



Mr Ali Noroozi
Inspector-General of Taxation
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SYDNEY NSW 2001
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Dear Mr Noroozi,

Please find attached the submission of Cbus Superannuation in response to your **Review into the ATO's employer obligations compliance activities**. Our submission focuses on the collection of Superannuation Guarantee arrears which, unfortunately, continues to be an issue for the Australian economy, and specifically the construction and building industry.

Cbus takes its Trustee obligations seriously to ensure that the monies owed to Fund members are paid in accordance with our Trust Deed and with SG requirements.

Cbus has recovered over \$213m for our members since July 2011; however we are aware and concerned that many workers are still missing out on their SG entitlements.

We welcome the IGT Review and look forward to advancing these important issues.

Should you wish to discuss any of the issues raised in the following paper, please contact Rod Masson on (03) 8648 6954 or James Bennett on (03) 9657 4218.

Yours sincerely

A handwritten signature in black ink, appearing to read "David Atkin", is positioned above the typed name.

David Atkin
Chief Executive Officer

11 December 2015

About Cbus

Cbus was established in 1984 as one of the first truly national industry based superannuation funds, predominantly representing employees and employers in the construction and building industry.

Cbus, originally known as BUS (Building Union Superannuation Scheme), was established as a not-for-profit trust to receive the deferred wages of construction and building workers delivered as a result of industrial campaigns by building trade union members.

The Fund's Trustee, United Super Pty Ltd, was formed on the basis of equal representation between construction and building employer associations and employee trade unions. That equal representation governance model remains current and reflects both the industrial origins of superannuation and the continued affinity with the construction and building industry.

Over the past 30 years, Cbus has grown in membership and funds under management, becoming a full public offer fund in 1996. Today, Cbus has over 720,000 Fund members, 97,000 participating employers (the majority of which are still drawn from the construction and building industry), with more than \$31 billion FUM.

Context

Unpaid superannuation guarantee contributions are a significant problem for a number of reasons.

1. They have an immediate and negative effect on the collection of government revenue through lost taxation;
2. There is a delayed and detrimental impact on individuals' retirement savings, robbing them of the benefits of capital accumulation and investment earnings;
3. Lower superannuation balances lead to a greater strain on the age pension and other public services which leads to a greater impost on the Federal Budget.

Non-payment of the superannuation guarantee is essentially non-payment of wages and should be treated with the same degree of seriousness by all stakeholders.

The tax treatment and design of the superannuation system has, quite rightly, been the subject of intense debate in recent years; however the problem of non-payment of superannuation seems to be strangely absent in these discussions.

Cbus submits that any debate or reform regarding the superannuation system is likely to be distorted or flawed unless superannuation guarantee contributions are robustly 'guaranteed' by the regulatory structures and relevant agencies. We believe the ATO (and other agencies) can potentially play a greater role in helping to ensure this outcome which would provide substantial economic and social benefits to Australia.

Our submission highlights a number of different areas and various recommendations relevant to the issue of superannuation arrears.

The size of the problem

The level of non-compliance with payment of the superannuation guarantee, as estimated by Tria Investment Partners, is \$2.6 billion annually, affecting an estimated 690,000 working Australians.¹

This is the second iteration of the Tria research and (unfortunately) shows a trend line where arrears are growing at around 5% per annum from 2012 to 2013. At this growth rate, total losses to the superannuation system resulting from SG non-compliance will be \$44b over the ten years to 2023. This also potentially equates to \$6.6 billion in lost taxation revenue over the same period.

Construction is the most affected industry; other industries with elevated non-compliance include property services, mining, hospitality, and manufacturing.

¹ *Superannuation Guarantee non-compliance*, Tria Investment Partners, 2015.

SG non-compliance has four main sources, in order of importance:

- Employer non-compliance (SG contributions are not made at all, or only in part), \$1.4bn;
- Cash economy (SG is part of avoidance of PAYG and other employment obligations), \$0.8bn;
- Sham contracting, \$0.3bn; and
- Employer insolvency, \$0.2bn.

