

Tax Scales and No Returns

Dr Carol J Steiner

June 2009

Executive Summary

Embracing the Government's desire for root and branch change to the tax system, this submission offers a new approach to tax scales and rates designed to encourage low- and middle-income earners to work more and earn more. It also suggests how to do away with tax returns for PAYG wage and salary earners. Finally, it suggests a major change to capital gains tax. One over-arching result of what I am suggesting is that tens of millions of dollars of administrative costs of the tax system can be saved.

My tax scales are based on multiples of the annual minimum wage (AMW), currently \$28,276. These multiples are more understandable than the current ranges, which are uneven and bear little relationship to what kind of income most people are earning these days. Using AMW allows us to gauge where we stand in relation to the lowest paid workers in our society and they allow us to have sensible classifications of income so we are all talking about the same thing when we talk about low income or high income. Once out of the middle-income bracket, your tax rate is determined by your last dollar earned and you pay that rate on every dollar of your income – no tax-free threshold and no marginal rates for higher income earners.

There is still a tax-free threshold for low-income earners but it is huge. I also retain it for middle-income earners to encourage them to pursue higher wages and more work. The middle-income band covers everyone on average weekly wages, most tradespeople and miners, most public servants and academics, pink- and blue-collar workers and clerks to middle-managers.

AMW = \$28,276	Taxable Income	Rate	Classification
Less than AMW	\$1-28,275	0%	Low Income
1 to 4 Times AMW	\$28,276-\$113,104	30%	Middle Income
Up to 7 Times AMW	1-\$197,950	32%	High Income
7 to 10 Times AMW	1-\$282,760	36%	Very High Income
<10 Times AMW	1-\$282,760+	40%	Extreme Income

The wide income bands make it unlikely workers will shift brackets, so concerns about bitsy deductions, not reporting income and avoiding the next bracket are removed. This makes it possible to do away with tax returns for PAYG workers, while also getting rid of certain offsets, rebates and work-related deductions. This produces massive administrative savings in policing the tax system.

My tax rates give low- and middle-income earners lower taxes while higher and extreme income earners pay only a bit more. Because of the big tax-free threshold, taxes for middle-income earners are quite low despite the seemingly high rate.

Regarding capital gains tax, I suggest that the discount be aligned with sound investment advice, which says equity and property investments should be long-term. Therefore, I recommend that the discount be phased in in 10% increments only after five years, reaching 50% at ten years. I recommend a transitional year to allow people to dispose of assets they do not wish to hold long term or that they bought with the intention of selling as soon as their capital gains tax discount applied.

AVERAGE Income	TAX New	RATES Current
>\$ 28,276	0%	10.5%
\$ 28,276	>2%	12%
\$ 56,552	15%	17%
\$ 84,828	20%	23%
\$113,105	30%	27%
\$141,380	32%	28%
\$169,656	32%	30.6%
\$197,932	32%	32%
\$226,208	36%	34%
\$254,484	36%	35%
\$282,760	36%	36%
<\$311,036	40%	37%

If the ATO crunches some numbers on my proposed changes, giving appropriate weight to the savings in administrative costs and also considering some changes I propose to family support benefits (see Appendix), I am pretty confident the result will be economically and socially worthwhile.

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The aims of this submission are (1) to make taxes and benefits more equitable and reasonable for working families and (2) to reduce the number of PAYG workers filing tax returns.

Three problems with the personal income tax system are addressed in this submission.

- **The clarity problem:** The tax system has become too complicated, cumbersome and incomprehensible for ordinary PAYG taxpayers. Dozens of different thresholds, income limits, sliding scales, deductions, rebates and offsets have forced millions of ordinary PAYG taxpayers to keep tedious and petty records and to pay accountants hundreds of dollars to do their taxes to avoid overpaying or underpaying.
- **The rationality problem:** Myriad ad hoc adjustments to the tax system have produced an irrational mess of mixed messages, ideological quirks and counter-productive rules, most that either discourage or penalise employment participation. Many of these problems relate to family and child care benefits, which I recommend be completely removed from the tax system and tax returns. Still, the tax system itself has inequities. For example, how equitable and work-friendly is it for a low-income person to find their marginal tax rate increases by 100% when they earn more than a mere \$35,000, while an executive faces only a 27% increase in his marginal tax rate when his salary jumps from \$80,000 to \$180,000?
- **The efficiency problem:** Hundreds, maybe thousands of ATO and Family Assistance Office staff and ever more expensive and sophisticated computer systems are required to manage the complexity of thresholds, limits, scales, deductions, rebates and offsets that now make up the tax and benefit system. And how much is spent from every budget to administer the myriad cents-in-a-dollar reductions in tax benefits to millions of taxpayers who probably need every cent? How can sweating the small stuff be efficient and worthwhile? This is why I suggest most of the tax benefit stuff needs to move out of the tax system and off tax returns.

The overriding principle of my submission is that we should focus more on delivering tax benefits and incentives to lower and middle income workers to encourage them to work or work more, while excluding people who will not work (and pay taxes) or who are fully capable of supporting themselves and their families without taxpayer subsidy.

I suggest the notion of "low income" should be anyone earning less than the Annual Minimum Wage (**AMW**), currently \$28,276. "Middle income" should be one to four times AMW, currently \$28,276 to \$113,104 pa, a reasonable income level that encompasses all workers on average weekly earnings plus the majority of public servants, academics, trades people and miners. I have incorporated these ranges into revised tax scales.

In a separate submission to the new Minister for Employment Participation (Mr Arbib), I recommend a lot of changes to eligibility for Family Tax Benefits A and B, the Child Care Benefit and the Child Care Tax Rebate based on these income scales, to encourage people to work. I have attached a copy of that submission as an appendix to this one in case you'd like to see how nicely these income ranges can mesh into the benefit system as well.

A Revolutionary Approach to Tax Scales

Australian tax scales are constructed along international conventions, but there is no reason why we must stick to those conventions if we want to be truly innovative and effective in encouraging more people to work, reducing the tax burden on the poor and simplifying the way tax is calculated and paid.

Current scales are based on the idea that it is equitable for everyone to pay the same percentage of tax on the same amount of income and higher income people only pay more because they earn more, until they slip into a higher income band on the tax scales. This may be equitable, but it is not as progressive as it seems because a worker earning \$75,000 is paying the same percentage of their income in tax as is the worker barely clearing minimum wage on \$30,001. *Following overseas trends to fewer bands and fewer rates can only mean less progressive tax.*

In the interests of genuinely progressive tax (not rates but tax paid on every dollar earned), I suggest a different kind of scale. On this scale, your top dollar determines your band, your percentage tax rate and the amount of income to which the rate applies. There are no marginal rates, so when a tax rate applies or increases, it applies to the whole amount earned.

My tax scales use the annual minimum wage (AMW) as the basic unit. Any increments on the scale are multiples of that wage. The AMW only changes once a year in July and is widely publicised, so taxpayers can be informed. The AMW is a good basis for tax scales and benefit entitlements because it represents the income of the most disadvantaged of Australian workers and what should be the minimum aspirational target for all Australians capable of work. Basing taxes and benefits on the AMW ensures that as goes the lowest earners, so goes the nation.

Also, multiples of the AMW make clear to everyone where they stand in relation to their poorest colleagues, so we don't hear from people like a family of three on \$176,000 pa who complained to *The Australian* that they are not well off and were disadvantaged by the last budget! Using multiples of the AMW could allow us to create more reasonable definitions of clichés like working families, the disadvantaged, the middle class and high-income earners.

RECOMMENDATION 1: New Tax Scales

AMW = \$28,276	Taxable Income	Tax Rate	Classification
Less than AMW	\$1-28,275	0%	Low Income
AMW up to 4 Times AMW	\$28,276-\$113,104	30%	Middle Income
Up to 7 Times AMW	1-\$197,950	32%	High Income
7 to 10 Times AMW	1-\$282,760	36%	Very High Income
More than 10 Times AMW	1-\$282,760+	40%	Extreme Income

On my scales, once taxpayers move outside the middle-income band, they no longer have a tax-free threshold. A tax-free threshold was probably initially designed to keep very low-income people out of the tax system, but now it is so low, it has become a pointless perk for everyone who earns more than this meagre amount. My tax-free threshold is huge and available only to middle-income workers, to encourage them to rise above the minimum wage and to aspire to a better income without facing a tax penalty. Once they attain a high income (more than \$113,104), they no longer need this inducement, so I've eliminated it for them. This allows me to keep tax rates quite close.

