Australian Government
Department of Social Services

Paul McBride
A/g Deputy Secretary

Senator Zed Seselja
Chairperson
Senate Standing Committee on Community Affairs
Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Senator Seselja

SUBMISSION TO SENATE COMMUNITY AFFAIRS LEGISLATION COMMITTEE

Please find attached the Department of Social Services submission to the Senate Community Affairs Legislation Committee Inquiry into the *Social Services Legislation Amendment (More Generous Means Testing for Youth Payments) Bill 2015*.

Thank you for providing the Department with an opportunity to make a submission.

Yours sincerely

Paul McBride

October 2015

Opening Statement

The *Social Services Legislation Amendment (More Generous Means Testing for Youth Payments) Bill 2015* (the Bill) introduces several changes that were announced in the 2015 Budget.

The measures will provide more consistent and more generous support for families with dependent young people who qualify for certain youth payments, in particular Youth Allowance and ABSTUDY Living Allowance which provide eligible young people with financial support while they study or train.

The Government has recognised the need for a simpler and fairer youth payments system that focuses on working families who need assistance. Low and some middle income families are disadvantaged under the existing means testing arrangements due to multiple means tests being applied concurrently.

The measures in this Bill are consistent with long term directions to simplify the system and align rules for dependent children from birth to independence as recommended in the Government commissioned Final Report of the Reference Group on Welfare *A New System for Better Employment and Social Outcomes (February 2015)*.

The measures simplify the complex array of parental means testing arrangements for Youth Allowance and would more closely align these with those applying to Family Tax Benefit Part A. Similar changes would be made to parental means testing arrangements to ABSTUDY Living Allowance and Assistance for Isolated Children Scheme via changes to the *ABSTUDY Policy Manual* and *Assistance for Isolated Children Guidelines*.

Another beneficial component of this Bill would expand the number of children that can be included in the ‘family pool’ for the youth parental income test to include a notional maximum rate of Family Tax Benefit Part A for all of the children for whom the parents have financial responsibility and hence lessen the reduction in youth payments as family income increases.

The changes to the *Social Security Act 1991* emphasise the need to boost assistance for working families by smoothing the transition to individual youth payments for young people and better supporting them into study or training to join the workforce, build their careers, develop economic opportunities and contribute to our economy. The measures in this Bill will particularly benefit those young students from regional and remote areas, who often face higher costs of further study or training due to the need to move away from home.

Around 33,500 families with dependent young people are estimated to benefit from these measures with the Government providing a financial commitment of $262.7 million over the forward estimates. Extra support would be provided to families as their children move into young adulthood, particularly rural and regional families whose young people continue to study or train beyond Year 12. An estimated 22,400 dependent young people would be eligible for an increase in youth payments while a further 11,100 dependent young people would become eligible for youth payments for the first time. Around 230,000 families currently subject to the Family Assets Test or the Family Actual Means Test would benefit from reduced regulatory burden.

Social Services Legislation Amendment (More Generous Means Testing for Youth Payments) Bill 2015

Part 1 – Parental Means Testing for Youth Allowance

Background

Under current means testing arrangements for Youth Allowance (YA), a non-independent young person is subject to:

- both a *personal income test* and a *Parental Income Test;* and
- both a *Family Assets Test* and *Family Actual Means Test.*

The *Family Assets Test (FAT)* takes into account personal, business and farm assets. The test is based on how much a family would receive for the assets if they sold them, less any debts or mortgages they owe. The family home is not included in the assets test, and a 75 per cent discount is applied to business and farm assets.

Under the FAT, YA is not payable to the dependent young person if the value of the family's assets exceeds $661,250. The assets of the parent(s), the dependent young person and any other dependent children are included in this assessment.

The *Family Actual Means Test (FAMT)* considers family spending and savings and applies if one or both of the parents in the previous financial year:

- had an interest in a trust, private company or unlisted public company
- were self-employed (except as a sole trader engaged wholly or mainly in primary production) or a partner in a partnership
- earned in excess of A$2,500 (including tax exempt from income) from a source in Norfolk Island or outside Australia
- were a wage or salary earner who claimed or will claim a tax deduction for a business loss (whether current or carried forward) that does not consist of a net investment loss in partnership income tax returns
- had an interest in assets held outside Australia in excess of A$2,500, or
- is a migrant who first entered Australia under a business skills category (business migrant) in the last 10 years

Where the FAMT applies, the spending and savings of all members of the immediate family (i.e. the parent(s) and the dependent children) in the base tax year is used to estimate the family's actual means.