Unfortunately there has been an increase in employer non-compliance with a significant jump in SG reported complaints from 18,000 in 2012 to 19,500 in 2013. Unless driven by increased compliance or education efforts, this increase may also suggest a parallel jump in unreported complaints and incidents where employees are not aware of the issue.

Commentary about the problem

Several reviews and audits relevant to superannuation entitlements have recommended various measures to improve SG compliance; however the issue does not yet appear to be improving or receiving the recognition we believe it requires.

- *Inspector-General of Taxation*

We note your 2010 report into the ATO's administration of the SG charge that cited figures of known SG non-compliance to be in the vicinity of \$1.5 billion; however this was only based on what has been raised through employers voluntarily lodging a SGC statement or the ATO issuing default assessment. Accordingly "The actual SG non-compliance could actually be much greater than the figures suggest."

As previously cited Cbus believes that the size and scope of the problem is significantly larger than \$1.5 billion and increasing. The evidence points to an issue that requires action on behalf of policy makers, regulators and even wider community attitudes and awareness regarding superannuation entitlements.

We note your 2010 findings and recommendations in respect of the ATO's administration of the Superannuation Guarantee (SG) Charge², in particular:

“RECOMMENDATION 2

The Government consider providing employees with more timely information regarding whether their employer has paid SG by the due date, by having employers, on a quarterly basis, include on each employee's payslip their ordinary time earnings for SG purposes and the amount of SG actually paid to the employee's superannuation fund or the ATO. This will also assist in reducing the timeframe between when a SG shortfall arises and when an employee lodges an EN complaint with the ATO.”

We strongly endorse this recommendation and believe it is still relevant and important today. Cbus has actually advocated a stronger position; namely amending the SG Act and/or any other relevant Act to require SG to be paid congruently with the payment of wages.

We accept that implementing this recommendation is a policy matter for Government; however given the ongoing issues with superannuation arrears and unpaid contributions we believe it should continue to be advocated wherever possible and would encourage the IGT to reiterate this recommendation as 'unfinished business'.

² Review into the ATO's administration of the Superannuation Guarantee Charge, Inspector-General of Taxation, March 2010.

In relation to the ATO's proactive work in the area of SG non-compliance we also agree with the 2010 IGT recommendation that:

RECOMMENDATION 4

To minimise the timeframe between SG non-compliance and the ATO's detection, the ATO should significantly expand its proactive SG audit work to allow for more real-time monitoring and rapid follow-up of high-risk employers, especially in the micro-business segment, who have not paid superannuation. This should include:

- *Increased reliance on data-matching approaches; and*
- *Increased community presence through more targeted field work along the lines of the FWO campaigns.*

This also requires the ATO to further develop its risk identification strategies to more effectively detect the different types of SG non-compliance as each requires different analysis techniques and detection mechanisms.

We note that the ATO rejected this recommendation and commented that:

"Having regard to the overall level of risk in the SG system, and the range of other tax and superannuation risks that the ATO is required to address, we believe that the current level of resources allocated to addressing SG risks is appropriate."

If there is \$2.6 billion in unpaid SG contributions then, by definition, the level of ATO resources allocated to addressing SG risks simply cannot be appropriate. We are not suggesting that it is entirely the ATO's responsibility to 'fix' this issue; however they have an important role to play and should be resourced accordingly.

Cbus' experience of the ATO SG compliance area has sometimes been frustrated by poor communication, extensive time taken in recovery and a lack of confidence in the willingness of the ATO to pursue arrears given their policy and resourcing restrictions. Feedback from fund members also suggests that employees often feel the ATO is not a key player in resolving issues regarding SG arrears.

It would appear that resourcing limitations continue to curtail the proactive work that the ATO can undertake in the SG non-compliance area and notes that any further efficiency dividends and reductions in the public sector will result in a further erosion of this capacity.

However, Cbus welcomes the efforts of the ATO in more recent times to build relationships with the Fund and its service providers, work jointly and share information and encourages further like activities.