Based on 2009 average tax rates calculated by Tax Watch, on my scales everyone in the middle-income band pays about \$1100-\$3400 less tax than on the current scale. People in the high-income band pay between \$2400 and \$4200 more tax than on the current scales except people right on the cusp who pay the same tax on both scales. People in the very high income band pay between \$2500 and \$4500 more tax, except right on the cusp where tax is the same. People in the extreme income band pay at least \$9300 more than on the current scales.

AVERAGE TAX RATES		
Top Income	My Scales	Current Scales
\$28,276	>2%	12%
\$56,552	15%	17%
\$84,828	20%	23%
\$113,105	30%	27%
\$141,380	32%	28%
\$169,656	32%	30.6%
\$197,932	32%	32%
\$226,208	36%	34%
\$254,484	36%	35%
\$282,760	36%	36%
<\$311,036	40%	37%

The extra taxes on high to extreme income earners will go a long way to funding the lower taxes on working families. In my proposal on family support payments, I also recommend reducing the amount of Family Tax Benefit A for people in the middle-income band, saving around \$2000 per child, to offset the revenue losses of my tax scale in the middle-income band. My scale leaves working families better off and only minimally increases the average tax rate of high, very high and extreme income earners. That's a very progressively equitable outcome.

This approach to tax scales eliminates a difficult political problem that arises when governments try to reduce taxes. The current tax scales pass on to highest income earners any tax reductions given to lower income earners. This creates a perception of inequity when a tax cut gives a low-income earner a few dollars and a high-income earner hundreds of dollars. This inequity also makes it too expensive to cut tax rates and leads instead to means-tested offsets and rebates to exclude high-income earners from tax reductions. This creates more complexity, more administrative costs and more confusion for taxpayers.

Eliminating Some Tax Returns

As Treasury conducts its tax inquiry, perhaps it is worth thinking about a complete revision of the personal tax system to make paying taxes on income paid by employers as simple, painless and predictable as possible. To do this, I recommend that we distinguish between wage and salary income and all other income. This allows us to do away with tax returns for most wage and salary earners in the PAYG system.

RECOMMENDATION 2: No tax return be required for income from wages and salary alone so long as full PAYG deductions are made by the employer.

My wide bands of income per tax rate should make this quite simple for workers, employers and the ATO to manage. Most complexity in the current PAYG and personal tax system now comes from the big changes in tax rates at the margins of quite narrow income bands. Consequently, wage and salary earners put a lot of effort and tax fiddling into keeping themselves out of higher tax brackets, which are actually quite commonly earned amounts (\$35,000, \$80,000, <\$80,000). As a result, the ATO has to do all kinds of monitoring, investigating and enforcement as millions of ordinary Australians try to diddle their taxes.

My bands mean very few wage and salary workers will face bracket shifting. The ATO would only have to link up PAYG systems to catch all income relevant to a taxpayer. Employers, financial institutions and government benefit systems would be required to produce compatible PAYG reports to the ATO. And, as I later propose, all work-related deductions would be eliminated for wage and salary earners. The ATO computers could then determine whether enough tax had been withheld for each worker by totalling their PAYG Summaries. They could send a bill for any underpayment, but this would be rare. There would be no tax refunds.

Wage and salary earners who have income from other sources would still be required to file a return. I'd call it a Business and Investment Return. It would be for people who earn money outside the PAYG system, and from business or investments (including superannuation and interest). Wage earners who need to use this return can include their wages on it as well. All income would be combined to determine tax rates, but losses from non-wage income could not be offset against wage income.

If income from other sources means inadequate tax has been withheld through the PAYG system, the reconciliation could happen as it does now. But regulation should put the onus on employees to advise employers to withhold at a higher tax rate if the employees know their wages plus other income will put them on a higher tax rate. This is important because the higher tax rate applies to all their income, not just their marginal income, so they could delay paying considerable PAYG tax if they aren't honest about their expected income.

For example if a worker on \$100,000 knows he is likely to receive \$25,000 in rental income in the same tax year, he would have to advise his employer to deduct tax at the high-income rate rather than at the middle-income rate. The penalty for failing to advise an employer to withhold tax at a higher rate should be a 50% penalty tax on the unreported extra income.

I don't mean this regulation to trap people who may have unexpectedly higher income from time to time. But people do know in advance about rental income, likely consulting or director fees, upcoming asset sales, maturing investments, etc. They need to be prevented from minimising PAYG contributions to delay when their taxes flow to the ATO.

To get rid of tax returns for PAYG taxpayers, a different approach to some forms of income and working expenses is required. Income will need to be in the PAYG system while work-related deductions must be eliminated. I deal with these according to their place on the current tax return.

Allowances: Two types of allowances should be treated differently: allowances for qualifications and risks, and allowances that cover expenses.

RECOMMENDATION 3: Allowances for qualifications and risks be included in the PAYG Payment Summary and taxed accordingly, as I think they are now.

To enable wage earners receiving expense-related allowances to avoid completing a tax return, the onus must be placed on employers to confirm that these allowances are fully and appropriately expended. They must collect and retain receipts and/or diaries. They report the allowances as fully expended on their PAYG Payment Summary for the employee. Any allowances they cannot certify as fully expended must be reported as wages with appropriate PAYG tax withheld.

RECOMMENDATION 4: Expense-related allowances be tax-deductible for employers only if they verify and certify expenses.

Most companies have (or should have) systems in place to manage reimbursable expenses and all that this approach would require is that those systems be brought to bear on allowances currently managed by recipients instead. Recipients who don't assist in this record keeping will have tax deducted from their allowances.

Commissions: Commissions are regular income, even if amounts vary over a pay period. They should have PAYG deductions made, if they don't already.

RECOMMENDATION 5: Commissions have tax deducted on payment and be reported as income on a PAYG Payment Summary.

RECOMMENDATION 6: Bonuses have tax deducted on payment and be reported as income on a PAYG Payment Summary.

This will ensure that any performance bonuses paid in cash to anyone, but especially to high flyers in finance, have tax withheld on payment. I would also ensure there were no offsetting deductions available and they cannot be offset by losses from somewhere else. You earn it in the PAYG system, you pay tax on it!

The wide income bands per tax rate will make managing the variability of commissions and bonuses easier, but if someone does move into a different tax band as a result of a commission or bonus, the PAYG withholding can collect the extra tax from the wage or commission. As long as workers know this is going to happen, they can plan their finances accordingly.

Earnings and Fees: If people earn income outside the PAYG, they will have to file a tax return as a business, even if they are primarily wage earners, to ensure appropriate tax is paid on this income.

RECOMMENDATION 7: Anyone earning money for work outside the PAYG system be considered a business and be required to complete a Business and Investment Return.

This might encourage some workers who earn extra money or fees on the side to put their income through the PAYG tax system, to avoid the hassle of having to file a return. To make it less desirable to operate in the black economy and to protect workers right to request PAYG withholding of extra earnings or fees,

RECOMMENDATION 8: Anyone paying individuals outside the PAYG system cannot claim deductions for those fees, unless the individual has an ABN.

Tips: Wage earners reliant on tips are likely to be on low incomes anyway, so they deserve to keep what they take, especially in a low-tipping country like Australia. In all likelihood, most tips are under-reported and untraceable, so it is simply inefficient to hassle low-paid workers to pay low tax on low amounts. To allow workers who receive tips to avoid filing a tax return,

RECOMMENDATION 9: Tips be untaxed for wage earners.

If tips for wage earners become untaxed, regulations should be introduced to stop employers claiming some of the tips for themselves or trying to reduce wages on the basis that tips are worth more. Tips for employers or business owners should be reportable and taxable.

Lump Sum Payments on Termination: To allow wage earners to avoid filing a tax return,

RECOMMENDATION 10: Tax be withheld at the employees' current tax rate even if the lump sum pushes the low-income or middle-income earner on to a higher rate.

This will avoid disadvantaging workers who might otherwise move into a higher tax band and still allow them to avoid filing a tax return. To avoid high-income earners rorting this rule by being offered excessive leave and leave loading, it should be available only to people in the low- and middle-income bands. People in other bands should be taxed at the actual rate for the full income received.

Eligible Termination Payments: The rules governing ETPs are too complex to be accommodated in the PAYG system.

