

# OVERDUE: TIME FOR ACTION ON UNPAID SUPER



ISA/CBUS  
REPORT  
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Industry  
Super  
Australia 

## ABOUT INDUSTRY SUPER AUSTRALIA

Industry Super Australia (ISA) manages collective projects on behalf of Industry SuperFunds with the objective of maximising the retirement savings of five million industry super members. These projects include research, policy development, government relations and advocacy as well as the well-known Industry SuperFunds Joint Marketing Campaign. Please direct questions and comments to:

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## ABOUT CBUS

Established in 1984, Cbus is the industry superannuation fund for the construction, building and allied industries. Cbus is run only to benefit members and recently received recognition for its 10 years as a platinum rated fund by independent ratings agency SuperRatings.\*

Cbus also invests back into the construction and building industry, which not only provides strong long-term investment returns, but also helps boost our economy and create jobs within the industry.

Cbus has over:

- 735,000 members
- 115,000 employers
- \$35 billion in funds under management

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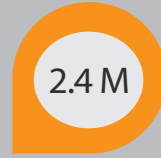
*\* SuperRatings is a ratings agency that collects information from superannuation funds to enable performance*

# OVERDUE: TIME FOR ACTION ON UNPAID SUPER

## COMPULSORY SUPER IS GOING UNPAID



**Compulsory super entitlements**  
Employers are required to contribute at least 9.5% to the superannuation accounts of every worker earning more than \$450 a month.



**Total unpaid super entitlements**  
At least 2.4 million workers were underpaid an average amount of around \$1500 of their superannuation in 2013-14.

## WORKERS ARE MISSING OUT



**\$3.6 BILLION**  
IN UNPAID SUPER



**30% OF ALL**  
**EMPLOYEES**



ON AVERAGE EACH  
WORKER MISSES OUT ON  
**4 MONTHS**  
OF THEIR SUPER OR  
**\$1,489**

WITHOUT ACTION UNPAID SUPER AND LOST EARNINGS WILL REACH  
**\$66 BILLION BY 2024**

## GOVERNMENT ACTION IS REQUIRED

- 1** Urgently investigate these new estimates
- 2** End the four month payment holiday between SG being disclosed on payslips and paid to a member's fund
- 3** Immediately close the loophole that allows employers to count salary sacrifice amounts towards their SG obligations
- 4** Investigate the introduction of real-time payment, reporting and compliance of SG using new Single Touch Payroll (STP) technology
- 5** Adequately resource the Australian Tax Office (ATO) to recover unpaid SG
- 6** Introduce a direct, clear, enforceable mechanism for superannuation funds to recover unpaid SG from employers on behalf of members
- 7** Retain and enforce existing penalties for employers and company directors who fail to meet SG obligations
- 8** Extend the government safety net that protects unpaid wages and entitlements when a company becomes insolvent to protect unpaid superannuation

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## KEY POINTS

Two new reports suggest retirement incomes are being undermined by employers who are not meeting their Superannuation Guarantee (SG) obligations on behalf of workers.

These reports estimate that employers failed to pay *at least \$3.6 billion in SG contributions in 2013-14*. The two components of the combined estimate are:

- Underpayment of SG for PAYG employees and sham contractors which Industry Super Australia (ISA) estimates was *at least \$2.8 billion in 2013-2014*
- Unpaid superannuation for workers employed in the cash economy which separate research by Tria Investment Partners for Cbus estimates added a further \$800 million.

**This equates to 30 per cent of workers not being paid part or all of their compulsory super.**

Younger workers, low income earners and workers in the construction, hospitality and cleaning industries were most likely to miss out on superannuation.

On average, affected workers missed out on **\$1,489 or almost 4 months of superannuation contributions**.

Using Tria's projections and its own, ISA estimates that unless action is taken, unpaid superannuation will amount to over **\$66 billion by 2024** including lost earnings.