In respect of income testing of YA, the rate payable will be the lowest of that produced by the FAMT, personal income test or Parental Income Test (PIT).

Currently, where the parent's income calculated under the PIT or FAMT exceeds the threshold of $50,151, the dependent young person's payment is reduced by 20 cents for every dollar over the threshold.

By way of comparison eligibility for Family Tax Benefit (FTB) Part A is subject only to an income test based on Adjusted Taxable Income and has no FAT or FAMT.

The following Table highlights the inconsistency in means testing arrangements for FTB Part A and YA.

Table: Comparison of Means Tests elements between Family Tax Benefit Part A and Youth Allowance

	FTB Part A	*Youth Allowance*
Personal Income Test	*No*	*Yes*
Parental Income Test	*Yes*	*Yes*
Low income Health Card Parental Income Test exemption	*No*	*Yes*
New Enterprise Incentive Scheme Parental Income Test exemption	*No*	*Yes*
Family Assets Test	*No*	*Yes*
Family Actual Means Test	*No*	*Yes*

Description of the measure

Under the changes contained in the Bill, from 1 January 2016 the FAT and FAMT would be removed from YA parental means testing arrangements. This would align these payments with FTB Part A, which does not include a FAT or FAMT. The PIT exemptions for YA will also be aligned with the existing arrangements for FTB Part A. There will be no low income Health Care Card (LIC) and New Enterprise Incentive Scheme (NEIS) exemptions from parental income testing for youth payments.

Removing the FAT and FAMT would increase payments for some YA recipients, and allow additional people to qualify for YA for the first time.

The changes mean families would receive a more consistent level of support as young people move from FTB Part A to an individual youth payment.

In particular, the measure would also reduce sudden decreases in income experienced by some families as their children move from FTB Part A and onto the youth payments system. Some of these young people are being disadvantaged under current rules, because the FAT or FAMT (which do not apply to FTB Part A) exclude them from receiving YA despite their low family incomes.

The measure means that from 1 January 2016 YA recipients would be subject to only the PIT, not multiple parental means tests, consistent with the existing arrangements that apply to FTB Part A. The definitions of income for the PIT and Adjustable Taxable Income for the FTB Part A income test are generally the same and consistent free areas and taper rates apply.

Importantly, the changes mean farming families would not have farm assets counted toward the means test for their dependent children claiming YA.

Policy rationale for the proposal

Families receive assistance for the direct cost of children through FTB Part A when the children are full-time secondary students and through Youth Allowance when dependent young people continue in further study or commence looking for work.

There is no rationale for additional family means tests for YA that do not apply to FTB Part A. The additional tests applied to YA are complex and can create barriers to accessing assistance for some families.

Many families have children in both the Family Payment system and the youth payments system, and have to meet multiple tests to receive payments. These families face different tests when determining their eligibility for payments supporting their dependent children which can be confusing for them and create anomalous outcomes.

There is no equivalent to the FAT or FAMT in the means test arrangements for Family Payments. This can mean that families who receive support for a dependent student child via the Family Payment system, may not be eligible for support when the child transitions to YA or ABSTUDY because of the FAT or FAMT, even though family circumstances have not changed. The removal of the FAT and FAMT would address this anomaly and the transition would be much smoother.

Under the changes in the Bill, after the FAT and FAMT are removed the PIT would continue to apply to YA. Exemptions from the PIT will be made consistent with arrangements for the FTB Part A income test by removing the exemption from the PIT for LIC and NEIS recipients.

Removing the Family Assets Test and the Family Actual Means Test

Family Assets Test

The FAT can create sudden drops in assistance when a child transitions to YA because the Family Payment means test does not include an assets test. In addition, asset testing YA does not always support good outcomes for the family and the young person. Unlike for retirees, where it is reasonable to expect those with substantial levels of savings or other assets to use them for self-support (and the Pension Loans Scheme is available for those who cannot), it is often not possible, or desirable in the long term, to expect families to draw down on their assets to support their young people through a relatively short period until independence and this can operate to discourage young people from pursuing post-secondary education or training.