RECOMMENDATION 11: Workers receiving an ETP be required to file a Business and Investment Return.

Small employers should not be expected to sort through the complexities of an ETP to produce a proper PAYG deduction. Also an ETP is usually going to end up as an investment anyway. Wage earners can report their wage income on the same Business and Investment Return.

Government Payments, Allowances, Pensions: I cannot see why these are reportable as income. Anyone required to rely on them is not wealthy (at least not after my suggested changes to benefits) and the amount of tax owing would rarely get above the lowest payable tax rate anyway, even under the current system. Reporting them as income seems highly inefficient and pointless. We give them the money and then we take it back.

If wage earners need a few months of Newstart between jobs, why hassle them to get a few dollars back. If a kid gets a job and gets off Youth Allowance or Austudy, why make the kid pay a penalty by taxing part of that income because he got a job that pays enough to face paying taxes. He should get a bonus, not a penalty!

RECOMMENDATION 12: Government payments not be counted as income for workers earning through the PAYG system.

Superannuation Income: This is income from investments. Therefore,

RECOMMENDATION 13: Report superannuation income on a Business and Investment Return.

Other Pensions, Interest, Dividends: These sources are income from investments. Therefore,

RECOMMENDATION 14: Recipients of pension, interest and dividend income not covered by a PAYG Payment Summary or recipients claiming an offset must file a Business and Investment Return.

Attributed Personal Services Income: This is non-wage income. Therefore,

RECOMMENDATION 15: Recipients of attributed personal services income must file a Business and Investment Return.

Supplement Income & Losses: Any such income is non-wage or business or investment related. Therefore,

RECOMMENDATION 16: Recipients of income or losses reported on the Supplement must file a Business and Investment Return.

Work-Related Deductions: To eliminate tax returns for wage earners, work-related deductions would have to cease for wage earners.

RECOMMENDATION 17: Work-related deductions be eliminated for wage earners in the PAYG system.

If the deductions are claimed only to offset allowances, these deductions can be eliminated by the employer assuming responsibility for determining if allowances have been properly expended or withholding tax for them if they haven't been. They will no longer be the individual's responsibility, and we will no longer see the allowances and deductions churning through the tax system for no apparent gain.

Any other deductions for work-related expenses should be eliminated because taxpayers should not subsidise expenses that should be covered by wage earners or their employers. Neither taxpayers nor the economy get any benefit from such subsidies.

- If someone uses their own vehicle to transport their tools or equipment to and from work, why should taxpayers subsidise their car expenses? People who take their laptop or pager home from work for safety don't get a taxpayer subsidy (at least I hope not!). If employees have to travel between sites for their work, then either they should get an allowance from their employer for use of their personal vehicle or if they are doing this for themselves, then they should carry the cost. You don't get a deduction for driving to and from work but you do if you work more than one job or if you carry tools? Where's the logic in that? If the employer won't cover an employee's car expenses, then the worker should refuse to use their car.
- If someone must travel for their job, then the employer should pay for that travel or offer an allowance for it. Why should taxpayers subsidise an employee's meals, taxis or tolls when they are on employer business? Why should taxpayers subsidise someone's travel because they have two jobs or work from home?
- If someone needs special clothing to do a job, that clothing should be provided by the employer or by the worker if they want to do that kind of work and it's the only way they can. Its maintenance should be the responsibility of the worker, perhaps with a subsidy from the employer if special washing or dry-cleaning is required. Why would it be the responsibility of taxpayers to subsidise a uniform when it won't subsidise a black skirt and white blouse a waitress is required to have, even if she'd never wear such a thing herself? Why subsidise laundry of special clothing when no one subsidises the detergent, water or washing machine that cleans what everyone else wears to work? Where's the logic? And what benefit does the taxpayer or the economy get from such subsidies?

- Why should taxpayers subsidise workers' voluntary training or study for self-improvement or advancement when, in most instances, they already heavily subsidise that training or study through government support of training, TAFE, universities and HECS? And why should taxpayers do this for people who are in employment when they don't do so for struggling students who don't have jobs? Self-education should be self-funded or employer-funded.
- If someone chooses or is required to maintain a home office to do their job for an employer, then the costs of that home office should be the responsibility of the worker or the employer. Again, the taxpayer and economy get no benefit from subsidising these costs. Further, the complexity and expense of determining and monitoring these deductions make them inefficient and expensive to grant.

Interest & Dividend Deductions: Wage earners who wish to avoid filing a tax return should organise for PAYG deductions from any interest they earn. If they do this, they will not be able to claim deductions for costs of earning that interest. Alternatively,

RECOMMENDATION 18: Deductions for interest and dividend income can only be claimed by filing a Business and Investment Return.

Gifts or Donations: Wage earners who wish to avoid filing a tax return would lose these deductions. Charities would probably want the ATO to determine how many charity dollars were claimed by wage earners to determine the extent of any losses they might suffer if workers give up this tax deductibility. But I suspect it is mostly the high-income earners, who make gifts and donations to reduce their tax bills, who would be concerned about tax-deductibility. As they are likely to have to complete the Business and Investment Return anyway, they'll still have access to this deduction.

RECOMMENDATION 19: Deductions for gifts or donations can only be claimed by filing a Business and Investment Return.

Supplement Deductions: Any of these likely relate to business or investment. Therefore,

RECOMMENDATION 20: Deductions from the Supplement be claimed on a Business and Investment Return.

These changes would certainly fall into the root-and-branch category of change and therefore are worth serious consideration. The cost savings in reduced ATO staffing and equipment should be substantial. The social dividend of ordinary wage earners not having to do battle with the ATO to save a tax dollar here or there has a value of its own. Finally, my approach is both more equitable and progressive and encourages rather than penalises working and striving.

Capital Gains Tax

According to the Ralph Report that recommended the 50% capital gains tax discount after 12 months, *"The Review's recommendations for capital gains taxation are designed to enliven and invigorate Australian equities markets, to stimulate greater participation by individuals, and to achieve a better allocation of the nation's capital resources."* In light of recent events, one must question whether these were reasonable aims or just rationalisations to make high-value pastimes like building share and property portfolios more profitable for speculators and brokers.

- The equities markets have been so “enlivened and invigorated” by speculators that all logic and sense have been lost, people are wagering on failure and shareholder irrationality, and sound businesses are being undermined while shonky operations produce ridiculous gains.
- Greater participation by ignorant, over-confident mum-and-pop investors has seen hundreds of thousands of amateurs lose their life savings, their retirement funds and their homes and default on huge loans.
- And still the nation’s capital resources are held primarily by a few hundred large institutional investors.
- In addition, housing prices have been grossly inflated by speculators chasing short-term capital gains or tax losses so that housing affordability has become an oxymoron.

The Ralph Report felt it was more important to “free up equity markets” and reduce “lock in” that it felt held investors in “less than optimal positions” than to reward “patient investors.” This was an uncritical and irrational value judgement rather than an evidence-based position. It was based on dubious assumptions driven by lust for “productivity.” It assumed that a lot of “free” trading was better than a little sensible trading, and that investors would hold bad stocks rather than pay modest capital gains tax to be rid of them. In the era of “greed is good,” I guess patient investors were seen as chumps.

To support the capital gains tax discount after 12 months, the Ralph Report also argued that start-up ventures needed to be able to restructure capital after only a few years. This argument is a furphy, since unincorporated individuals are unlikely to be the main source of venture capital anyway and companies are not covered by the capital gains tax discount.

In these straitened times, when governments need all the revenue they can generate, it is time to revisit the discount on capital gains. It is time to resolve the serious conflict between the received wisdom on share and property investment and the 12-month capital gains tax discount.

Punters are advised that share market investment must be long term to allow for steady, healthy growth and to allow time to recover from extreme market ructions that occur from time to time. Therefore, a “free” market is an invitation to invest badly. When that invitation goes to amateur investors who don’t know what they’re doing, it is a recipe for disaster.

Property is also supposed to be a long-term investment unless one is a flipping speculator, someone who buys a dump, slaps on some paint and flips it for a tidy profit. Why would the tax system encourage such speculation when the benefit is purely personal and the cost is purely social: higher property prices, higher rental costs, taxes foregone?

