Exemptions and concessions in the Australian tax system: Equity at the expense of simplicity

Kathrin Bain*

Equity is often viewed as the most important criteria of the Australian taxation system. As such, there are many examples in the Australian tax system of tax concessions and exemptions that have been introduced to promote equity — but these have usually been at the expense of simplicity. After discussing the characteristics of a ‘good’ tax system and the conflicts between such criteria, the treatment of food as GST-free under the goods and services tax regime, Family Tax Benefit (Part A and B), and the Education Tax Refund will be considered. Overall, it will be shown that these government initiatives, which have been introduced under the premise of promoting socio-economic objectives in the tax system, have resulted in increased complexity in the system, and further, have often not promoted the desired equitable result.

*Associate Lecturer, Atax, University of New South Wales
Exemptions and concessions in the Australian tax system: Equity at the expense of simplicity

Kathrin Bain*

Introduction
The primary objective of the tax system is to raise revenue to allow government expenditure. This has recently been reiterated in Australia’s Future Tax System Review (colloquially known as the Henry Review), where it was stated numerous times that Australia’s tax system must be sustainable. However, the overall success of a tax system is not simply evaluated by the extent of revenue raised. The Henry Review identified five design principles for the tax and transfer system: equity, efficiency, simplicity, sustainability and policy consistency. For many years, equity, simplicity and efficiency have been the main criteria against which the Australian taxation system has been evaluated. However, as shown by their inclusion as ‘design principles’, they are not only important after the fact (ie to evaluate a taxation system once it is in operation), but can also play a key role in designing a tax system in the first place. This is highlighted by the government’s response to the Henry Review, where they have stated: ‘The Government’s tax reforms will build a stronger economy and a fairer, simpler tax system for Australian families and businesses’. Whether the reforms introduced achieve these objectives is a separate issue, but statements such as this reiterate the fact that these ‘evaluative criteria’ are at the forefront of policymakers’ minds when designing or reforming the tax system.

Australia is a clear example of a taxation system that is designed not only to raise revenue, but also for socio-economic purposes, being highly redistributive compared to

---

3 Australia’s Future Tax System, Part One Overview, above n 2.
other OECD countries. Essentially, as stated by Young ‘tax systems are not merely revenue raising instruments. They are in fact massive spending programs and should be evaluated as such’. Such a statement recognises the fact that any redistribution does not only occur by direct government payments, but also through tax offsets and exemptions—known as tax expenditures. In Australia, tax expenditures are reported each year through the Tax Expenditures Statement, in order to improve transparency and allow for scrutiny of the expenditures, which, unlike direct expenditures, are not scrutinised through the annual budget process. The impact of tax expenditures on government revenue should not be underestimated, with measured tax expenditures in 2008–09 being estimated at approximately $102 billion, or 8.5% of GDP.

While such tax expenditures exist to achieve socio-economic objectives through the taxation system, they have greatly increased complexity. The examples to be explored further in this paper to demonstrate this conflict between equity and simplicity are the exemption of food under goods and services tax (GST), Family Tax Benefit (FTB) Part A and B, and the Education Tax Refund (ETR). Not only have these concessions significantly increased the complexity of the tax system, but arguably they have not had the desired effect of making the tax system more equitable.

**Equity versus simplicity in the tax system**

As highlighted above, the key criteria used to evaluate a taxation system are equity, simplicity and efficiency. Unfortunately, as stated by Hill ‘these criteria are often, and probably always, incompatible with each other’. This paper will focus on the conflict that exists between equity and simplicity; that is, as concessions and offsets have been


10 Australian Treasury, above n 9, 15.

introduced to achieve equity objectives, complexity in the system has also increased. Before turning to an evaluation of the impact of the GST food exemption, FTB and the ETR on the equity and simplicity of the taxation system, what is meant by the concepts of equity and simplicity will be defined in further detail.

Equity (or fairness) is considered one of the fundamental requirements of a taxation system. For example, in the recently released Henry Review, when discussing the concept of sustainability, it was stated: ‘To be sustainable the tax system, together with the transfer system, must contribute to a fair and equitable society’. Perhaps what is even more important than an equitable tax system is the public’s perception of equity. If taxpayers do not believe the tax system is fair, they are less likely to comply with their taxation obligations. This is especially the case in tax regimes that rely on self-assessment such as Australia. However, what is considered ‘fair’ may differ between cultures and between individuals, making it very difficult to determine whether a tax system is fair or equitable. As noted by the Commonwealth Taxation Review Committee (the ‘Asprey Committee’), fairness ‘is an ideal exceedingly difficult to define and harder still to measure’.