These estimates are conservative - using a compliance benchmark of 8.5% of assessable income rather than the statutory rate of 9.25% in 2013-14.

If these estimates took into account a loophole that allows employers to count employees' voluntary contributions, via salary sacrifice, towards their SG obligations, the problem would be greater.

Government action is warranted. It should:

- Urgently investigate these new estimates and undertake detailed analysis of the types of industries and employers that do not pay SG
- End the four month payment holiday between SG being disclosed on payslips and paid to a member's fund
- Immediately close the loophole that allows employers to count salary sacrifice amounts towards their SG obligations
- Investigate the introduction of real-time payment, reporting and compliance of SG using new Single Touch Payroll (STP) technology
- Adequately resource the Australian Tax Office (ATO) to recover unpaid SG
- Introduce a direct, clear, enforceable mechanism for superannuation funds to recover unpaid SG from employers on behalf of members
- Retain and enforce existing penalties for employers and company directors who fail to meet SG obligations
- Extend the government safety net that protects unpaid wages and entitlements when a company becomes insolvent to protect unpaid superannuation

## 1. Background

The Superannuation Guarantee (SG) was introduced in 1992 at three per cent in lieu of a wage increase and as a means of boosting retirement savings. It is now considered a matter of right.

Today, employers are required to contribute at least 9.5 per cent (up from 9.25 per cent in 2014) to the superannuation accounts of every worker earning over \$450 a month.<sup>1</sup>

In doing so, Australia has amassed a \$2.1 trillion savings pool that, in shifting economic winds, increasingly holds both the nation and its people in good stead.

However, two new reports suggest some employers are undermining the system by not meeting their payment obligations.

Separate analyses conducted by Industry Super Australia (ISA) and by Tria Investment Partners for Cbus indicate the non-payment of superannuation entitlements could be much more widespread than previously thought and, in dollar terms, increasingly significant.

Further work is needed to fully understand the scale of this problem with more comprehensive ATO audit activity.

## 2. Unpaid SG is extensive, and growing

Combined, two new reports show that at least \$3.6 billion in SG was not paid in 2013-14. At least 2.4 million workers or 30 per cent of all SG employees were underpaid an average amount of almost \$1500.

The two reports are from ISA (*Appendix 1*) and Tria Investment Partners for CBUS (*Appendix 2*). The original and combined results are shown in Table 1.

The ISA report uses detailed ATO data to estimate the underpayment of SG by employers and sham contractors to be at least \$2.8 billion in 2013-14. This equates to at least 2.15 million workers underpaid on average \$1300 (*Appendix 1*).

This analysis utilises a sample file of 250,000 taxpayers and a conservative SG cut-off of 8.5 per cent which is lower than the 9.25 per cent employers were actually required to pay in 2013-2014.

### “2.4 million workers or 30 per cent of all SG employees were underpaid”

Separately, Tria Investment Partners uses ATO, Australian Bureau of Statistics (ABS), Reserve Bank of Australia (RBA) and Fair Work Australia data to estimate the cost of SG non-compliance in the cash economy.

Tria found that an additional 277,000 workers employed in the cash economy did not receive the superannuation they were entitled to in 2014. This amounts to additional SG losses of \$800 million. On average, each affected worker missed out on \$2,888 or more than seven months of SG contributions (*Appendix 2*)

Without proper monitoring and enforcement mechanisms there is currently no effective response to this issue.

Table 1 presents the ISA and Tria cash economy estimates for 2013-14.

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<sup>1</sup> The compulsory SG is currently 9.5 per cent of wages, rising to 10 per cent in 2021 and 12 per cent in 2025.