For example, assets tied up in a farm, business or other long term or illiquid investments such as real estate are not able to be readily drawn down from without borrowing or outright sale. Taking on debt or selling such assets to provide support for a dependent young person for a relatively short period is often not practicable or in the long term best interests of the family.

Family Actual Means Test

The FAMT requires details about the spending and savings of all family members during the relevant financial year to be supplied. There are concerns around the complex and intrusive nature of this task, the level of detailed information required and the additional complexity of claim processing and long delays in granting some payments. .

One of the main concerns raised is that these requirements can act as a disincentive and/or a barrier for families to test their eligibility for assistance when the young person transitions to a youth payment and again this may discourage some young people from pursuing further studies or training.

Furthermore, there is anecdotal evidence that the FAMT has unintended consequences.
For example, Department of Social Services (DSS) data shows that the YA entitlements of around 700 dependent students of parents <u>receiving income support payments</u> have been adversely affected by the FAMT. This suggests that the FAMT does not always produce consistent outcomes because income support customers have, by definition, low incomes and the income support means test is comprehensive and includes rules that attribute assets and income controlled through private trust and private company arrangements. In addition, it includes salary sacrificed income, fringe benefits and foreign income, and does not allow investment losses.

Subject to the passage of this Bill through Parliament, the PIT would continue to apply, as would the usual social security personal income test for the dependent young person.

Regulatory burden on families due to the Family Assets Test and Family Actual Means Test

The FAT requires families to list and value their assets. The FAMT requires families to document their expenditure and savings in detail and many families require the services of an accountant. These can be onerous tasks and, even with full diligence to this task by families, can be prone to omissions and under and over estimations. It can also result in long claim processing times and delays in payments.

The removal of these tests will reduce the regulatory burden for around 200,000 families subject to the FAT. The regulatory burden will be reduced for around 30,000 families subject to the FAMT - there is a large regulatory burden yet there is only an impact in about 6,000 (20 per cent) of cases.

It is estimated that removal of the FAT and FAMT will provide a regulatory saving to families of around $26.5m a year.

<u>*Key facts and customer impacts*</u>

Removal of the Family Assets Test

DSS estimates that removing the FAT would increase the number of dependent YA recipients by around 2-2.5 per cent (approximately 4,100 a year) at a cost of $30.7 million a year (average annual gain of more than $7,000 per year). It would particularly benefit students and their families from regional and remote areas, who often have large assets which are assessed under the FAT, while at the same time being more likely to have lower adjusted taxable incomes than their metropolitan counterparts that would then attract YA.

Removal of the Family Actual Means Test

DSS has estimated that removing the FAMT would cost $9.7 million a year. Approximately 4,900 affected customers who would experience an average payment increase of around $2,000 a year. A further 1,200 individuals would benefit from being able to access YA for the first time at a cost of $2.4 million a year. Around 50 AIC customers may receive an increase in AIC payments, or the dependent student will transfer to YA as it would provide a higher rate. Another 50 would qualify for one of these youth payments for the first time. Around 1,200 youth payment recipients from regional and remote areas would benefit.

Aligning Youth Allowance Parental Income Test exemptions: removing the low income Health Care Card (LIC) and New Enterprise Incentive Scheme (NEIS) exemptions from the Parental Income Test

The LIC and NEIS are not provided as a measure of the need for an income support payment, but rather to assist with particular costs, i.e. certain health care costs and state concessions (LIC) and start-up costs for a new business (NEIS).

About the Low income Health Care Card

The LIC gives low income earners access to cheaper prescription medicines, and various concessions from government and private organisations. Qualification for the card is subject to an income test. The LIC income test only operates to determine eligibility for the card and no taper rate applies. That is, if a person’s income is below the relevant limit they may be able to receive the LIC and if their income exceeds the limit they cannot be granted a LIC.