In discussions of fairness in the taxation system, distinction is made between two concepts: horizontal equity and vertical equity. Horizontal equity refers to the fact that persons with the same or similar ability to pay tax should bear a same or similar tax burden. Two taxpayers earning the same amount may not have the same ability to pay tax if, for example, one person is single with no dependants whereas the other has a dependent spouse and child. Therefore, a tax system that treats all taxpayers in exactly the same way will not result in equitable outcomes. Vertical equity is the notion that those who are in a better position to pay should pay a greater share of tax. Both concepts ‘reflect the ability to pay principle’. The clearest example of vertical equity in the Australian tax system is the use of

---

14 Taxation Institute of Australia, above n 4.
17 Commonwealth Taxation Review Committee, above n 12.
18 Ibid.
19 Young, above n 8, 492.
20 Commonwealth Taxation Review Committee, above n 12.
progressive individual marginal tax rates. When an individual’s taxable income increases, the percentage of income required to be paid also increases (if they move into a higher income tax bracket).\textsuperscript{21} However, as will be shown through the examples in this paper, there is often conflict between these two concepts of equity.

The Asprey Committee stated in 1975 that ‘after equity, simplicity is perhaps the next most universally sought after of qualities in individual taxes and tax systems as a whole’.\textsuperscript{22} Tran-Nam has drawn the distinction between legal simplicity and effective simplicity.\textsuperscript{23} Legal simplicity refers to the ‘simplicity of rules’; that is, the ‘ease with which particularly tax law can be read and understood’.\textsuperscript{24} On the other hand, effective simplicity refers to the ‘ease with which the correct tax liability can be determined’\textsuperscript{25}, and will be reflected by the level of compliance costs (i.e., the cost to taxpayers in complying with their taxation obligations) and administration costs (costs of the revenue authority in administering the taxation system).\textsuperscript{26} In recent years, there have been many efforts to improve the simplicity of Australia’s tax system — starting in 1993 with the Tax Law Improvement Project (TLIP), which aimed to make the legislation more user-friendly; through to 2006, where as a result of the \textit{Taxation Laws Amendment (Repeal of Inoperative Provisions) Act 2006} (Cth) the volume of legislation was significantly reduced by repealing inoperative provisions.\textsuperscript{27} However, these efforts have focused on legal simplicity rather than effective simplicity, and as noted by Woellner et al ‘the inherent difficulties in keeping tax laws simple are increased by the government’s continued use of the tax system for complex “social engineering” purposes’.\textsuperscript{28} This will be highlighted in the examples following — that is, attempts to use the taxation system to achieve socio-economic objectives via exempting food from GST, the FTB and the ETR have increased the complexity of the system.

\begin{footnotes}
\footnote{21}{Woellner et al, above n 6, 74.}
\footnote{22}{Commonwealth Taxation Review Committee, above n 12.}
\footnote{23}{Tran-Nam, above n 1, 505–8.}
\footnote{24}{Ibid 505.}
\footnote{25}{Ibid.}
\footnote{26}{Tran-Nam, above n 1, 507; Woellner et al, above n 6, 25.}
\footnote{27}{Woellner, above n 6, 27.}
\footnote{28}{Ibid.}
\end{footnotes}
**Goods and services tax**

The GST is a broad-based consumption tax levied at a flat rate of 10% on most goods and services supplied in the course of business. The supplier charges the consumer GST on the price of the goods or service, and then remits this to the ATO. The supplier may have also paid GST at points along the supply chain — this tax is effectively passed on to the final consumer, and the supplier is able to receive a credit for GST paid on their inputs. The notion of a broad-based consumption tax was first recommended by the Asprey Committee in 1975, but was not introduced in Australia until 1999 (with commencement from 1 July 2000).

One of the main criticisms of consumption taxes such as GST is that they are regressive. A regressive tax, in contrast to the progressive structure of marginal income tax rates, imposes a greater burden (relative to economic ability) on lower income earners. Carlson and Patrick state: ‘The notion that a tax on consumption is regressive is based on consumer expenditure studies and surveys showing that the percentage of income spent on consumption declines as income rises.’ If a tax of the same rate is imposed on all goods and services, a low income family that spends a higher proportion of their income on consumption than a high income family will hence be paying a greater proportion of their income as consumption tax.

