the OECD confirms that Australia should invest in the early years to secure short and long term productivity gains.[6]

The issues paper for Early Childhood Education notes that the provision of high quality childcare and early learning is in Australia's national interest, and we would argue that a strong not-for-profit presence in the early learning and care sector is also in the national interest.

Goodstart supports the Government's new childcare subsidy noting that it is strongly targeted towards increasing workforce participation. However, ongoing investment by the Commonwealth through the tax transfer system is also necessary to ensure that <u>all</u> children have the opportunity to participate in quality early learning, regardless of where they live or their parents workforce participation status. In particular, the evidence about the benefits of attending a high quality preschool program in the year before schooling is undisputed, yet there is also clear evidence that Australian children from disadvantaged backgrounds who would benefit most from these programs are least likely to attend. As there is significant variation between states in the infrastructure and delivery models for preschool and kindergarten, ongoing investment by the Commonwealth is needed to ensure that every Australian child has the opportunity to access affordable high quality early learning and care programs, including, but not limited to, in the year before school.

We look forward to continuing to work with the Government to secure opportunities to access quality early learning and care for all Australia's children.

[6] OECD, *Going for Growth,* 2014

Attachment A – Fringe Benefits Tax

In an attempt to improve the efficiency and fairness of the FBT system, the recent Productivity Commission Inquiry made a series of recommendations for the childcare sector. However, like many issues raised in the Tax Discussion Paper, changes to FBT are not straight forward and there is a high risk of unintended consequences that would potentially reduce financial incentives to work for low-income earners. In principle, we believe that reforms made to the tax system should ensure that low income workers do not experience higher effective marginal tax rates than they do now.

The summary below outlines the complexities and unintended consequences of what could be considered a relatively straight forward recommendation: abolishing salary sacrificing for childcare for high income earners. The policy objective, to address inequities associated with providing higher levels of government subsidy to very high income earners has merit, however the negative knock-on effects are substantial and far outweigh the limited benefit associated with abolishing salary sacrificing for childcare for high income earners.

Impacts of abolishing FBT concessions for childcare

The Productivity Commission (PC) proposed that not-for-profit providers should lose access to Fringe Benefits Tax (FBT) concessions. As a rebatable employer, this would mean Goodstart would no longer be eligible for the 48 per cent rebate on Fringe Benefits, which is currently capped at approximately $16,000 (2016 $31,177 taxable) of benefits per employee. Few employees access these concessions within Goodstart and the cost to Goodstart of removal of the concessions would be fairly small, in the order of $0.3 to $0.45 million.

However the PC also recommended removal of section 47(2) from the *Fringe Benefits Tax Act 1986*. Goodstart is very concerned about this recommendation, as it would inadvertently render most staff discounts on childcare liable for FBT. Offering discounts for childcare to childcare employees is reasonably common across the sector, both for-profit and not-for-profit, and provides a vital workplace incentive. Within Goodstart, 3,660 of our 13,000 staff enjoy access to staff discounts. The concession is important to the staff, as it allows educators to work in the same centre as their children, improving their work and family balance. The practice also builds commitment of educators to their centre, contributing to lower staff turnover. In what is acknowledged as a low-wage sector, this is an important and valuable incentive to staff.

As outlined in our submission, notwithstanding the current section 47(2) exemption, staff discounts on childcare are classified as an “in-house residual benefit” and are eligible for concessional valuation rule for FBT purposes. Our advice is that removal of section 47(2) would have the effect of rendering the benefit as a taxable fringe benefit. The impact to Goodstart is substantial—based on FY14 figures, Goodstart provides approximately $10.2 million in employee discounts to a total of 3,660 employees. Excluding around 500 employees for whom the benefit is likely to remain outside the FBT net, $9.9 million of benefits would become subject to FBT. Using FY14 discounts, the application of the FBT valuation rules would give rise to taxable Fringe Benefits of $6.9 million or FBT of $6.45 million (before rebate). In addition, bringing the existing level of staff discounts within the FBT net would impact approximately 2,100 employees due to the inclusion of $13.87 million in

Reportable Fringe Benefits on their incomes reported for government benefit purposes, reducing their entitlements to childcare subsidies, family payments, and so forth.