About the New Enterprise Incentive Scheme

The NEIS is administered by the Department of Employment and assists eligible unemployed people to start new, viable small businesses. Payments made under NEIS are excluded from the ordinary income test under section 8(8)(t) of the Social Security Act 1991 (the Act) and subject to discrete NEIS provisions under Part 3.15 of the Act.

Rationale for removing the exemptions

The rationale for exempting families on income support from the PIT is that they are already subject to an income test with a progressive withdrawal rate or taper rate and they should not be subject to a second income test at the same time. This would mean they could be subject to cumulative withdrawal rates applying to the same income. This issue does not apply to families with a LIC or NEIS exemption as they are not subject to cumulative withdrawal rates through the operation of separate income tests.

It is important to note that the majority of families with a LIC or in receipt of a NEIS payment would continue to qualify for maximum assistance for their dependent child through Youth Allowance as their income will be below the relevant free area (currently $50,151). That means they will be assessed on the same basis as other low income families and will therefore be treated equitably with other low income families on similar incomes.

However, where families who currently are subject to the LIC and NEIS exemptions have family income over the year above the free area ($50,151), there is no reason why they should retain access to the exemptions. It is fair that they should be subject to the same parental means testing as applies to other families with the same income.

The exemptions are also largely redundant following the increase in 2010 in the YA PIT income free area from $33,300 to $44,165 under the *Review of Australian Higher Education* (Bradley Report). Prior to these increases in the YA PIT free areas the exemptions affected far greater numbers of families.

The LIC and NEIS exemptions do not apply to FTB Part A.

Impact of the removal of low income Health Care Card and New Enterprise Incentive Scheme exemptions

Currently, around 3,000 YA recipients are exempt from the YA PIT due to a parent holding a LIC and a further 275 due to a parent being assisted by the NEIS.

Assistance would be reduced for approximately 270 recipients, with an average fortnightly reduction around $85 saving around $0.6 million a year.

Part 2 – Adding Family Tax Benefit Children to the Family Pool for Parental Income Testing for Youth Allowance

Background

The so-called 'family pool' arrangement for the YA parental income test (PIT) was introduced in 2010 to ensure that parents face a maximum effective tax rate of 20 cents in the dollar from parental income testing of YA payments, regardless of how many dependent young people they financially support.

However, the current rules do not take full account of other younger children the parents might be financially supporting, and who attract FTB Part A.

Only FTB Part A children aged 16-19 years at YA maximum rates, along with the total youth payments subject to parental income testing are included. Families with FTB Part A children aged under 16 years may face a higher reduction of youth payments than families with FTB Part A aged 16-19 years .

Description of the measure

Under changes contained in the Bill, from 1 July 2016, youth income support PIT arrangements would expand to include a notional maximum rate of FTB Part A for all of the dependent children in the family pool for whom the parents have financial responsibility. This recognises all the children and dependent young people for whom the parents have financial responsibility.

This amendment will apply to families that have dependent young people receiving individual youth payments that are parentally income-tested, and also younger dependent siblings, and will result in a lower rate of reduction to the dependent young person's YA than is currently the case. The current rules unfairly reduce assistance to families as young people move to parentally income tested youth payments by imposing excessive withdrawal rates.

Policy rationale

The youth PIT pool was introduced in 2010 to ensure that parents face a maximum effective tax rate of 20 cents in the dollar from parental income testing of youth income support payments, regardless of how many dependent young people they support. However, the current rules do not take full account of other younger children the parents' support, who attract FTB Part A.

In this respect, adding FTB children to the family pool will reduce sudden drops in family assistance as young people move from FTB Part A and onto YA or certain other youth payments.

Currently, only FTB children aged 16-19 years at YA maximum rates, along with the total youth payments subject to parental income testing are included in the family pool. Families with FTB Part A children aged under 16 years may face a higher reduction of youth payments than families with FTB Part A dependent students aged 16-19 years.