There are different ways to address the regressive nature of a consumption tax. The most common method is to either exempt certain goods and services (generally those that are considered ‘necessities’) or tax them at a lower rate than other ‘luxury’ goods and services. Alternatively, a tax credit method could be used, whereby lower income taxpayers are reimbursed ‘for the tax paid on a minimal or essential level of consumption’. A further solution would be to provide low income families with a direct payment.

---

29 Ibid 1766.
30 Commonwealth Taxation Review Committee, above n 12, 511.
34 Ibid 345.
Taxing certain items at a lower or zero rate is ‘probably the most frequently used method of alleviating the regressivity of a consumption tax’. Indeed, it is the approach taken in Australia with a number of goods and services which tend to either be thought of as necessities or deemed to be ‘merit’ goods; that is, goods that are considered ‘worthy’ and should not be taxed. Certain food, health and medical related expenses, education and child care are GST-free. A GST-free supply is one where no GST is payable on the supply by the consumer, but the supplier can claim input tax credits for GST paid on the business inputs relating to that supply. However, the existence of GST-free categories of goods and services increases the complexity and associated operating and compliance costs of the tax system.

This paper will further look at the GST-free category of ‘food’. There are three reasons for this. First, it is arguably one of the most complex categories of GST-free goods and services, due to only certain foods being GST-free. Second, it was considered one of the most necessary GST-free categories in terms of equity by some groups, with the Australian Democrats refusing to support the GST legislation until the Liberal National Coalition agreed to the GST-free status. Third, a review of the Tax Expenditures Statement reveals that out of all the GST-free categories, food has the largest monetary impact — estimated at $5600 million for 2009–10, rising to $6400 million in 2012–13.

‘The equity problem of taxing food at a flat rate occurs because of the greater proportional cost of food to income for low income earners as opposed to high economic earners.’ This is indicated in the table below. Taken from ABS statistics, it shows the percentage of household income spent on food and non-alcoholic beverages in 2003–04. Households in the

---

36 Carlson and Patrick, above n 33, 344.  
38 Woellner et al, above n 6, 1795.  
39 Tran-Nam, above n 35, 343.  
43 Australian Treasury, above n 9, 192.  
44 Kenny, above n 40, 425.
lowest income quintile spent just over three times as much of their weekly household
income on food and non-alcoholic beverages as households in the highest income quintile.

<table>
<thead>
<tr>
<th></th>
<th>Gross income quintiles</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Lowest</td>
</tr>
<tr>
<td>Mean gross household income per week ($)</td>
<td>263</td>
</tr>
<tr>
<td>Food and non-alcoholic beverages ($)</td>
<td>78.36</td>
</tr>
<tr>
<td>Expenditure relative to income (%)</td>
<td>29.79</td>
</tr>
</tbody>
</table>

Table 1: Household food expenditure relative to gross household income\(^{45}\)

As Kenny stated, ‘there is no doubt that the exemption of food from GST will add to
complexity, imposing higher compliance costs on business and administration costs on the
Government. It is also alleged that such an exemption will create definitional problems that
would wreck havoc for business and the Australian Taxation Office.’\(^{46}\)

The definitional problems become apparent when working through the necessary
steps to determine whether a food item is to be treated as GST-free. First, it needs to be
determined whether an item is ‘food’. Such a simple word has a relatively long definition in
the GST Act,\(^{47}\) and it is worth noting that the first sub-part of the definition of food is ‘food

\(^{45}\) Data obtained from: Australian Bureau of Statistics, *Household Expenditure Survey, Australia: Detailed
Expenditure Items 2003–2004* (5 March 2009),

\(^{46}\) Kenny, above n 40, 425.