Table 1: ISA and Tria Additive Estimates for 2013-14

Estimate of:	ISA underpayment	Tria cash economy	Combined estimate
Billions of dollars lost 2013-14	\$2.8	\$0.8	<b>\$3.6</b>
Number of workers affected	2,150,000	277,000	<b>2,427,000</b>
Average effect on workers effected	\$1,309	\$2,888	<b>\$1,489</b>
Proportion of All SG employees in 2013-14	27%	3%	<b>30%</b>
Average months of contributions lost for those affected	3.3	7.6	<b>3.8</b>

Younger workers, low-income earners and workers in the construction, hospitality and cleaning industries are most likely to miss out on superannuation.

Using Tria's projections and its own, ISA estimates that unless action is taken, unpaid superannuation and forgone investment earnings will amount to over \$66 billion in the ten-year period to 2024.

Both projections assume that the return on the unpaid contributions would be 5 per cent after tax and after fees. Because mostly young workers are affected, the assumption is that workers affected do not retire or die over the ten-year period.

Table 2: Projections of the Superannuation Assets Lost from Unpaid SG Contributions – 2014 to 2024

Year ending June	ISA Cumulative gap in \$billions	Tria Cash Economy Cumulative gap in \$billions	Combined Cumulative gap in \$billions
2014	\$2.88	\$0.80	<b>\$3.68</b>
2015	\$6.11	\$1.64	<b>\$7.75</b>
2016	\$9.62	\$2.60	<b>\$12.21</b>
2017	\$13.42	\$3.65	<b>\$17.07</b>
2018	\$17.55	\$4.79	<b>\$22.34</b>
2019	\$22.05	\$6.04	<b>\$28.08</b>
2020	\$26.94	\$7.40	<b>\$34.34</b>
2021	\$32.26	\$8.87	<b>\$41.13</b>
2022	\$38.28	\$10.47	<b>\$48.76</b>
2023	\$45.09	\$12.21	<b>\$57.30</b>
2024	\$52.75	\$14.09	<b>\$66.84</b>

Non-payment of SG by some employers creates an un-level playing field for business, because employers that do not pay SG avoid costs that the majority of employers, who comply with their SG obligations, incur.

### 3. Action to recover unpaid SG

Industry super funds take their obligations to recover unpaid SG on behalf of their members seriously, and spend significant resources doing so.

Unions do the same, recovering unpaid entitlements including SG on behalf of members.

Unlike retail funds, industry super funds engage a credit control and debt recovery provider, Industry Funds Credit Control (IFCC), which acts as safe-keeper of members' SG entitlements.

IFCC focuses exclusively on recovering unpaid SG contributions for members of industry super funds.

Through specialised legal and insolvency services IFCC has recovered more than \$1 billion in SG entitlements over the past two decades.

For example, in many insolvency cases the ATO does not lodge claims to recover unpaid SG on behalf of employees.

In these instances IFCC will step in and lodge a claim on behalf of a fund member.

#### Case Study

IFCC recently lodged a claim for over \$10,000 in SG entitlements for a single member of an industry super fund. Due to poor record-keeping, the insolvency practitioner was unaware that the fund member's SG entitlements had gone unpaid.

The member was unaware that he could recover his unpaid SG entitlements through an insolvency action, or that his default industry super fund had acted to recover his SG. Hence, had no SG claim been lodged on behalf of the member, his SG entitlements would not have been paid to him. IFCC facilitated the SG payment to be directly deposited into the member's account without delay.

### 4. The problem is likely to be worse

Currently, if an employee makes voluntary contributions, a loophole allows their employer to count this towards SG obligations.

Many employees make voluntary additional super contributions under a salary sacrifice arrangement in the belief that they are increasing their superannuation over and above the SG.

**“If the estimate excluded salary sacrifice arrangements, the total amount of unpaid SG for 2013-2014 would be \$1 billion higher”**

The majority of employers understand and support the efforts of their employees to build their retirement nest eggs by providing genuine salary sacrifice arrangements over and above their SG obligations. However, some do not.

To err on the conservative estimate of unpaid SG, ISA's report counts all voluntary super contributions under salary sacrifice arrangements as SG contributions.