Example

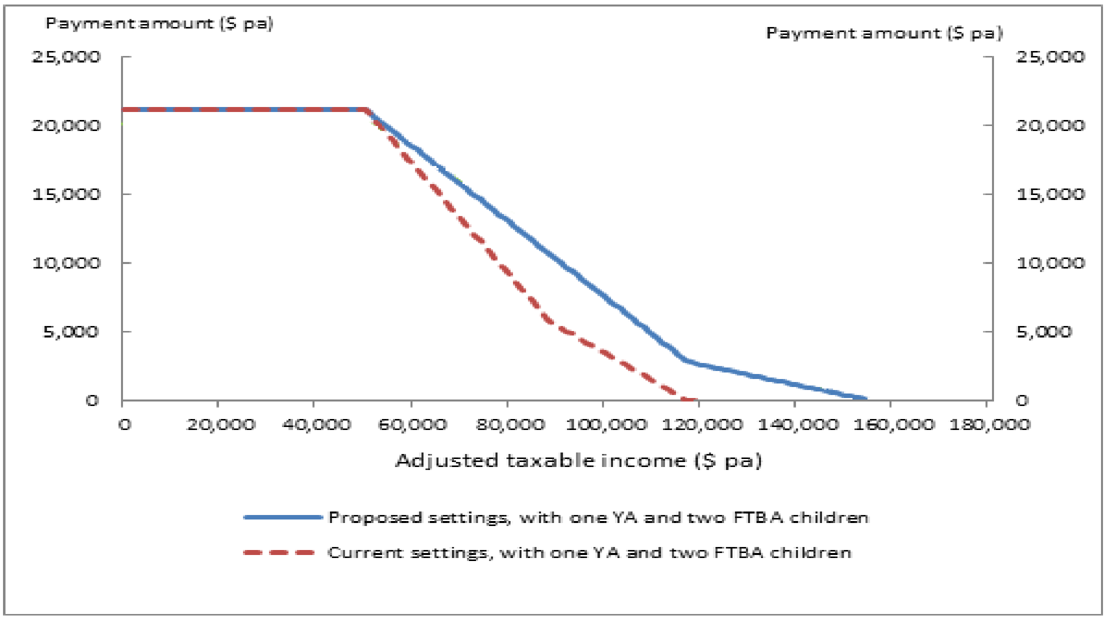
Peter and Liz have three dependent children/youth who are students living at home - John aged 19 years receiving parentally income tested Youth Allowance and Frank aged 14 years and Mary aged 8 years for whom the family receives Family Tax Benefit Part A. The family's combined adjusted taxable income is $70,000 a year.

Currently, John's annual Youth Allowance rate is reduced by 20 cents for every dollar that Peter and Liz earn over the income free area of $50,151 a year.

As Frank and Mary are under the age of 16 years, they are not taken into account in the family pool when calculating John's Youth Allowance. Based on the family's income, the amount of Youth Allowance they receive is around $132.92 a fortnight ($3,455.80 per annum).

From 1 July 2016, the younger children (Frank and Mary) will be included in the youth parental income test pool to recognize the support they receive from their parents. This will reduce the Youth Allowance parental income test withdrawal rate from 20 per cent to 7.54 per cent.

As a result, John's Youth Allowance will increase to around $228.01 a fortnight ($5,928.39 per annum). This is an increase of $75.33 a fortnight ($1,958.59 per annum).