\(^{47}\) *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 38-4 states:
(1) *Food means any of these, or any combination of any of these:*
(a) food for human consumption (whether or not requiring processing or treatment);
(b) ingredients for food for human consumption;
(c) beverage for human consumption;
(d) ingredients for beverages for human consumption;
(e) goods to be mixed with or added to food for human consumption (including condiments, spices,
seasonings, sweetening agents or flavourings);
(f) fats and oils marketed for culinary purposes;
but does not include:
(g) live animals (other than crustaceans or molluscs); or
(ga) unprocessed cow's milk; or
(h) any grain, cereal or sugar cane that has not been subject to any process or treatment resulting
in an alteration of its form, nature or condition; or
for human consumption”48 and shows a clear example of poor drafting — defining ‘food’ by reference to ‘food’. If the item in question is in fact food, then the next step is to determine if the food falls under a taxable category. These categories are listed in Schedule 1 of the GST Act, and include food for consumption on the premises from which it is supplied, hot food for consumption away from those premises, prepared food, confectionery, savoury snacks, bakery products, ice-cream food or biscuit goods. It is a reasonably short list, but in the ATO GST Food Guide (a guide for food retailers to enable them to determine whether their food items are taxable or GST-free), retailers are told to ‘always check both the “GST-free food” and the “Taxable food” lists when determining the GST status of a food item’.49 The latest ‘detailed food list’ available on the ATO website contains over 850 items.50 It needs to also be noted that there are a number of food items that may or may not be taxable, depending on how they are prepared or sold. Bread rolls are a prime example. Bakery products are listed as a taxable category of food, but this category excludes bread or bread-rolls (ie bread and bread-rolls are generally GST-free). If you buy bread fresh from the oven at a bakery, it could be argued that as hot food it should be taxable under the category, ‘hot food for consumption away from those premises’. However, as it is not intended to be consumed hot, it will remain GST-free. But, if a restaurant supplies bread or bread-rolls, these items will then be taxable, as the good will be consumed on the premises where it is supplied.51

The above shows how a simple premise, that ‘basic’ food is GST-free, is fraught with complexities, particularly when whether a food is taxable is based on a number of different criteria, and the GST-free categories of food have themselves various exemptions.52 In a speech made by Michael Carmody (the then Tax Commissioner) in 1999, urging Parliament not to treat food as GST-free, he used an example from the UK, where VAT was payable on meat pies sold in a bakery before 3:00pm (when they were considered snack food), but were not subject to VAT after 3:00pm (when they were considered a

51 Australian Taxation Office, above n 49.
52 Taxation Institute of Australia, above n 4, 189.
Apart from adding to the complexity of the system, there are arguments that treating certain goods and services as GST-free has not in fact succeeded in the goal of making the system more equitable. All consumers, regardless of their income level, receive the benefit of the GST-free status of food. Although the ABS figures shown earlier indicate that lower income households spend a higher proportion of their income on food, higher income families spend a higher amount in dollar terms. A study from New Zealand found that higher income families actually receive more of a benefit as a result of exempting food from the GST. As noted earlier, the GST food exemption causes the largest ‘cost’ to the government out of all GST exemptions. With both low and high income households benefiting from this exemption, it is questionable whether the large cost to the government can be justified on equitable grounds.

Unfortunately, there is no perfect alternative, and possible reforms were not examined in the Henry Review, with the potential to broaden the GST-base outside the terms of reference. The provision of direct payments would arguably be a simpler solution and could allow the payments to be targeted specifically to low income households. However, such a solution would require means testing of payment to ensure it was distributed to the appropriate households. The discussion below in terms of FTB will demonstrate how complicated means testing can become.

**Family tax benefit**

From 1941 when child endowment was first introduced, the Australian government has provided some form of assistance to families through the tax and social security system. Depending on the payment or concession in question, these can be thought of as trying to promote either horizontal or vertical equity. In terms of horizontal equity, the argument can

---

53 Carmody, above n 41, 172.
be made that all families with children have additional costs not borne by individuals or couples without children, and therefore all such families should receive some form of benefit or tax concession.\(^{56}\) An example of this is the original child endowment payment — it did not have an associated income test and was paid to all mothers with dependent children. However, since the 1980s the objective of family benefits has shifted to alleviating poverty. For example, payments such as the Family Income Supplement introduced in 1983 under the Hawke Labor government was strictly income tested.\(^{57}\)