If the estimate excluded salary sacrifice arrangements, the total amount of unpaid SG for 2013-2014 would be \$1 billion higher and affect a further 3 per cent of workers.

## 5. Why is this important?

Across the developed world people are living healthier for longer.

Longevity is a cause for celebration but it also poses challenges for both governments and individuals around how to structure and finance retirements that could stretch over decades.

With access to government pensions tightening and home ownership in decline, future generations of retirees will be increasingly reliant on superannuation.

Yet in 2013-14, more than twenty years after the introduction of compulsory superannuation, the ABS measured the average balance at retirement to be \$322,000 for men and \$180,000 for women. The estimate which is more indicative for industry fund workers was the median – this was \$150,000 for men and only \$80,000 for women aged 55 to 64 years.

With voluntary contributions well out of reach for most young and low-income Australians, there is simply no room for employers to avoid their SG obligations.

Not paying employees their wages is unacceptable – so too is not paying superannuation or treating it as a business cash flow which can be paid late.

## 6. Monitoring compliance

The ATO has primary responsibility for ensuring SG compliance. Historically, however, it has not measured or reported the extent to which employers have failed to pay SG on behalf of their employees.

In 2015 the ATO suggested that SG was being paid at a rate of 9.8 per cent per employee.

This figure is inaccurate because it averages over the entire workforce and includes member salary sacrifice contributions and employer contributions above the minimum SG rate.

**“Not paying employees their wages is unacceptable – so too is not paying superannuation or treating it as a business cash flow”**

The ATO is currently working on better measuring non-compliance. Results were expected in the 2016 ATO *Annual Report*.

ISA and Cbus look forward to the release of this SG gap reporting and to continuing the discussion about the extent of SG non-compliance and how best to address this problem.

## 7. Monitoring and recovery are highly inadequate

Responsibility for ensuring SG payments are made rests almost entirely with individual employees.

High levels of disengagement, low levels of financial literacy and extreme information asymmetry mean that employees are ill-equipped to determine or address SG non-compliance.

Those most at risk of not having their SG contributions paid are younger, lower income earners working in industries with high levels of casualisation and sham contracting, including construction, cleaning and hospitality.

Small and medium-sized businesses are least likely to pay SG.

## 8. Very difficult to know if SG has been paid

Employees cannot rely on their payslip to confirm that their SG has been paid.

Employers are required to pay SG quarterly, while wages are typically paid weekly, fortnightly or monthly.

Payslips include an amount for SG payable for each pay cycle. However, in most cases that amount is hypothetical, as wages and superannuation are not synchronised and therefore the actual SG payment may not have been made. An employer can currently satisfy SG obligations by not paying it up to four months after an employee is entitled. Lost investment and accrual opportunities during this delay impacts retirement income.

While a three month and 30 day grace period for payment may have been normal practice 25 years ago, in this day and age a four month delay in payment of SG entitlements is unacceptable.

This also hampers the capacity of the ATO to track non-compliance. Single Touch Payroll processes which are being progressively implemented should increase the availability of real time data on SG compliance.

Currently, plans for Single Touch Payroll fall short of aligning reporting and actual payment. To be effective Single Touch Payroll should be standard for all businesses small and large, and require alignment of reporting and payment.

## 9. Mechanisms for acting on employee complaints are under-resourced and inadequate

If an employee identifies that they have not received SG, they do not have the right to directly recover that unpaid amount from their employer.

The primary recourse is by making a complaint to the ATO.

Despite improvements in their handling, the ATO remains insufficiently resourced to effectively investigate reports of non-compliance.

In 2014-15, the ATO raised just \$474 million in SG liabilities from employee complaints. The Auditor-General found that the ATO only collects about half of the SG non-payment that it identifies.

Many people who identify that they have not received SG approach the Fair Work Ombudsman (FWO).