Cbus is cognisant of the legislation passed following the 2010 IGT review of the ATO SG compliance, specifically the requirement to disclose superannuation payment amounts on payslips and the expansion of the Director penalty regime for unpaid SG monies.

While Cbus supports the reforms, the continued growing levels of SG non-compliance would seem to indicate that their effect has been limited. This may be a further consequence of the resourcing and policy restrictions binding the ATO in launching and promulgating prosecutions.

- *Australian National Audit Office*

The 2015 ANAO Report, *Promoting Compliance with Superannuation Guarantee Obligations*, emphasized the importance of compulsory superannuation to help employees, particularly lower paid workers, enhance their living standards in retirement and to supplement reliance on the age pension in the future.

They observe that:

“The age pension is the Commonwealth’s largest spending programme, with annual expenditure of \$39.5 billion in 2014, growing at 3.7 per cent per year in real terms to 2023-24. For the SG Scheme to operate effectively, the ATO has an important role to play, supporting employers to comply with their SG obligations and dealing with those that do not.”

The ANAO made four recommendations as to how the ATO could improve its SG compliance activities – broadly these related to better data analysis and engagement with external stakeholders, increased emphasis regarding compliance in communications and better alignment of its Superannuation Guarantee compliance strategy with the compliance activities conducted by other relevant business lines.

It is encouraging to note that the ATO accepted all recommendations. It is obviously too early to observe any effect from these recommended changes; however the need for the ATO to ‘do more’ in relation to SG compliance is not a new observation (as highlighted by the 2010 IGT Report).

- *Senate Economics Committee*

The recent Senate Economics Committee Report³ into Insolvency in the Australian construction industry also voiced concerns regarding the issue of SG non-compliance and recommended that:

“Recommendation 5

The committee recommends that the ATO and ASIC increase their formal cooperation with superannuation funds to coordinate measures around early detection of non-payment of superannuation guarantee.”

Cbus endorses this sentiment and note that the ATO is positively engaging with funds like Cbus through the Superannuation Industry Reference Network (SIRN); however more still needs to be done. For example, it may require legislative changes to allow for greater flow of information between the ATO and superannuation funds to help facilitate early detection and recovery of arrears.

- *Proposed reduction of penalties for SG non-compliance*

Given the size and ongoing nature of the problem Cbus was disappointed when the Government recently introduced an omnibus Bill that would actually reduce the penalties for SG non-compliance under the auspices of ‘red tape reduction’.⁴

Payment of superannuation entitlements is not a regulatory burden – it is a legal entitlement and should never be viewed as discretionary or troublesome. If a company can’t pay basic employee entitlements then it either shouldn’t be in business or shouldn’t be an employer. A company that does not pay wages is rightly condemned; however a company that does not pay superannuation is not treated as seriously.

As highlighted by the Tria Report there is a serious need to address the growing problem of non-compliance with superannuation guarantee payments for employees. Cbus does not support reduced penalties for employers who fail to pay superannuation guarantee contributions.

Cbus Arrears Policy and Practice

Being an industry fund, Cbus has maintained a strong affinity with the building and construction industry throughout its 30 year existence which has resulted in an intimate understanding of the issues confronted by businesses and employees in the sector.

³ *Insolvency in the Australian construction industry*, Economics References Committee, December 2015.

⁴ *Treasury Legislation Amendment (Repeal Day 2015) Bill 2015*, introduced to the House of Representatives, 12 November 2015.

Business and employment in the industry is largely precarious because of the project nature of the work. In the 2012/13 financial year, some 57,000 businesses exited the industry with some 36,000 entering. The ABS notes that nearly all of the businesses working in the construction industry are small businesses and collectively are responsible for 82% of all employment in the industry. Cbus' own figures suggest that over 90% of employers who are in arrears with the Fund have less than 20 employees.

The industry employs over 1 million people. Many of those are self-employed, with the industry having the second highest amount of self-employed behind farming. The Inspector-General of Taxation (IGT) review into the ATO's administration of SG in 2010, noted ABS figures that showed at that time there was almost 1 million independent contractors, with nearly a third of those in construction. Cbus suspects that a large proportion of these may be 'sham contracting' and should actually be classified as employees.