Significant reform occurred to family benefits under the Howard Coalition government — a shift to greater use of the taxation system and a reduction in the number of payments. ‘In the Coalition’s first budget of 1996–97, a new measure of family income support was introduced, named the Family Tax Initiative, which authorised use of the tax system as well as the transfer system to deliver the additional benefits … The measure signalled, both in its symbolic naming and in the mechanism of delivery of the benefit, a clear reversion to the use of the tax system (through a tax rebate method) to deliver family income support’.\(^{58}\) The system was further reformed by the Coalition government in 2000, with the introduction of Family Tax Benefit (FTB). The Explanatory Memorandum to the Bill introducing the legislation stated: ‘As part of the Government’s plan for a new tax system, the structure and administration of family assistance is being simplified with effect from 1 July 2000. Twelve forms of assistance, currently available under the tax and social security systems, will be reduced to three.’\(^{59}\) The three benefits being referred to were the FTB Part A, FTB Part B and the Child Care Benefit. Only the FTB Part A and B will be discussed in this paper. The FTB can hardly be considered simple, and the complexity will be shown through a discussion of the criteria that must be met to receive payments, and the problems that have arisen with these criteria and overpayments. As Hodgson stated, the ‘combination of benefits does not necessarily result in the simplification of benefits’.\(^{60}\)

It is interesting to note that the actual provision of FTB Part A and B are not recognised as tax expenditures in the Tax Expenditures Statement, despite the fact that they

\(^{56}\) Ibid.
\(^{57}\) Cass and Brennan, above n 6, 43.
\(^{58}\) Ibid 51.
\(^{59}\) A New Tax System (Family Assistance Bill) 1999 (Cth), Explanatory Memorandum.
\(^{60}\) Hodgson, above n 55.
are tax offsets.61 What is recognised as a tax expenditure is the cost to the government in treating such benefits as exempt income.62 Generally speaking, in dollar terms, this exemption is the largest tax expenditure for exemption of government income support payments, with a cost of $2010 million for 2009–10.63

In regard to FTB, the preliminary eligibility criteria are not difficult — you must care for a dependent child at least 35% of the time and must meet certain residency requirements.64 Where the complexity arises is in the calculation of the amount of FTB a family receives. In relation to FTB Part A, the Family Assistance Office states: ‘to assist the families that need it most there is a maximum rate of benefit for those on low incomes and a base rate for families on moderate income’.65 It is clear from this statement that vertical equity is a key policy objective behind the payment, but is also one of the reasons the calculation is so complex.

In order to determine the amount of FTB Part A, the ‘actual annual family income’ must first be calculated.66 This does not equate to taxable income, but is the sum of taxable income, employer provided or reportable fringe benefits, reportable superannuation contributions, total net losses from rental properties included in taxable income, tax free pensions or benefits, and foreign income (either exempt or not taxable in Australia). Any maintenance payments that are paid by the taxpayer are subtracted in this calculation.67 If ‘actual annual family income’ is less than $44 165, the maximum rate of FTB Part A will be

---

61 Commonwealth Ombudsman, Own Motion Investigation into Family Assistance Administration and Impacts on Family Assistance Office Customers (Commonwealth of Australia, 2003).
62 Australian Treasury, above n 9, 52.
63 For the 2009–10 year, the exemption of the Tax Bonus for Working Australians was the largest tax expenditure item in regards to exemption of government income support payments, ‘costing’ $2070 million for the 2009–10 income year. However, as this bonus was a ‘one-off’, based on taxable income in the 2007–08 income year, the ‘cost’ of this exemption will drop significantly to $95 million in 2010–11, with no further cost estimates past that time: Australian Treasury, above n 9, 57.
66 Ibid.
received. However, the maximum rate varies based on age of children and number of children. If the actual annual family income is above $44 165, the maximum rate is reduced by 20 cents for each dollar over the amount until the ‘base rate’ of FTB Part A is reached. As the base rate varies based on the number of and age of children, the maximum income level a family can have will also vary based on these factors. Once a family’s actual annual income reaches $94 316 (plus $3796 for each FTB child after the first), the base rate reduces by 30 cents for each dollar over that amount until the payment stops. If you receive an amount over the base amount, the maintenance income test may also apply, where the FTB Part A is reduced by 50 cents in the dollar if child support or spousal maintenance is received over certain amounts.