I think we need to bring the capital gains tax regime into line with sound investment advice, withholding the discount for at least five years and phasing in discounts so the maximum discount applies to long-term investment. To counter opposition to this, the ATO needs to quantify any economic or social benefit that it imagines flows from the discount as well as the obvious social cost of the discount. It needs to avoid the baseless assertions of the Ralph Report.

RECOMMENDATION 21: The capital gains tax discount be phased in only after five years of investment and at a rate of 10% per year up to 50% at ten years.

This is preferable to simply eliminating the discount. For responsible investors there is still a reward for patient investing. Also listed companies will doubtless enjoy the more stable prices their shares will enjoy and their executives can concentrate on their core business rather than on manipulating share prices.

What is important to keep in mind is that this change should not negatively interfere with share markets. It has no effect on institutional investors, and individual investors can still trade as normal, as day traders already do. There is no change to when one can buy or sell. Speculators can still speculate, just without a taxpayer subsidy for doing so. And people who find they need to sell assets will simply have to pay their fair share in taxes. How can there be a downside to that? How can people be disadvantaged when they realise a capital gain? We need to be reasonable about what this change entails - it entails very wealthy people paying fair taxes on their good fortune, much of which has already been funded by tax deductions for their investments. No poor people will be suffering, no businesses will be destroyed, institutional investment won't dry up.

A transitional year at the old discount should allow investors to divest of investments they do not wish to hold long term. This will allow a reasonable time for property investors to flip their properties. Right now is not a bad time to sell as the low-end is booming and interest rates have never been better. And equities investors can clean out their share portfolios, as many are doing already anyway, without any penalty.

After those twelve months, the new discount regime will apply to existing assets from their date of acquisition and to new investments.

Restructuring Family Support Benefits to Increase Employment Participation

Dr Carol J Steiner

June 2009

THE PROBLEMS: Two main problems with the family benefits system discourage employment participation:

Problem 1: Myriad ad hoc adjustments to the family benefits system have produced an irrational mess of mixed messages, ideological quirks and counterproductive rules, most that either discourage or penalise employment participation. For example,

- What message is sent by a child care benefit that subsidises up to 24 hours of child care for a stay-at-home mum whose husband earns over \$2400 a week, but if a working family wants 50 hours of subsidised child care a week (funded at a princely \$3.47 an hour) *so they can both work*, they can't make more than \$700 a week between them?
- Whose ideology lies behind Family Tax Benefit B that penalises any poor working wife who earns more than \$87 a week for her children, but gives the full benefit to a single mum earning \$2885 a week?!
- How is it not counterproductive for a low-income person to find their marginal tax rate increases by 100% when they earn more than a mere \$35,000, while an executive faces only a 27% increase in his marginal tax rate when his salary jumps from \$80,000 to \$180,000.

Problem 2: The complexity of thresholds, limits, scales, reductions, rebates and offsets that now make up the family benefit system is beyond the comprehension of most ordinary workers. But more importantly, this complexity *forces low-income workers to calculate whether or not it is worth their while to accept a job, work more hours or take a promotion.*

If we want to have a working nation in which all able people see participation in employment as their right and responsibility, then we cannot create situations in which this calculation must be made. Any work, any extra hours or any advancement has to offer more rewards than not working, not seeking extra work and not advancing in one's career. *Working should never make a person on a low or moderate income worse off.*

Tax bureaucrats and politicians talk about this problem in terms of "high effective marginal tax rates" that apply when benefits are reduced. But the message sent by a system that penalises people for working is not about marginal tax rates. It is about *the crushing realisation that employment participation is not a route out of poverty.*

Limits that affect income-based entitlements diminish the desirability of working. I understand that limits are meant to stop taxpayer money going to people who don't need it and to reduce taxpayer obligations, but it seems pretty arbitrary and often counterproductive how these limits are set. And the limits are different for every benefit. Why would that be? People either deserve a benefit or they don't. They're needy or they're not.

While it might seem pretty obvious who the most needy are, based on raw income numbers, these numbers can be misleading. We might think an income of \$80,000 is pretty healthy, but that depends on whether it is being earned by an individual working a 38-hour week in an air-conditioned office or by two parents both doing manual labour full time and some overtime to earn that \$80,000. As a rule,

- The lower the income threshold for reducing a benefit, the more likely that benefit is going to be lost if one works.
- When those thresholds for reducing a benefit are based on family income rather than individual income, the more likely a poor family is going to lose the benefit if both parents work.
- When disqualifying family income limits are set very high, they mostly benefit high-income families in which wives can stay home while husbands earn big bucks.

This is why I advocate much higher income thresholds for reducing Family Tax Benefit A and the Child Care Benefit and much lower income thresholds for losing Family Tax Benefit B and the Child Care Tax Rebate. The resulting eligibility bands ensure the benefits reward and encourage working families and motivate single-income and non-working parents of school age children to participate in employment.

Also, sliding scales for benefits are probably intended to improve the lot of the needy, but too often those benefits “slide” into the pockets of families earning well beyond a middle-class income. If anything, sliding scales increase inequity because, despite appearing progressive, they end up paying benefits to people who don’t need them – hence, middle class welfare – and limit the value of benefits that can be paid to people who really need them to motivate them to work. Therefore, my submission recommends that sliding scales be eliminated. If you qualify for support, you get it, and it doesn’t reduce as you do what you ought to do: earn extra money for your family.

Not having sliding benefit scales and having higher income cut-offs for full benefits may cost more initially, but the money will be more appropriately targeted to encourage employment participation while improving living standards and rewarding self-sufficiency. Significantly, getting rid of sliding scales of entitlement will also greatly reduce the cost of managing these benefits, so any extra costs can be offset against administrative savings, which I think will run into tens of millions of dollars.

The aims of this submission are (1) to make family support benefits more equitable and reasonable for low- and middle-income families, to encourage employment participation; and (2) to show how Family Tax Benefits A and B, the Child Care Benefit and the Child Care Tax Rebate can be improved to encourage parents to work once a child attains school age.

I suggest the definition of “low income” should be anyone earning less than the Annual Minimum Wage (**AMW**), currently \$28,276. “Middle income” should be one to four times AMW, currently \$28,276 to \$113,104 pa, a reasonable income level that encompasses all workers on average weekly earnings plus the majority of public servants, miners, academics, trades people, clerks and middle managers. I use this range in my suggested eligibility limits for family support benefits.

WORKING PARENTS: My submission focuses on how four existing benefits can be changed to encourage unemployed parents to return to work when their youngest child starts school and to reward working parents on low to middle incomes. This is worth doing because working parents are better able to provide for their children, are less of a burden on taxpayers, and raise children to have a work ethic. Also, working parents are better role models for children.

I focus on parents because current family support benefits encourage parents not to work, reward minimal or no work, and discourage full-time work. When one looks at means tests, thresholds, benefit reduction triggers and what qualifies and disqualifies parents for family support benefits, we see a system riddled with ill-targeted generosity and counterproductive limitations and exclusions.

CONSIDER THIS!

*An unemployed single parent on a parenting payment with just one school age child under 8 years old receives **\$33,182.80** per annum from taxpayers, including the parenting payment, Family Tax Benefits A and B with supplements, rent assistance and the Child Care Benefit, all for doing only 15 hours a week of work, job search or volunteering.*

*A similar single parent working 38 hours a week (instead of 15) for the annual minimum wage of only \$28,276 receives just **\$15,014** per annum from taxpayers -- less than half the non-working parent. Granted, they also have \$10,000 more income, but they have to work an extra 23 hours a week (1196 hours per year away from their child) to get it and probably spend most of it on child care, even after a Child Care Tax Rebate!*

Is it any wonder that people would rather be on welfare than work?

The incomes that affect benefit entitlements are particularly skewed. For example, a working single mother of one on \$150,000 pa (think corporate lawyer or consultant) is eligible for a \$7500 Child Care Tax Rebate and a \$3700 Family Tax Benefit B, while a couple with one child earning only \$36,574 pa *between them* loses 20 cents of the \$3.47 per hour Child Care Benefit for every extra dollar they earn. Even stranger, Family Tax Benefit B is unavailable to that couple if the lower earner earns a paltry \$16,225 of that \$36,574. What are we encouraging? What are we discouraging? ***Working shouldn't cost such a low-income family the benefits it obviously needs to make working worthwhile.***

While the family support system probably aims to look after the disadvantaged, what we find instead is that it actually creates or perpetuates disadvantage. To qualify for various benefits, parents must continue to earn little. The system encourages them to remain disadvantaged. This sends the message to parents and their children that it is easier and smarter to be unemployed and "disadvantaged" than to earn a living and aspire to be self-sufficient.