The FWO cannot force an employer to comply with the obligation to pay SG, but it can require compliance with superannuation entitlements insofar as they are set out in a relevant industrial instrument or contractual provision.

**“the ATO only collects about half of the SG non-payment that it identifies”**

Resource limitations constrain proactive auditing of high-risk employers. In 2014-15, the ATO raised just \$156m in SG liabilities from proactive risk-based audits. In addition, \$105m was raised from voluntary

lodgement. Although \$735 million in tax debts for SG was raised in 2014-15, only \$379 million in SG was collected.

The ATO has had the capability to match contributions to industrial wage and salary earners for at least 15 years (it has matched longitudinal files for individual Tax File Numbers). It is unclear why the ATO has not used analysis of individuals from this matched file for compliance purposes and to advise individual taxpayers and industry at-risk employees that they may have a shortfall in SG.

Superannuation funds are well-placed to ensure compliance, but do not have clear powers to do so.

## 10. Policy solutions

Significant efficiencies could be achieved by reducing leakage from the system due to unpaid SG. Policy responses should be urgently considered, including:

### 1. **Requiring real time payment and reporting of SG payments and requiring SG contributions to be paid monthly**

Payslips report an amount for SG but this does not reflect the amount actually paid. This hampers the ability of employees to identify unpaid super. The fact that employers are permitted to pay SG on a quarterly cycle increases the risk of non-compliance, because it can take many months before unpaid SG is identified.

- Some stakeholders have suggested payment of SG should be aligned with payment of wages.
- Payslips should report the amount of SG actually paid each pay cycle.
- Systems should enable real-time visibility of SG payments by employees, funds and the ATO.
- The Super Guarantee Charge (SGC) should move to a minimum monthly compliance cycle.

### 2. **Amending the *Super Guarantee Administration Act 1992* so that employers cannot count salary sacrifice amounts towards compliance with their obligation to pay SG**

Employees do not understand that if they salary sacrifice into super, their employer can use this to meet their SG obligation. The key motivation for an employee to make additional salary sacrifice contributions is to boost their retirement savings. This loophole should be closed immediately.

### 3. **Facilitating collection of unpaid SG by superannuation funds directly**

Superannuation funds are best placed to recover unpaid SG on behalf of their members but do not have a direct, clear, enforceable mechanism for doing so, particularly where:

- An employer becomes insolvent, as insolvency practitioners are reluctant to liaise with funds due to perceived privacy issues;
- An employer is contributing to a fund on behalf of a choice member, as regulations prohibit funds from making acceptance of contributions conditional on an employer becoming a standard employer-sponsor of the fund.

### 4. **Measuring and reporting on the extent of the problem**

The ATO intends to measure and report on the level of unpaid SG annually. ISA and Cbus welcome this development and encourage the ATO to further develop its measurement tool to enable more sophisticated, granular analysis of the types of industries and employers that do not pay SG. This will enable the ATO to target its compliance and enforcement activity.

## **5. Increase ability of regulators to recover unpaid SG**

In 2014-15, the ATO raised liabilities of three times as much in unpaid SG as a result of employee complaints than it raised as a result of its own proactive risk-based work. In a compulsory system, significant resources should be allocated to recovering unpaid SG regardless of whether an employee lodges a complaint with the ATO. It is also concerning, that only 51 per cent of debts raised, result in payment of SG. The Fair Work Ombudsman, which is responsible for recovering unpaid wages, should also be empowered to recover unpaid SG.

## **6. Retaining and using strong penalties**

In 2012, the Government introduced legislation making directors personally liable for unpaid SG. Under the legislation, the ATO can issue a notice requiring a director to pay unpaid SG. If the director does not comply with the notice by the due date, the director becomes personally liable for the penalty amount until it is paid in full. The Fair Work Ombudsman should be given equivalent powers to require directors to pay unpaid SG.

In 2016 the Government introduced the Treasury Legislation Amendment (Repeal Day) Bill 2015 which reduced penalties for SG non-compliance. ISA and Cbus strongly opposed this. The Bill lapsed but remains Government policy.