FTB Part B provides further assistance to single parent families or a two parent family with one main income. If the family in question is a single parent family, the single parent can earn up to $150 000 and still receive the maximum rate of FTB Part B (with the maximum rate varying based on whether the child is under or over 5 years). Once the $150 000 is exceeded, no FTB Part B will be paid. In a two parent family, the main income earner must earn less than $150 000, and then an income test is applied to the lower income earner. The secondary income earner can earn up to $4672 and still receive the maximum rate of FTB Part B. Once the income exceeds this limit, the maximum rate of FTB Part B is reduced by 20 cents for each dollar over this amount. Based on current rates and payment thresholds, the secondary income earner can earn up to $23 817 if the person has a child under 5 years of age or $18 542 if the person has a child between 5 and 18 years of age.

One of the main issues regarding the FTB is the potential for overpayment. FTB can be paid in a number of ways: fortnightly, annually, or a combination of both. The majority of families receive the benefit as a fortnightly payment, but these payments are

---

69 Ibid.
70 Ibid.
74 Family Assistance Office, above n 65, 6.
based on an estimate of actual income. The Family Assistance Office provides a list of circumstances where ‘you are at a high risk of being overpaid’. This includes items such as income changing because of being a casual or shift worker. As pointed out by Hodgson, it is often low income families that are in casual employment. The annual payment option means that FTB is not paid until the actual income is known. However, it is obviously low income households who are more likely to need to receive the payments fortnightly.

Both FTB Part A and B include a supplement payment, with all families who are eligible for FTB eligible to receive the supplement. These supplements can only be paid annually once the relevant tax returns are lodged with the ATO (or the Family Assistance Office has been advised that a tax return does not need to be lodged and annual income has been verified), and the Family Assistance Office has balanced the FTB payments. If necessary, the supplement can be used to reduce FTB or Child Care Benefit overpayments from the current year or previous years, and/or recover an outstanding tax debt.

Prior to 1 July 2009, the FTB could be claimed either through the ATO as a refundable tax offset or through the Family Assistance Office. However, from 1 July 2009, it has only been able to be accessed via the Family Assistance Office. However, despite this, links with the taxation system are clear. First, taxable income, which forms part of ‘actual annual income’, is one of the key criteria for determining whether a family is eligible to receive FTB. Secondly, the supplement payment can be used to recover outstanding tax debts.

In the 2010–11 Budget, the ‘estimated actual expenses’ of FTB for the 2009–10 year was $17,821,898 and this does not include the ‘cost’ to the government of exempting these payments from income tax, as discussed earlier. Although it is not being argued that assistance to families is unnecessary, with FTB being a significant cost to the government,

74 Family Assistance Office, above n 65, 4.
75 Family Assistance Office, above n 65, 6.
76 Hodgson, above n 55.
77 Family Assistance Office, above n 65, 8.
78 Family Assistance and Other Legislation Amendment (2008 Budget and Other Measures) Bill 2009 (Cth).
the system should be as equitable as possible, but also simple enough so that families can understand their entitlements and obligations. In an attempt to be equitable the system is now overly complex and, due to the extent of overpayments, there was a Commonwealth Ombudsman inquiry into the administration of the FTB.\textsuperscript{81} It can be safely said that if the purpose of the Howard government’s reforms in 2000 were to simplify the system, they did not succeed.

It is also arguable that the FTB system is not equitable, regardless of whether the focus is horizontal or vertical equity. In terms of horizontal equity, all families with children should receive FTB, as all have costs not faced by those without children. By means testing the payment, higher income families, that still have the costs associated with raising children, do not receive assistance. If vertical equity is the policy objective behind FTB, then means testing the payment is necessary. However, the current method of means testing the payment is by no means equitable, particularly in regards to FTB Part B. Under this payment, any family with only one income earner who earns less than $150 000 receives the maximum rate of the payment. It seems logical that a family with one income earner earning $50 000 a year is more in need than a family with one income earner earning, for example, $145 000.

The impact of the secondary income earner means test could result in further inequitable outcomes. Consider a family with one parent earning $145 000 and the other partner not working. This family will receive the maximum rate of FTB Part B. In contrast, a family with both parents working, each earning $50 000 a year, will not be entitled to any FTB Part B, as the secondary income earner thresholds will be exceeded. Overall, the second family earns less than the first family, and yet the first family will receive assistance. As stated by Hodgson, ‘if there are two conclusions that must be drawn ... they must be that the current system of transfer payments to families fails the tests of both equity and simplicity’.\textsuperscript{82}

Recommendation 90 in the recent Henry Review stated:

Current family payments, including Family Tax Benefit Parts A and B, should be replaced by a single family payment. The new family payment should:

\begin{flushright}
81 Commonwealth Ombudsman, above n 61.
82 Hodgson, above n 55.
\end{flushright}
(a) cover the direct costs of children in a low-income family (that is, the costs associated with food, clothing, housing, education expenses); and
(b) assist parents nurturing young children to balance work and family responsibilities. 83

As yet, this recommendation has not been specifically accepted or rejected by the Australian government. 84 If accepted, whether this recommendation improves the simplicity of the system, or is merely a repeat of the Howard government’s earlier efforts to combine family payments is unknown. However, it seems unlikely that such a further combination of payments will simplify the system, unless the current method of means testing such payments is significantly simplified.

**Education tax refund**

The Education Tax Refund (ETR) was a Rudd Labor government initiative, introduced by the Tax Laws Amendment (Education Refund) Bill 2008, and contained in Subdivision 61-M of the *Income Tax Assessment Act 1997* (Cth). In the second reading speech of the Bill, although ‘equity’ was not mentioned per se, the requirements of the ETR (which are discussed below), as well as some of the phrases used in the speech, indicate that equity was a key reason for its introduction. For example, Treasurer Wayne Swan stated:

> Education is the engine room of prosperity and helps create a fairer, more productive society. It is the most effective way we know to build prosperity and spread opportunity. A key part of the education revolution is helping parents meet the everyday costs of their children’s education.

He further stated that ‘education increases productivity and participation, it builds prosperity and it also offers the hope of breaking the intergenerational cycle of poverty’. 85

Essentially, the ETR allows eligible families to claim 50% of eligible education expenses for their children incurred during the income year. The 50% refund applies to a maximum of $750 per primary school student and $1500 per high school student (ie a

---

85 Tax Laws Amendment (Education Refund) Bill 2008 (Cth), Second reading speech.
maximum refund of $375 and $750 respectively). Although the explanatory memorandum accompanying the Bill stated that the compliance cost impact would be low, the FAQ section on the ATO website contains 38 questions. There are a number of criteria that must be met in order to claim the ETR.

Persons who care for a child who is enrolled in primary or secondary school, and some independent students, may be eligible to claim the rebate. In terms of persons who care for a child, in order to be eligible for the ETR, they must receive FTB Part A in relation to that child. If they do not receive FTB Part A in relation to the child, that must be because either a payment was made to the child that prevented the person from receiving the benefit (such as youth allowance or a disability support pension) or the child stopped full-time school during the year and received income over the cut-out amount of FTB Part A.

Independent students must be under the age of 25 and receive a payment such as youth allowance or ABSTUDY living allowance (and be considered independent for the purposes of that payment). Further, they must be an Australian resident who lives in Australia, and meet the schooling requirement, which is the undertaking of full-time secondary school studies.

If it is determined that the carer or independent student is eligible for the ETR, they must calculate what their eligible education expenses were for the year, which also has a number of requirements. An eligible education expense is incurred by an eligible person (ie a person who meets the eligible requirements discussed above), relates to the education of the child or independent student, must be specified as an eligible education expense in the legislation, and is incurred on a day when the schooling requirement was met. Eligible education expenses specified in the legislation include computers and related equipment or repairs, software, textbooks or other learning materials, or trade tools prescribed for trade courses undertaken in secondary school.

---

86 Ibid.
87 Tax Laws Amendment (Education Refund) Bill 2008 (Cth).
90 Ibid.
As stated above, the maximum expenses allowed are $750 for primary school students and $1500 for secondary school students. If expenses are incurred above this amount, the excess may be carried forward for a maximum of one year (and the eligibility requirements must be met in the year the claim is made). If a person shares care of a child, they claim an amount based on the FTB Part A shared care percentage. However, further complications arise if a person shares the care of a child with a person who is not the person’s current partner and a payment was made to the child that prevented the person receiving FTB Part A. In this case, the ETR eligible to be claimed is based on the number of nights during the year that the child was in the person’s care.92

The above should show that any tax rebate, even one with a simple premise of paying a tax refund for educational expenses, has a number of layers. It is less complex than FTB in terms of calculation; that is, every person who meets the initial eligibility requirements can claim up to the maximum amount based on expenses incurred. However, by being linked to FTB Part A, some of the complexities associated with its calculation pass over to the ETR. It is administered through the tax system, and for those who are not required to lodge a tax return, requires the lodgement of an additional form to access the tax rebate.93

It also arguably does not meet the criteria of either horizontal or vertical equity. Due to the eligibility requirements, not all taxpayers who have eligible educational expenses can claim the rebate, and therefore the ETR is inequitable in terms of horizontal equity. However, once the eligibility criteria are met, persons with various levels of income may be eligible to claim the same amount (assuming they had the same amount of eligible educational expenses).