The transient nature of the workforce is known and understood by Cbus and was one of the key drivers to the establishment of a national, portable, industry based superannuation fund.

The majority of Cbus' 97,000 participating employers accept the terms and conditions of the Cbus Trust Deed and their legal obligations to pay SG entitlements to their employees. However, the transient nature of the industry does present significant challenges in ensuring employee entitlements are being properly paid and that gaming the system or non-payment is not occurring by a minority of businesses for the purposes of establishing an unfair and unlawful cost arbitrage between business competitors. Such gaming, as experienced by Cbus, includes 'short' or non-payment of superannuation entitlements.

Exacerbating this challenge is the incidence of sham contracting in the industry which sees some employers transferring obligations such as superannuation to individual workers. The industry also has relatively high incidences of insolvency and company 'phoenixing'.

Cbus' Trustee, United Super Pty Ltd and its Board of Trustee Directors, has always taken very seriously its role in ensuring the fund is administered effectively, including its responsibility to ensure that superannuation monies owed are paid to members.

To meet this challenge, Cbus has in place a rigorous arrears process designed to establish a level playing field of payment timing across the industry with a built in early detection process of payment failure. It is the Fund's experience that time counts in ensuring compliance with SG payments. Early detection of non-payment and intervention means a much greater likelihood of recovery of monies.

The Cbus Trust Deed provides that participating employers make superannuation payments on behalf of their employees monthly by the 1st day of the following month. Employers, upon joining the Fund, enter a contract accepting these payment terms.

Failure to make payment within 18 days of the due date triggers an arrears letter to be sent to the employer reminding them of their obligations under the Trust Deed of the Fund, requesting payment and offering assistance.

Should payment still not be received after the elapse of 28 days from the due date, further arrears communication is triggered reminding employers of their obligations and the possibility of being subject to legal action. Employers with greater than 10 employees are contacted by phone if they have not responded to the first arrears letter.

Coupled with our own efforts, our sponsoring organisations, trade unions and employer associations, also play a role in educating members about Cbus requirements and in being parties to industrial agreements that often stipulate amounts of superannuation to be paid on behalf of employees, the fund to which they are paid and the timings of those payments.

The parties to those agreements have an interest and responsibility in ensuring that those agreements are complied with on behalf of their members and the industry at large. Our trade union

sponsors effectively work with employers, employees and the Fund in ensuring SG payments are made.

Cbus, through its Trust Deed and Privacy Policy, makes it clear to Fund members and employers that the Fund may release certain personal details to its sponsoring organisations for this specific purpose.

Should the Funds approach to employers via arrears letters not succeed in eliciting payment 48 days from the due date, we ask our credit control agency, Industry Funds Credit Control (IFCC) to take over the process.

With the non-payment issue being moved to IFCC, a 7 day demand call is placed to the employer. This is often a customer service type interaction in which a discussion is had to determine the reasons why payments have not been made and what action is required including establishing a repayment agreement if required.

Should a further 10 days elapse and payment not be received, a solicitor's letter will be sent to the employer.

Should payment still not be received 48 days from the matter being transferred from the Fund to IFCC a demand call will be placed. Should this not result in a repayment agreement, legal action will be commenced that may lead to insolvency.

IFCC recovered more than \$53 million in unpaid Cbus members' superannuation in FY14/15. Over the past 20 years of its operation IFCC has recovered approximately \$1 billion in unpaid superannuation, the vast bulk of which would be SG.

Effective as this process is, the increasing amounts of recovered unpaid monies highlights the continued and growing problem of SG non-compliance.

Cbus argues that this problem will only become worse should default fund status in industry awards not impose a quality filter, over and above MySuper accreditation, that includes funds seeking default status being required to have in place a rigorous arrears collection process.

The expanding opportunities provided by digital platforms and technologies are also being pursued by Cbus and other funds. Real time account balances and payment histories are now provided online to allow Fund members to check that payments are being made.