Key facts

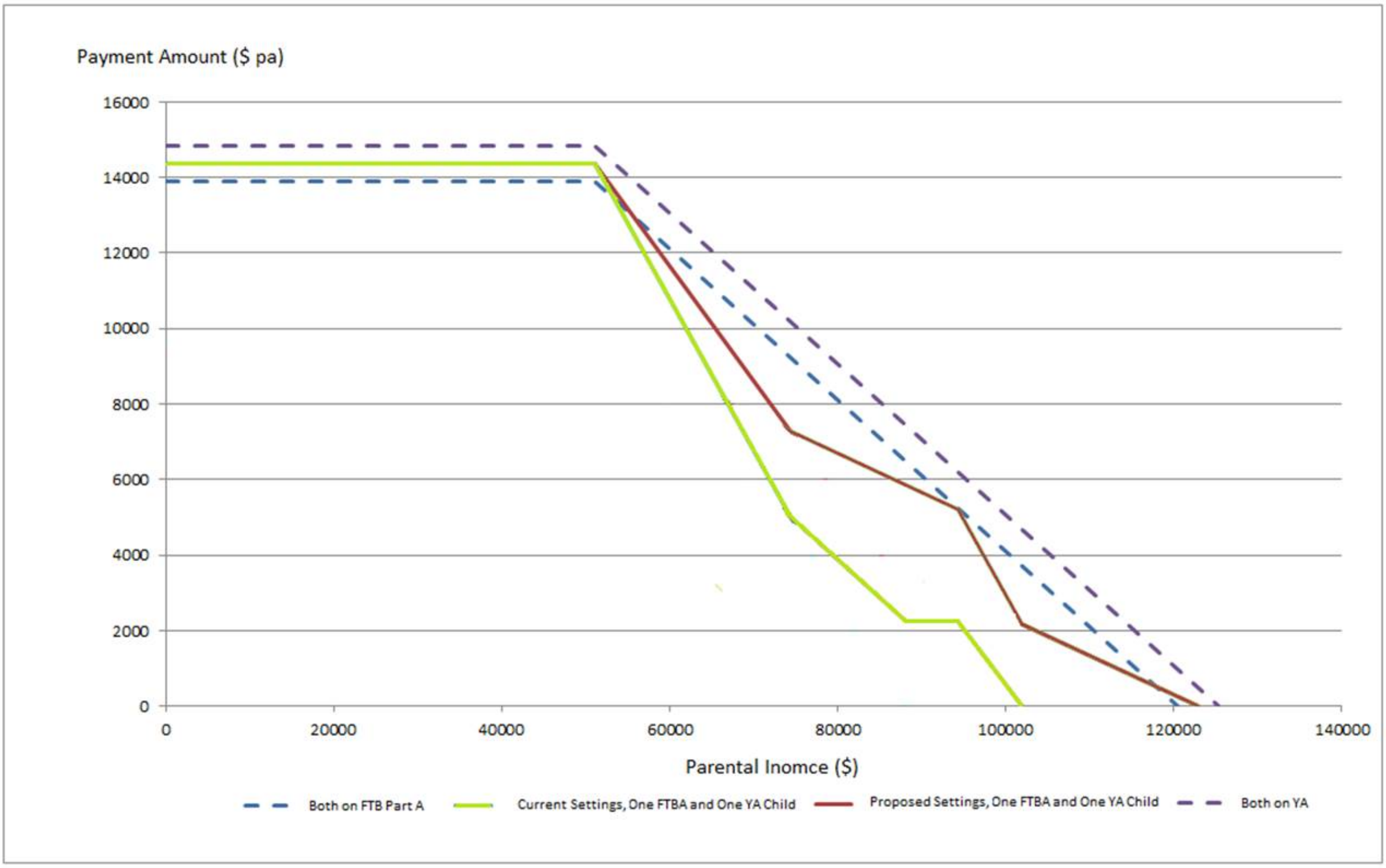
Including all FTB children in the family pool for the youth PIT will allow around 13,700 families, with dependent children in both the FTB Part A and youth systems, to become eligible for an average increase in payment of around $40 per fortnight ($1,100 per year).

Around 5,800 families, who currently miss out on payments due to the combined higher taper rates, will also become eligible for an average payment of around $50 per fortnight ($1,300 a year).

Around 500 families with older children in shared care arrangements who attract FTB Part A may be worse off, because the new family income test rules for the youth PIT would better reflect the level of financial responsibility of parents with less than 65 per cent care than the existing rule.

The following chart shows how assistance to working families with more than one child can reduce as the first child leaves FTB Part A and moves on to parentally income tested youth income support payments (moving from the blue dotted line to the green line on the chart). This occurs when the family has children in both these systems by imposing high withdrawal rates.

The changes in this Bill would extend access to youth income support to families with dependent children eligible in both systems by reducing high cumulative withdrawal rates resulting in increased assistance (moving from the green to the red line on the chart).



Part 3 – Maintenance Income Test for Youth Allowance Recipients.

Background

Under current YA rules, child support/maintenance for all dependent children is included in the PIT, regardless of whether the child is in receipt of YA.

This contrasts with the treatment of maintenance under FTB Part A rules, where a separate Maintenance Income Test (MIT) only takes into account the contribution of child support payers to the costs of children and young people attracting FTB Part A for a parent.