To fix the problem, we must look at rewarding parents when they return to work, not penalising them for doing so. We must make it worth their while to take a job and keep it. At the same time, we must withdraw or diminish benefits for parents who resist working once their kids are at school. We must make it financially undesirable for them to be dependent on welfare.

I'm not talking about a draconian US approach to welfare that sends kids to bed hungry or makes them sleep in cars. But Australia has gone too far in the other direction so that it is actually better to be on welfare than to be earning a modest living by working.

Politicians rarely consider reducing benefits to "poor" parents because they don't want to punish the children. But in Australia we are well positioned to reduce benefits without harming children because the current benefits for non-working parents are very generous, despite what the welfare lobby might have us believe. \$33,000 a year is more than the annual minimum wage and more than enough to provide for a frugal parent and child! And it is much higher if you have more kids. We need to let the figures speak for themselves.

December 2008 Henderson Poverty Lines	
<i>Single Parent, One Child, including Housing</i>	
Unemployed	\$454.28 pw
Employed	\$532.86 pw
\$33,182.80 Govt Benefit	\$638.14 pw

Imposing a work test that reduces benefits for parents who refuse to work will not plunge such parents into poverty. They will remain well clear of the poverty line, which is why being on benefits is much more attractive than being employed on a low wage.

What I am suggesting targets non-working parents whose youngest child attains primary school age. Once a child reaches school age, they no longer need care during school hours, which means that carers are free to return to work.

But what I'm proposing applies from around age 6, not age 5, the age the tax system currently uses. I've built in this extra year because littlies starting school at 5 are already experiencing a lot of change, so having someone at home before and after school may help them make the transition a little more smoothly with a little less stress. Making a good start affects future success at school. Staying at home during the first school year also allows a parent to be involved in activities at the school like tuck shop and fund-raising. And the parents can also use school time to dabble in part-time work or get some training before they have to return to work.

Following are current family support benefits that I think can be restructured to make working more attractive to parents, the objective of this exercise. Two of the benefits provide income-support for children while the other two support child care.

- **Family Tax Benefit A** is likely a substitute for a tax deduction for children and also an income-tested supplement to help families meet the common costs of having children. It is an effective way to improve incomes for families with children, and I recommend retaining it but tightening up the income test and requiring parents of school age children to work to access the full benefit.
- **Family Tax Benefit B** is an ideological benefit that mostly rewards single and stay-at-home parents. It has a very low income test, which disqualifies most dual-income families and discourages both parents from working. I recommend this be recast as a narrowly targeted supplement to low-income working parents.
- **Child Care Benefit** helps parents with a small part of the upfront cost of child care. It is managed through the Family Assistance Office.

- **Child Care Tax Rebate** allows parents to claim the balance of their child care costs when they file their tax return, up to \$7500 pa. It isn't actually a tax rebate but it is paid through the tax system. I recommend this benefit be significantly recast to include a work test and a means test.

Any changes I recommend will greatly reduce the cost of administering these benefits by simplifying eligibility, doing away with variable and reducing benefits, and eliminating middle class welfare for people who don't need it. These cost savings can be applied to the higher costs that may be incurred by paying full rather than reducing benefits to working families and increasing eligibility thresholds so they encourage working.

Family Tax Benefit A: This benefit is worth between \$1259.25 and \$5818.10 per year per child depending on their ages. It is payable in full to parents with family income below \$42,559, and reducing (20 cents in the dollar) for families with income over that but under \$94,316, and further reducing (30 cents in the dollar) for families with incomes over that, up to \$160,150, depending on the number of children.

If a family is poor enough to attract this full benefit (family income under \$42,559), then it is even more important that the carer return to work to bolster family income when the youngest starts school. If a carer thinks they need to stay at home even when their children do not and even when they have trouble supporting their children, then they must pay a penalty to discourage that attitude.

I suggest a **Minimum Earned Income Test (MEIT)** be introduced as a qualification for the full Tax Benefit A with supplement once the youngest child attains school age. The only income counted must be earned, not received as a taxpayer-funded benefit, gift, prize or maintenance payment. The required minimum income should be the AMW (currently \$28,276) to encourage full-time or substantial part-time work. The MEIT should apply for single parents and both parents in a family. The MEIT should apply from the first full tax year after the youngest child attains age 5.

RECOMMENDATION 1: Parents who do not pass the MEIT be entitled only to the under-18 base rate of this benefit (\$1259.25 per child) after their youngest child attains school age.

RECOMMENDATION 2: No supplement be available to parents placed on the base rate for failing the MEIT.

The minimum income must be earned in one tax year and cannot be pro rated. It can be earned from casual, part-time or full-time work, but regardless of how much or little work one does, the full-time AMW must be earned. The point is not to encourage people to put in a lot of working time but rather to earn a decent income to support their families and to persist in a job even if it isn't fun or satisfying or well-remunerated.

These recommendations would result in a loss of benefits of \$3372.60 per year or \$64.85 per week per child. They would still be getting more than the current AMW in taxpayer-funded benefits, and even more if they had more children. ***Their income will still be \$119 above the poverty line for an unemployed person.***

To be most efficiently administered, all people eligible for Benefit A should go on the base rate in the first full tax year after their child turns 5 because that is the minimum payable for all on this benefit. At the end of the tax year, people who have earned the AMW or higher can receive their full entitlement plus the supplement as a lump sum. Parents will know this \$64.85 pw reduction is coming well in advance and can plan to minimise its effects for the first year. Subsequent year entitlements can be based on the previous year's MEIT so eligible parents get their full benefit and supplement.

This change will give parents an incentive to find work, at the very least to make up for what they will lose temporarily. They could certainly do so with a casual job during school hours alone. But hopefully, instead, the changes will motivate parents to pursue full-time or substantial part-time work rather than sporadic casual work, in order to meet the annual income target to get that \$3372.60 back as a working bonus.

Some may argue a work test would be an unreasonable burden in times of high unemployment, but that is precisely the time when the strongest incentives are required to push people to pursue employment rather than give them an excuse to be unemployed. Also, many if not most of the recipients of Family Tax Benefit A affected by the MEIT will be finding employment in shadow sectors not well represented in unemployment figures –casual retail and hospitality, home help, informal child care and unskilled services like lawn mowing – jobs often worked in the black economy and more plentiful than official figures suggest. Also, I have argued in my submission to the Henry Review that workers earning less than AMW not be taxed. If a work test is introduced along with a tax exemption for incomes under the AMW, work currently hidden in the black economy may be brought to light by workers wanting to qualify for the full Benefit A.

Study: If parents choose to return to accredited full-time study instead of work when their last child starts school, they should be able to do so as an alternative to the MEIT but with strict conditions.

RECOMMENDATION 3: Successfully completing a full year of full-time study or training be an acceptable alternative to the MEIT.

To qualify, a parent must carry a full study load and pass all subjects for the year. If they are doing research-based postgraduate study or an apprenticeship, they must make satisfactory full-time progress, assessed by their supervisor. Taking short courses or studying part-time does not satisfy the MEIT.

Parents should be able to claim this alternative to the MEIT for only one qualification and up to a maximum of four consecutive years. If a second qualification is required or if a qualification takes more than four years to earn, the parent will only receive the base rate of Tax Benefit A and no rent assistance for the subsequent qualification or extra years. A break in study will also end access to this alternative to the MEIT.

The purpose of encouraging full-time study or training when the kids are all off to school is to prepare the parent to earn a good living as quickly as possible, not to set them on a sporadic and lingering path to a qualification, not to indulge their love of learning and not to prepare them for yet another course of study. If they drop or fail subjects, or if they want to drop out for a time or drag out an undergraduate or research degree over more than four years, then they'll have to be satisfied with the base rate of Tax Benefit A and no rent assistance. The onus is on the parent to have a bit of ambition, and to work hard, be persistent and be effective in their studies.

Rent Assistance: Being on the base rate of Family Benefit A makes the family ineligible for rent assistance, so placing parents on the base rate may create an extra \$130 per week hardship for a single parent with one child. But maintaining that rent assistance indefinitely will work against the incentive to return to work. Therefore, I propose continuing rent assistance to eligible parents for one year after they fail the MEIT, to cushion the hardship but still provide a clear incentive to use that time to train for or secure work or to find a way to cover or reduce their rental costs. After that year, no rent assistance will be available to those parents not earning the AMW in the previous year.