Cbus is also developing smartphone technologies to increase member engagement with their superannuation fund. Work is being undertaken to determine costs and capabilities of triggering direct notifications to members of their payment status.

Cbus Experience of ATO

Cbus referrals to the ATO of unpaid SG contributions are minimal. Our collection agency, IFCC, will only recommend that the Fund refer employer cases to the ATO when:

1. All arrears processes of the Fund and IFCC have been exhausted.
2. Recovery through legal action is not fruitful and
3. The employer is currently registered with the Fund and continuing to incur superannuation arrears.

Over the five year period 2010 – 2014, Cbus files registered with the ATO averaged roughly 800 per annum. Across the same period the ATO has recovered an average of \$3.5 million per annum for Cbus members.

There are varied reasons for the minimal levels of referral from the Fund, but principally it is because of both the success in recovery of members' funds through Cbus' internal processes, the Trustee's obligation to maintain management of members and employers accounts, the extensive time taken in the ATO recovery process and/or because it is known that the ATO will be unlikely to pursue, let alone be successful in the pursuit, of the arrears given policy and resourcing restrictions.

A large part of the frustration of the Funds with the ATO process arises because of poor communication resulting from privacy constraints. Owing to these privacy constraints, the ATO does not confirm payment details to Funds. Therefore, the only acknowledgement the Fund has that superannuation arrears have or will be paid to the ATO is if a payment is received from the ATO into members accounts or alternatively through the legal action process if the defendant signs a statutory declaration and provides evidence of the payment being made to the ATO.

Furthermore, during the ATO payment process it is inconclusive as to what period/s the payment covers given that the ATO does not provide any information other than the payment amount to the members default fund. This problem with information flows has been raised in various previous submissions and directly with the ATO who in the past have shown a strong resistance to assist in disclosing information regarding employers either as a consequence of legislative restrictions or other reasons. In effect, once the matter is referred to the ATO, little or no communication is afforded to the Fund regarding the ATO's recovery activities.

Where the Fund is aware that the ATO has been involved there are often extensive delays in remittance of superannuation entitlements into members' accounts which can take the ATO up to 2 years to remit superannuation payments to members' accounts.

In insolvency matters, the ATO Proof of Debt for employee superannuation entitlements has precedent over the Fund. This requires the Insolvency Practitioner to pay the dividend to the ATO rather than directly into workers accounts. This creates further time delay in funds finding their way to their rightful accounts compounding problems associated with member exits or deaths.

Positively, in more recent times the ATO has demonstrated a more flexible approach in being prepared to discuss some matters with IFCC and to build relationships. This is to be commended and Cbus would like to see greater efforts from all parties in increasing communications between Funds and the ATO.

Cbus also welcomed the opportunity to participate in 2011 in a Joint SG Pilot with the ATO and Industry Funds Forum (IFF). This pilot helped all parties to gain a shared understanding of each other's processes and acted as a catalyst to better communication between the parties.

However the key finding drawn from the pilot was that the ATO determined that significant investment would be required to build a predictive model and that:

“although it has responsibility to ensure employers meet their superannuation obligations, this must be balanced against resources available, in particular our existing commitment to Government to investigate every complaint we receive from employees.”⁵

This further entrenches a view amongst stakeholders that the ATO is not adequately resourced to be able to seriously tackle the problem of SG non-compliance.

A Broader View of the ATO

Reported employee complaints to the ATO average around 20,000 per annum. The ATO statement in their 2012/13 Annual Report suggests that SG non-compliance may not be a priority for the Office.

“The number of employees notifying us that their employers have not paid their superannuation guarantee entitlements continues to be less than 0.2% of all employees.”

However, somewhat contradictory, they also note the enormity and growth in the problem stating:

“Since 2009, we have transferred over \$1.3 billion in previously unpaid superannuation into member accounts. In 2012–13, collections of the superannuation guarantee charge increased by 4.3% to \$337 million.”

⁵ Australian Taxation Office “ATO & IFF Joint SG Pilot Outcomes – Report on the superannuation guarantee joint pilot between the ATO, Industry Funds Forum and Cbus super fund” 2 August 2011.