Description of the measure

From 1 January 2016, the treatment of maintenance income would be more closely aligned with FTB Part A rules by removing child support amounts from the parental income test for YA.

From 1 January 2017, the treatment of child support would be further reformed by introducing a separate MIT to YA, similar to the MIT applying to FTB Part A. The YA MIT would apply where YA recipients attract child support above the relevant free area.

Policy rationale

The current YA rules can double count the contribution of non-resident parents through child support in some circumstances. This is because child support for all dependent children is included in the PIT, regardless of whether the child is in receipt of YA. This means the YA parental income test includes child support payments for siblings that may have already been assessed under FTB Part A MIT, effectively resulting in a double-testing of the same source of income. That is, child support being paid for an FTB Part A child and therefore potentially reducing FTB Part A paid in respect of that child can at the same time be reducing that child's siblings YA payment.

In contrast, FTB Part A is subject to a separate MIT that only takes into account the contribution of child support payers to the costs of children and young people attracting FTB Part A for a parent.

This measure changes the treatment of child support for YA so that it more closely aligns with the treatment of child support for FTB Part A. The changes remove any double counting of child support paid while still ensuring that child support paid in respect of a YA recipient is still taken into account when determining the rate of YA paid.

Key facts and customer impacts

The 1 January 2016 change to the treatment of maintenance income for YA would be beneficial as it would result in increases in assistance for around 3,770 YA recipients. They would experience an average increase of $921 a year due at a cost of $3.5 million a year.

The changes from 1 January 2017 would result in reductions in assistance for some families. It is estimated that around 850 young people aged under 18 years would be subject to the new MIT and experience a rate reduction due to this element of the measure.

Responses to Concerns Raised

In its paper *Budget Analysis 2015-16*, the Australian Council of Social Service (ACOSS) raised some concerns relating to the measures within this Bill:

> "Changes to the Parental Income Test for Youth Allowance will have mixed results: reducing high effective marginal tax rates for some families, but enabling others to benefit from income minimisation strategies to access higher payments. In particular, YA parental means testing will no longer take account of income minimisation through private trusts and negative gearing."

ACOSS is correct that the measure will reduce high effective marginal tax rates for some families through the changes to the family pool PIT arrangements for YA.

In respect to income minimisation strategies, many of the common mechanisms used to minimise taxable income <u>are captured</u> by the PIT which is not being changed in the Bill. For example, the major income minimisation strategies - negative gearing of financial investments and property, salary sacrifices to superannuation and salary paid as fringe benefits, are included under the PIT. The components of income currently assessed under the PIT are:

- Taxable income, plus
- Adjusted employer provided benefits, plus
- Target foreign income, plus
- Total net investment losses or net passive business losses, plus
- Reportable superannuation contribution, plus
- Maintenance received by either parent for the upkeep of a child in care, and spousal maintenance, less
- Maintenance amounts paid out.

> ***Case Example:***
> *David's salary is $60,000 a year. He salary sacrifices $10,000 of this each year to superannuation and also has an investment property that is negatively geared and loses $5,000 a year. His taxable income would be $45,000; however $60,000 would be assessed under the PIT – his taxable income of $45,000, plus his $10,000 salary sacrifice, plus the $5,000 loss from his investment property.*

Accordingly, ACOSS's concern regarding opening up options for families to benefit via increased YA payments by having negatively geared investment properties is addressed by existing components in the PIT.

Another common mechanism to minimise taxable income is via a family trust. Family Trusts allow income to be allocated to trust beneficiaries (generally family members but can include a private company) who attract a lower rate of income tax. In many cases, the income is effectively retained in the trust via the beneficiary "loaning" the income back to the trust.

Distributions to parents from the trust are assessed under the PIT, even if the funds are loaned back to the trust. This is the same outcome as under the FAMT.

Where trust income is paid to beneficiaries other than the parent(s) and the dependent children (for example, an independent adult child), neither the PIT nor the FAMT would count this as income for the parents as the amounts involved would not form part of the income, spending or savings of the family.

If a trust distribution is paid to the dependent young person it would be assessed under the personal income test.