RECOMMENDATION 4: Rent assistance eligibility be maintained for the first year after a parent fails the MEIT, despite the parent being on the base rate for Benefit A.

This one-year grace allows rent assistance eligibility to be assessed on the previous rather than current year's income. This will be more efficient to administer than the current year-end reconciliation system, and parents will know well in advance if their rent assistance will end. And if the parent earns too much in a current year to qualify for the rent assistance they are receiving based on the previous year, so what? A one-off over-payment of, at most, \$3,392. To take it away would be a penalty for doing exactly what taxpayers want parents to do - earn enough to support their children. Asking for it back would be worse! Let it be a reward to parents getting their family on track out of poverty by finding substantial work.

Once rent assistance is removed, a non-working single parent of one school-age child will fall below the poverty line by \$11 pw, a serious incentive to find work to make up that loss or to hold on to rent assistance. The onus is on the parent to avoid falling into poverty and they'll have 12 months to sort themselves out before it happens.

Income Limits: Another problem with this benefit is that when family income exceeds \$42,559, Benefit A reduces by 20 cents in the dollar for income over that figure, a penalty for working. This low family income threshold discourages both parents in a family from working; it penalises dual-income families. It also punishes single parents aspiring to a decent wage. Given that Australia needs all the workers it can get and families on lower incomes need all the income supplementation they can get, this seems an irrational penalty to exact.

RECOMMENDATION 5: Increase the family income limit for the full benefit from \$42,559 to \$113,104 (4xAMW) regardless of the number of children.

RECOMMENDATION 6: Make any family earning over \$113,104 ineligible for Family Benefit A.

It is important to keep in mind that this \$113,104 is family income. This can mean that if one parent earns average weekly earnings (around \$60,000) another will be earning less than that. These are hardly well-to-do people on easy street! While the \$113,104 is a lot higher than \$42,559, it is realistic for contemporary and aspirational income levels for dual-income families participating in meaningful employment.

Of course, this higher threshold can also mean a single parent on a good wage still gets the full benefit, but why begrudge this benefit to someone who is obviously making an effort to support their child? It can also mean a single high-earner in a family with a stay-at-home parent gets the full benefit, but \$113,104 is a lot lower than the current disqualifying income limits that can reach way above \$160,000 pa depending on the number of children. Part of the push to limit benefits to well-off parents has often penalised dual-income families who are not well-off at all. Better a few high-income families with a stay-at-home mum sneak through than a lot of middle-income working families miss out and are sent a bad message about the desirability of working.

Making families on more than 4xAMW ineligible for the benefit signals an end to middle-class welfare. The government needs to draw a line in the sand somewhere, and I suspect this figure is quite reasonable. It is almost twice average weekly earnings so it is likely to accommodate a majority of dual-income families of blue and pink collar workers and clerical to mid-level white collar workers, while eliminating most senior white collar workers, professionals and small business owners.

Sliding Scales: The sliding scale of benefits and incomes for different numbers of children of different ages means that a lot of higher income families still get some of the benefit, and the costs of administering the benefit are enormous as every change in income results in a change in benefits, as do any additional children and some age changes in children. This is why there has to be a reconciliation and supplement at year end, to sort out the mess.

Further, parents are expected to estimate their annual income in advance to set their benefit entitlement, so any parent lucky enough to earn a bit more than they thought they'd earn is punished at year end by the reconciliation, and if they happen to be poor into the bargain, repaying any overpayment can be a serious burden for them.

RECOMMENDATION 7: Sliding scales of income and benefits be replaced by a single full rate per child aged 0-18 years, a penalty rate for parents who fail the MEIT, and an identical rate for adult dependent children in full-time study.

The new rate per child could be an average of the current variable rates plus supplement per child per year over 18 years of eligibility. This would be \$4,531 per child between the ages of 0 and 18 years based on current benefit rates.

The total amount payable over the first 18 years is the same as it is now. All that is different is the way the benefits are apportioned over the 18 years. They are equal so the government doesn't have to keep track of children's ages (under 13, 13-15, 16-17, 18-24) and doesn't have to pay different benefits for each different age group.

There may also be an ancillary social bonus to paying the benefit equally across the years. Currently, when children reach their late teens, there is a huge drop in family payments, from \$5818 to \$1945. Just when children are at their most troublesome and testing for a family, the reduced benefit makes keeping them at home much less worthwhile. Perhaps if there isn't a nearly \$4000 loss of financial support for these kids, parents might be more inclined to keep them around and a lot less likely to chuck them out on the street.

An alternative: If the alternative tax scales I have proposed are adopted, the value of Benefit A could be reduced from \$4531 per child to \$2500 per child. The alternative tax scales deliver middle-income earners a tax savings between \$1100 and \$3400 pa. Reducing Family Tax Benefit A by \$2000 will still leave most families better off. If my proposal to transform Family Tax Benefit B into a supplement for workers earning less than average weekly earnings was also adopted, even those at the lower end of the middle-income band will not be disadvantaged by a reduction in Family Tax Benefit A.

The penalty and adult student rate could be the current base rate without supplement (\$1259), a loss of \$21.50 per week for adult students. Kids should be earning their own income by this time, and even contributing a bit of board to the family coffers, so I don't think this reduction should be a hardship for anyone and it is the first message to young adults that employment participation is the path of self-sufficiency.

Getting rid of the sliding scales of eligible incomes and benefits should produce some savings from not paying partial benefits to parents with family income over \$113,104 pa. And more substantial administrative savings will further offset some of the costs of paying the full benefit to families with a higher family income.

These savings will likely be in tens of millions of dollars per year because currently this benefit has 5 levels of maximum payment based on the ages of children, plus 2 levels of supplementary payments based on age, plus 775 levels of reduction of 20 cents in the dollar once family income reaches \$42,559, plus 45 maximum income levels based on the number of children and their ages, plus different thresholds for a 30 cents in the dollar benefit reduction for incomes between \$94,316 plus \$3796 per each additional child and those 45 maximum income levels. Could there be a more complex and opaque approach to providing taxpayer support to children? And all this expensive complexity manages to do is punish families on very modest incomes who try to increase their financial security by working! *By sweating the small stuff to save 20 cents here and there, a very big message is sent about the futility of working to improve your lot in life!*

Extra Reductions and Benefits: Although not directly relevant to employment participation, other features of the Family Benefit A add to its cost and will make it more difficult to fund the work-encouraging changes I am proposing, so these features need attention at the same time, to free up money to support more working parents in need.

Currently the amount of family benefit payable is reduced by income the children earn or receive and by maintenance payments. The costs of reporting, managing, adjusting and monitoring these small extra incomes likely far outweigh any savings to taxpayers. And if my broader eligibility range and single benefit payment are adopted, they will be irrelevant to eligibility and benefit amount anyway. Therefore,

RECOMMENDATION 8: Children's income or maintenance payments be irrelevant to Family Tax Benefit A eligibility or payments.

I would also do away with extra benefits for large families or multiple births. These were introduced before the baby bonus came into existence, and it is hard to argue that, over 18 years, caring for triplets costs more than caring for three siblings born separately. I also don't think government should encourage large families by offering them extra taxpayer support.

RECOMMENDATION 9: The Large Family Supplement and the Multiple Birth Allowance be eliminated for new claimants.

While eliminating benefits to higher earners and non-workers and extra payments for large families and multiple births will generate some savings, as will simplifying management of this benefit produce substantial administrative savings, overall this approach will likely be more expensive because more working families will qualify for the full benefit. But I think I've made a strong argument that the changes proposed will encourage employment participation by parents committed to supporting their children and improving their standard of living. The changes also make good sense and will result in more parents contributing to the economy and the tax system and setting good examples for their children.

FAMILY TAX BENEFIT B: This is a ridiculous benefit for single parents and families with only one income earner. It was John Howard's ideologically-driven attempt to encourage and reward stay-at-home mums, especially in well-off families. Why else would you offer \$2675.45 to a family with school age children, regardless of the family income, so long as one member of the couple doesn't earn more than \$4526 pa? And you'll even pay that \$2675.45 if a single parent is earning \$150,000 pa! This is just nuts!