The Inspector-General of Taxation's report in 2010 noted that "In 2009-10 proactive risk based auditing will still only represent 27 per cent of the ATO's total SG audit activities."

Cbus is not able to comment on the level of pro-active auditing being currently undertaken by the ATO on SG compliance but notes again the outcome of the 2011 Joint Pilot program which disappointingly identified resourcing as the obstacle to building a predictive model designed to flag likely non-compliance and allow the ATO to undertake proactive measures.

Cbus welcomes recent reports of the ATO's involvement with ASIC and the Fair Work Building and Construction Commission in investigating large construction projects for the existence of phoenix activities by contractors. This type of cross-regulator cooperation and pro-active investigation is to be encouraged.

As mentioned, Cbus' experience is that time counts when it comes to intervention to avoid loss of superannuation payments. Predictive and proactive activities by the ATO may have a significant bearing on compliance with SG.

However, most of the ATO's resources given to SG compliance are absorbed in complaint handling. Complaints are usually not received until some 22 months from when the SG shortfall occurs and when an employee lodges a complaint with the ATO. This means that there is usually a 2 year gap between an investigation starting and the incident.

It is Cbus' experience that non-payment timeframes of beyond 6 months generally indicate that employers are in severe financial difficulty, require payment plans or are looking at insolvency.

While it is a very important task for the ATO to follow up all employee complaints, greater resourcing is needed to do this whilst also implementing greater proactive measures around compliance activities.

That appears less and less likely as efficiency dividends and planned reductions in the size of the public service announced by the current Government mean fewer staff and impacts on service standards.

Unfortunately, continued decreases in resources will not enable the ATO to expand its activities in the non-revenue raising sectors of their operations such as SG compliance, will continue to undermine stakeholder and public confidence and will likely embolden non-compliers.

In this context it is perhaps ironic to note that the ATO's 2014/15 Annual report states that \$468 million⁶ was budgeted for SG activities; however only \$344 million was actually spent. Cbus appreciates there may be complex reasons as to why \$124 million was not spent; however it does seem unfortunate this money was not used for more proactive activities that may have helped stopped \$210 million⁷ being lost to insolvency.

⁶ ATO Annual report 2014–15, Page 132.

⁷ ATO Annual report 2014–15, Page 56.

Recommendations

Given the extent and pervasiveness of the SG non-compliance problem, Cbus believes that there is a requirement for both public policy and practical responses.

We understand that raising public-policy concerns is not the central focus of the IGT's review; nevertheless we take the opportunity to do so with a view that such policy suggestions may assist the ATO carry out its functions or that they may go towards remedying the broader issue of SG non-compliance.

Cbus recommends the following legislative measures:

1. Amend the SG Act and/or any other relevant legislation to require SG to be paid congruently with the payment of wages.
2. Amend ATO provisions to allow for superannuation insolvency dividends to be paid by Insolvency Practitioners direct to affected employees Fund accounts.
3. Amend Privacy provisions to allow for greater flow of information between the ATO and APRA regulated superannuation funds under binding Memorandums of Understanding.
4. Amend the SIS Act to require and empower all APRA regulated funds to pursue payment of SG entitlements.
5. Abandon the proposed reduction in penalties for SG non-compliance.
6. Require funds seeking default status in industry awards to have a rigorous arrears collection process in place.

Cbus recommends the following organizational measures:

7. Continue and increase interaction between Funds, their administrators and service providers and the ATO;
8. Increase pro-active measures being undertaken by the ATO in relation to SG compliance, including, developing predictive models, conducting a greater number of audits, and targeting known 'problem' industries. As recommended in the IGT's 2010 Report (Recommendation 4).
9. A coordinated education campaign to inform employees of their rights and employers of their responsibilities regarding SG compliance.
10. Improve communication between the ATO and APRA regulated funds, particularly in assisting in tracking recovery payments.
11. Improve practices around the recovery of SG debts in insolvency matters that allow for Insolvency Practitioners to direct dividend payments to the default fund for affected employees.