The expenses claimed must be able to be substantiated, with the Treasurer stating in the second reading speech: ‘This offset will apply to eligible expenses incurred from 1 July 2008. Those eligible for the education tax refund should start keeping their receipts — I cannot stress this enough — to allow them to claim the tax offset in their 2008–09 income

tax return from 1 July 2009.\textsuperscript{94} However, this raises an issue as the legislation was not introduced into the House of Representatives until almost four months into the 2008–09 financial year. It was not passed by the Senate until 27 November 2008 and did not receive royal assent until 9 December 2008. Therefore, it seems quite possible that an eligible person could have incurred eligible expenses from the period 1 July 2008 until the ETR was publicised, and not kept receipts. This could further violate the principle of horizontal equity, as persons in the same economic position who incurred a similar level of expenses at different times of the year may be eligible for a different amount of the rebate.

As with FTB Part A and B, the ETR itself is not included in the Tax Expenditures Statement (despite the fact that it is also a tax offset).\textsuperscript{95} However, the cost of exempting the ETR from income tax is included in the Tax Expenditures Statement and is estimated at $180 million for the 2010–11 year, increasing to $190 in 2011–12 and 2012–13. The cost listed in the explanatory memorandum over three years (2008–09 through to 2011–12) is $4410 million.\textsuperscript{96}

The Henry Review recommended (Recommendation 6) that the ETR be removed from the income tax system, and instead be included in a single family payment and paid as an advance lump-sum-amount at the start of the school year.\textsuperscript{97} “The proposed reform would reduce the compliance burden (substantiation requirements) for family payment recipients, provide more timely compensation and reduce complexity and administration costs in the tax system.”\textsuperscript{98} This recommendation has not been accepted (although also not specifically rejected) by the Australian government.

**Conclusions**

No tax system will be able to fully achieve the goals of tax simplicity, equity and efficiency. In the Australian tax system, equity is considered paramount, and as such there are a number of instances where attempts to make the tax system more equitable have occurred at the expense of simplicity. Further, as shown through the examples in this paper, it is arguable that such attempts have not in fact achieved the goals of either horizontal or vertical equity.

\textsuperscript{94} Tax Laws Amendment (Education Refund) Bill 2008 (Cth), Second reading speech.
\textsuperscript{95} Australia’s Future Tax System, *Part Two Detailed Analysis*, above n 2, 89.
\textsuperscript{96} Tax Laws Amendment (Education Refund) Bill 2008 (Cth).
\textsuperscript{97} Australia’s Future Tax System, *Part Two Detailed Analysis*, above n 2, 32.
\textsuperscript{98} Australia’s Future Tax System, *Part Two Detailed Analysis*, above n 2, 89.
Although the Henry Review suggested changes to FTB and the ETR, these recommendations have not yet been accepted by the Australian government. Further, due to the review panel’s terms of reference, no recommendations could be made to broaden the base of the GST. It therefore seems unlikely that any changes will occur in the near future to any of the examples discussed in this paper.

The government itself has stated that the primary goal of a taxation system is to raise revenue, and yet it continues to use the tax system to achieve socio-economic objectives. If the government continues to use the tax system to achieve socio-economic objectives, greater emphasis needs to be placed on how to achieve such objectives without further complicating the system. Further, attention needs to be given to whether the tax concessions and offsets introduced under the premise of ensuring the tax system is equitable actually achieve that objective. As demonstrated through the examples in this paper, it is arguable whether the GST food exemption, FTB and the ETR achieve either horizontal or vertical equity.

If vertical equity is a policy objective, this will be best achieved by maintaining progressive tax rates. Further assistance can then be given to those in need via direct payments, rather than the use of tax expenditures and offsets. Each method is a significant cost to the government, but the complexities that have resulted in the tax system due to tax expenditures have caused additional (and arguably unnecessary) administrative and compliance costs.