For low-income families, the effect of this “benefit” is to discourage a second parent from working, even if the family would benefit from some extra income. It discourages work by reducing payments once the low earner earns only \$4526 pa and cuts out completely if the low earner earns as little as \$16,225. Who needs money more – the mum driving a school bus to supplement her husband’s minimum wage or the corporate lawyer single mum working half-time at home for \$150,000 a year?!

The Benefit B experiment in social engineering should be abandoned or significantly revised. If a family can afford to have a parent stay at home just to look after children, even when they are old enough for school, then they don’t need any government support and taxpayers shouldn’t be subsidising their lifestyle choice.

RECOMMENDATION 10A: End Benefit B and use the savings to fund the more expensive Family Tax Benefit A.

RECOMMENDATION 10B: Alternatively, if the government won’t eliminate Benefit B, then it should be available only when the youngest child is under 5, the benefit reductions shouldn’t start until the low earner’s income reaches 2xAMW (\$56,552), and it should be means tested to stop when the higher earner or single parent earns twice the AMW (\$56,552), not \$150,000 as it is now.

Such a revised Benefit B would support only low- and middle-income families, families in which a lone parent or both parents were each on less than average weekly earnings.

CHILD CARE BENEFIT: This is one of two forms of subsidy for child care costs. This seems to be the upfront benefit, while the Child Care Tax Rebate is the reimbursement benefit, although the child care benefit can also be taken as a year-end lump sum. Making some contribution to the upfront cost of child care is probably important to low-income families who may not have the disposable income to fully fund care upfront to enable them to work. But this need must be balanced against the costs of administering the program and ensuring that it is used appropriately, to support work. Currently, this balance is not achieved.

Administratively Expensive and Wasteful: The child care benefit is small while the costs of providing it are horrendous. Twenty-four hours of approved child care for one school-age child attracts only \$70.79 a week. Fifty hours attract a payment of only \$147.47. If the kids are only in registered care, the payment is a miniscule \$24.69 for 50 hours.

Despite these small sums, millions of claims and payments must be made by and paid to thousands of approved child care providers. There must be hundreds, maybe thousands, of Family Assistance Office staff and millions of dollars of computer resources devoted to managing this benefit, not to mention the costs child care providers face in making claims. I suspect the costs to the government and the providers are nearly equal to the benefits paid.

Also, approved child care providers are allowed to claim for hours of care not used. If child care centres charge a daily rather than hourly rate for care regardless of how many hours the child is there, they are allowed to bill the child care benefit for the daily hours (maybe 9 or 11 hours), even if a child is only there for 2 hours. Very wasteful use of taxpayers’ money! It was probably allowed in acknowledgment of the ridiculous costs of claiming the tiny benefit. Even if using registered care, the claimant has to have all receipts for a year to get their maximum \$24.69 a week in an annual lump sum.

In addition, half the benefit is not work tested at all and half is subject to a very weak and ineffective work test. And its income threshold for reductions is so low that it penalises most dual-income families.

If we want to make this benefit useful to working parents, especially lower-income working parents, it must be better targeted and simplified to support employment participation and to reduce administrative costs for both the government and child care providers.

Regular & Casual Employment: I suggest we need to distinguish between two groups of working parents: those in regular employment (full or part-time) and those employed casually. Their approach to employment should affect their entitlement to the Child Care Benefit. Accessing the child care benefit should be easier for people in regular employment, to encourage parents to aim for such employment rather than casual employment.

If parents are in regular employment, their hours will be predictable, their need for care will be predictable, and their entitlement will be stable. These people do not need to be involved in the current administrative regime full of variability, uncertainty and high administrative cost. They also should not have to deal with a second claim for their child care, the tax rebate.

RECOMMENDATION 11: Parents in regular employment be entitled to the upfront Child Care Benefit and to upfront payment of the Child Care Tax Rebate.

RECOMMENDATION 12: Parents in casual employment be required to establish a stable work history to claim the Child Care Benefit upfront or be required to claim the Benefit in a lump sum in arrears.

Child care providers for parents in regular employment should receive an automatic monthly payment of the parents' entitlement, including a twelfth of their rebate entitlement. This entitlement can even include the extra payments authorised for school age children during school holidays. Providers should be required to file only a quarterly report on hours actually used by the parents so the Family Assistance Office can do a reconciliation. Overpayments can be deducted from future monthly payments. This will greatly reduce the workload of child care providers.

Child care providers for casually employed parents do not make any claims on the parents' behalf but provide parents with evidence of actual child care used to claim lump sum reimbursement. Providers should not have to be involved in the complex and expensive government claims process for casual users.

To qualify for access to the regular employment system of child care support, existing workers will only have to provide to the Family Assistance Office a PAYG Payment Summary or, for new appointments, an employer letter confirming they have regular employment, their regular hours and their regular annual income. When they work (their roster) and any overtime are not relevant to their entitlement, provided they meet the work and income tests generally. This information must be provided by all single working parents and by both parents in a couple to ensure both pass the work test and the income test.

Parents who work casually can only qualify for the upfront child care benefit based on a quarter of stable work history and passing the income test. The system is too expensive to allow people working only sporadically to claim upfront payments when there is no guarantee that they will be working enough subsidised hours. The current work-free 24 hours were probably intended to cover such casual workers, but those hours are easily abused by non-working parents and should no longer be available.

Casual workers will have to cover their upfront costs for the first quarter and claim for those expenses as a lump sum at year end. If they cannot establish a stable work history over a quarter, they will then have access to the child care benefit only as a lump sum in arrears. To reduce the hardship of being denied upfront access, casual workers should be able to make lump sum claims quarterly rather than annually as now.

Work Test: It is difficult to see why anyone who is not working should receive government-subsidised child care. It is also difficult to justify subsidising up to 24 hours of approved child care per week per child without a work test, including for single-income families earning well over \$125,000 per year.

Even when subjected to a work test, parents are only required to work 15 hours each to claim 50 hours of subsidised child care. This encourages idleness and lack of ambition because it does not encourage or expect parents to work full time before putting their kids in care at taxpayers' expense.

Likewise, unemployed people on parenting payments and Newstart are guaranteed 50 hours of subsidy per child each week even though they are only required to work, job search or train for 15 hours a week. If their children are under school age, they don't even have to work those hours. Another perk of being on welfare instead of working and trying to support a family. This taxpayer-funded disincentive to work has to end.

I suspect the work-free 24 hours and the 15-hour work test for 50 hours of child care were introduced because of the difficulty of keeping track of hours worked. Only two levels of eligibility are used because a sliding scale of eligibility based on actual hours would be impossible to administer. As a result, too many hours of child care are subsidised by the taxpayer without increasing employment participation and without benefit to family income or the economy. This could be addressed by basing eligibility on easily verified income rather than on hours worked.

RECOMMENDATION 13: Eliminate the no-work-test 24 weekly hours of subsidised child care.

RECOMMENDATION 14: Introduce an income-based work test for the Child Care Benefit:

- To qualify for up to 50 hours of subsidised child care per week, single parents and both parents in a family must each earn at least AMW (\$28,276).
- To qualify for up to 25 hours of subsidised child care per week, single parents and both parents in a family must each earn at least half AMW (\$14,138).
- The Child Care Benefit not be available to parents who earn less than half AMW.
- No more than 50 hours of benefit be available to anyone.

Basing eligibility on the AMW increases the likelihood that lower-income parents will work full time instead of just sporadic casual hours. Of course, better paid parents may be able to work fewer hours and still qualify for the full benefit because they earn more per hour, but that is both sensible and an incentive for lower earners to up-skill so they can work fewer hours if they want to.

Dual-income families in which one or both parents work part-time get subsidised care based only on the income of the least employed parent. If they work fewer hours, they should get fewer subsidised hours of child care.

Because it is expensive to administer, this benefit should not be available to parents who only dabble in work. If they can't both earn at least half AMW, then taxpayers shouldn't be asked to subsidise their half-hearted dabbling in work.

It is difficult to justify taxpayer subsidies for more than 50 hours of child care per week, given that the normal working week is only 38 hours. If parents are working more than 50 hours a week, one has to question their work-life balance and their efficiency as earners.

Income Threshold: Reducing benefits once the family income threshold reaches only \$36,573 makes the benefit worth much less to dual-income families, even if they are on very low wages and even if they need child care to enable them both to work. What is a better use for a child care subsidy – allowing a well-off stay-at-home mum to have a spa day or supporting a low-income family to bring in a second wage?