The precise prevalence of this type of arrangement across the sector is unknown, but is expected to be significant, and will likely extend to both not-for-profit and for-profit providers. It should be noted that were this recommendation to be adopted, the impact could not be circumvented by way of contra deals with other providers. It is not possible to estimate the impact on individual employees, as Goodstart does not have visibility over an employee's individual circumstances.

The interactions within the FBT system are complex. While the intention was only to capture salary sacrificing arrangements, this demonstrates a serious unintended consequence that would disproportionately impact low income earners.

Attachment B – Payroll Tax

The exemption for charities from payroll tax was a significant outcome of the payroll tax harmonisation exercise undertaken by COAG in the period 2007-2009. The harmonisation exercise saw states and territories agree to a common approach to payroll tax under eight key topics, including treatment of charities and schools.

Based on the information available, Goodstart considers that only a minority of the sector—possibly as low as 20 per cent—actually pays payroll tax. This is because the charities, schools, state and local government exemptions cover 60 per cent of centres (LDC and preschools). Around half of the remaining 40 per cent of centres that are privately owned are likely to fall below the payroll tax thresholds in each state, as around half of all centres are standalone operations. Table 1 outlines the different thresholds in different states. Further, even if payroll tax exemptions for not-for-profits were removed, there would continue to be anomalies and distortions in the market:

- Standalone operators, both for-profit and not-for-profit, would continue to be exempt, covering around half of all centres.
- Preschools would continue to be exempt as part of the schools exemption, providing a further market distortion for LDC centres providing preschool programs.
- State and local government services could continue to be exempt under their separate exemptions.

Table 1: Payroll Tax Thresholds[7]

Jurisdiction	Payroll Threshold	Equivalent sized LDC centre (est. no places)
NSW	$750,000	65
Vic	$550,000	50
Qld	$1,100,000	90
WA	$800,000	70
SA	$600,000	55
Tas	$1,250,000	105
ACT	$1,850,000	155
NT	$1,500,000	125

As only a small part of the ECEC sector currently pays payroll tax (privately owned operators owning more than one service), it could be argued the least-distorting approach would be to extend payroll tax exemptions to all ECEC providers, both for-profit and not-for-profit.

This would be consistent with the broader tax treatment of schools and preschools, recognising that since COAG endorsed the National Strategy on Early Childhood in 2009, the early years have been recognised as an important part of the national education effort.

7 http://www.payrolltax.gov.au/harmonisation/payroll-tax-rates-and-thresholds

Behind Goodstart

Goodstart was created by a partnership of organisations who saw the potential of early learning to transform Australia. They wanted to address one of the key sources of many future problems—poor early childhood experiences.

From alcoholism to drug abuse and homelessness, many adult conditions can be traced to early childhood experiences.
It made perfect sense for these groups to pool their energy and invest in early learning to fix the root cause of so many social problems.

The Benevolent Society is Australia's first charity—an independent, non–religious, non–profit organisation with nearly 200 years' experience of driving positive social change. It makes a difference every day by helping people to break down the barriers that prevent them from participating fully in society. Its goal is to improve quality of life for all Australians by building connected, inclusive communities where everyone feels they belong.

The Brotherhood of St Laurence began during the Great Depression, as the vision and creation of Father Gerard Tucker, a man who combined his Christian faith with a fierce determination to end social injustice.

Based in Melbourne, but with a national profile, the Brotherhood continues to work for an Australia free of poverty.

The organisation undertakes research, develop and deliver services, and engage in advocacy. The Brotherhood's aim is to address unmet needs in innovative ways and translate learning from research and services into new policies, new programs and practices that can be implemented by government and others.

Mission Australia is a Christian community service organisation that has been transforming the lives of Australians in need for more than 150 years.

Today its 550 community and employment services assist more than 300,000 people nationwide by providing a hand up, a way forward and hope for the future.

The organisation strengthens families, empowers youth, strives to solve homelessness and provides employment solutions. Working with government, corporate Australia, churches and the wider community, Mission Australia aims to create a fairer Australia for all.

Social Ventures Australia (SVA) was established in 2002 as an independent non–profit organisation. SVA invests in social change by helping increase the impact and build the sustainability of those in the social sector.

SVA's investments are focused on high–potential organisations that are fostering solutions to some of the most pressing challenges facing our community. It provides funding and strategic support to carefully selected non–profit partners, as well as offering consulting services to the social sector more broadly.