The value of the benefit per child is much lower than the cost of care. Working parents may face child care costs of more than \$20,000 a year per child, while even the full benefit offers less than half that, so reducing the benefit as low incomes rise only makes it harder for poor parents to afford child care essential to allow them to work.

In addition, reducing an already low benefit based on a low income threshold is very inefficient and costly. To save a few cents an hour that low-income earners doubtless need to afford to work, the government must track income levels for millions of claimants, right up to incomes over \$160,000.

An unrelated anomaly corrected by my recommendations is that the rate of payment per child increases as you have more children. Why would it cost more per child to have two or three kids in care instead of one? If anything, parents would get a volume discount!

RECOMMENDATION 15: Replace the low income threshold with an eligibility band from half AMW to 4xAMW (\$14,138 to \$113,104), applicable to single parents and each parent in a couple.

RECOMMENDATION 16: Replace the sliding scale of benefits with a single full benefit per child (currently \$3.47 per hour per child).

The generous eligibility band that applies to each parent rather than to family income means most working parents will qualify and continue to qualify even if they do a lot of overtime or get a good promotion.

Giving the full benefit to most working parents may cost more, but administrative costs will be much lower and the elimination of the 24 hours per week of care currently available without a work test should also produce substantial savings as well as improving the targeting of the benefit.

Equity and Right to Work: The 4xAMW maximum income allows even a relatively well-paid parent or high income family to qualify for this benefit. While this might seem unreasonable, we need to keep in mind that child care is an equity issue related to the right to work. It is about enabling parents, especially women, to earn an income even while having responsibility for child rearing. Therefore, in the interests of encouraging employment participation by all parents but especially women, I have tried to improve eligibility and reduce penalties for parents who work while excluding parents who don't work or don't work regularly.

For example, I base disqualifying limits not on family incomes but on low earner incomes because the low earner is often the primary carer who needs child care assistance to make working worthwhile, even if the high earner is on a good wage. Child care subsidies are less about financial need than about the right to work. Just because a woman has a high-earning husband doesn't mean she should be denied subsidised child care if she wishes to work.

But for balance, the work test ensures higher-income families only get subsidised child care based on how much the least employed parent earns. This means high-income earners won't get a full child care subsidy unless the low earner works enough to pass the work test.

Exceptions: Sometimes exceptions to the work test must be made for good social reasons or emergencies.

RECOMMENDATION 17: Recipients of government carer payments and eligible grandparents with primary care responsibilities for grandchildren be eligible for 50 hours of the child care benefit without the work test.

These people are already doing taxpayers a favour, so they should be rewarded with as much respite time as they can get.

RECOMMENDATION 18: Working parents, eligible grandparents and recipients of carer payments who are hospitalised, looking after a hospitalised child, or too sick to look after their children (subject to a medical certificate) be entitled to the Child Care Benefit for up to 50 hours per week without the work test for the period of the illness or hospitalisation.

This can be seen as emergency child care support and the modest subsidy will do a lot to reduce stress and worry. It also means working parents who are sick won't have to keep the children at home just because they are at home.

Parents living on government payments like the parenting payment and Newstart currently have more generous entitlements to the Child Care Benefit than working parents. In addition, they can claim the difference between the Benefit and their actual costs, without limit, through a special scheme not available to even low-income working parents.

In the interests of linking subsidised child care to employment participation, parents living on government payments should be ineligible for the Child Care Benefit and the Child Care Tax Rebate. Instead, they should claim through their Jobs, Education and Training Child Care Fee Assistance Scheme. Currently the scheme covers only costs not covered by the Child Care Benefit. The scheme should be modified to cover all child care costs for parents living on government payments so the Child Care Benefit and Tax Rebate can be reserved for working parents.

RECOMMENDATION 19: The child care benefit not be available to parents receiving government support payments.

CHILD CARE TAX REBATE: This is not a tax rebate but a refund of 50% of child care costs. One does not have to have paid tax to get it, so it does not rebate tax.

RECOMMENDATION 20: The Child Care Tax Rebate be renamed the Working Parent Child Care Subsidy.

Work Test: This rebate has no quantified work, study, training, job search or volunteer test. It is ideologically designed to reward stay-at-home mums instead of supporting working parents.

For example, currently a stay-at-home mum can take a 2-hour course on painting fingernails and claim 50% of the cost of a whole week of child care at the most expensive child care centre. And she can do this repeatedly until her claim reaches \$7500! This does not encourage work or return to work. It encourages scamming the system to use taxpayers' funds to offload your kids in child care at half price. There are no grounds to justify such a policy.

Staying at home with children is an option mostly available only to quite well-to-do parents or single parents on welfare. Most working families can't afford the luxury, even if parents would dearly love to stay home and look after their children. They work because they have to or because they want to provide a better life for their children. Therefore, any child care subsidies should be directed only to enabling them to do so.

RECOMMENDATION 21: The Working Parent Child Care Subsidy be subject to the Child Care Benefit work test.

With a mandatory work test, this benefit rewards genuine working families in which both parents are contributing to family income. If both parents in a dual-parent family are not required to work, they could use taxpayer funds to pay for child care so a non-working mum can get her hair done and have lunch with the girls. If stay-at-home mums need a break from their kids, the taxpayer should not be subsidising that break. And if the family can afford to have a stay-at-home mum, then it doesn't need a child care subsidy. Taxpayers should not subsidise lifestyle choices, especially not for the wealthy.

Value of Rebate: The current maximum rebate is \$7500. Because this doesn't specify the number of hours that must be worked to claim it, taxpayers can be subsidising many more hours than working requires. This places an unreasonable burden on taxpayers and reduces the amount of money that might be allocated to support working families.

RECOMMENDATION 22: The value of the rebate be based on the number of hours worked by a single parent or by the lesser employed parent in a dual-parent family.

If the rebate were pro-rated over part-time working hours, the maximum claimable would look like this:

Hrs Worked	Max Rebate
10-15 hrs	\$2960
16-20 hrs	\$3947
21-25 hrs	\$4934
26-30 hrs	\$5921
31-38 hrs	\$7500

If both parents are not working full time, they should not be entitled to the full rebate. Otherwise, taxpayers are rewarding unemployment by subsidising either at a higher rate per hour worked or non-work activities like shopping and spa days.

Proof of hours will be required for casual workers. Parents in regular employment only have to provide proof once and if there is a change in their hours.

RECOMMENDATION 23: Make the rebate payable monthly to child care providers for people in regular employment.

In the previous section I suggested the Child Care Tax Rebate be paid monthly to the child care provider along with the Child Care Benefit for parents in regular employment. The amount paid would be based on their regular hours of work and could be reconciled at year end with provider records and any overpayment recovered. This would increase the amount of upfront support offered for child care, which would be especially helpful to lower income working families.

I wouldn't make this upfront payment available to casual workers. The upfront payment then becomes another incentive for casual workers to find regular employment. Casual workers must claim a lump sum rebate at year end as they do now.

Means Test: The Child Care Tax Rebate is not means tested. This means very wealthy families can claim it. In straitened times, when government budgets have to be cut, it is inexcusable that taxpayer subsidies be poorly targeted. But that said, we also need to keep in mind that child care is an equity issue that affects the right to work. Therefore, we cannot be too harsh in limiting access.

For this reason, in a dual income family, only the income of the lower earner (usually the woman) rather than family income should be tested. This encourages working women to earn independent incomes and have careers, even those with high-earning partners. Also women usually have most responsibility for child care, so they need child care support to help them work.

RECOMMENDATION 24: The Child Care Tax Rebate be subject to the Child Care Benefit eligibility band (half AMW to 4xAMW) for a single or lesser employed parent.

The lower earning parent can earn up to \$113,104 and regardless of what the higher earning parent earns. This means a quite wealthy family may still be eligible for the rebate. This is acceptable because a parent who wants to work should not be denied a child care subsidy just because the other parent earns a lot. This would be unfair to the lower earner and would make it less worthwhile for them to exercise their right to work.

Because the \$113,104 is not family income but single income for the lower earner, the means test will not disqualify low-earning dual-income families from this subsidy.

Restricting access to the rebate to working families, reducing the maximum claimable for parents who do not work full time, and having a lower disqualifying income should ensure substantial savings are realised. These might be used to offset the increased costs of wider eligibility for the full Child Care Benefit.