## **7. Extending the safety net for unpaid entitlements in the event of employer insolvency**

Employees of companies with insufficient assets to pay their wages, leave and redundancy entitlements are protected by a Government safety net, the Fair Entitlements Guarantee (FEG).

However the FEG does not cover any form of superannuation contributions. The predecessor to FEG, the General Employee Entitlements and Redundancy Scheme, also did not cover unpaid SG, but did fund 3 months of superannuation contributions.

Many other jurisdictions, including New Zealand, Canada, the UK, the US and Germany provide an additional layer of protection for employees in the event of employer insolvency, in the form of either bankruptcy priority, a statutory safety net or both.

## Appendix 1

### RESEARCH NOTE: ISA Estimates of SG Compliance

ISA is using the ATO's two per cent sample file of personal tax and matched member contribution statement records for 2013-14 to derive estimates of apparent underpayment of SG. These estimates are complemented by the Auditor General's report on SG Compliance.

The Commonwealth Auditor-General's report on *Promoting Compliance with Superannuation Guarantee Obligations*<sup>2</sup> noted on page 17 that:

"The ATO's own internal risk assessment indicates that as many as 11 to 20 per cent of employers could be non-compliant with their SG obligations, and that non-compliance is 'endemic', especially in small businesses and industries where a large number of cash transactions and contracting arrangements occur. Importantly, this non-compliance primarily affects lower paid employees and those are most likely to rely on the age pension in later years. "

Two methodologies have been trialed:

1. A methodology based on wages and employer contributions aggregated for groups. This method is a refinement of the ATO that found that aggregate employer contributions are 9.8 per cent of aggregate wages. The ISA refinement involved removing salary sacrifice and adjusting for overtime.
2. A methodology based on classifying individual records on the ATO file by apparent level of SG contribution, with an overtime adjustment based on either the ABS AWOTE series or the ABS Survey of Income and Housing.

The 'individuals' methodology is preferred because it is more precise and conservative. It is more precise because it selects out only those individuals under the SG contribution rate. It does not average over people above and below the contribution rate. It also precisely takes out salary sacrifice (RESC) for the individual. Using RESC to satisfy SG obligations is legal, but not desirable, so it is useful to contrast the legal and moral definitions. The method also allows the adjustment for overtime to be done on the basis of the individual's gender and taxable income.

#### The methodology based on (anonymous) individual tax records

To calculate the rate of SG paid compared to what should have been paid it is necessary to:

- Isolate records in the ATO dataset which are for people who should receive the SG;
- Adjust for the maximum SG contributions base;
- Break the employer contribution recorded into two components – the salary sacrifice component and the SG component;
- Create an estimate of ordinary time earnings (the SG base) from the salary and wage data on the ATO individual tax return; and
- Adopt conservative cutouts for apparent underpayments which provide a margin of error for the imprecision in the overtime adjustment and which also allow for the lagged quarterly payment of SG.

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<sup>2</sup> <https://www.anao.gov.au/work/performance-audit/promoting-compliance-superannuation-guarantee-obligations>

The following sub-sections discuss how these estimates have been constructed and give sensitivity analysis for alternative methodologies. The conclusion from the sensitivity analysis is that the ISA methodology is robust and considerably better than previous published estimates.

The ATO data file has all identifiers removed, the age classifications have been put into groups, some variables have been top-coded and values have been perturbed. This prevents identification of individuals, and the ISA methods average out the perturbed data for large groups consistent with the ATO advice that:

*The Tax Office has conducted some initial analysis of the difference between labels before and after perturbation. The difference is marginal, and in our view acceptable given the steps that are required to make the file confidential.<sup>3</sup>*

The ISA analysis was conducted by Phil Gallagher, PSM, who managed retirement income modelling in the Treasury for 21 years. Phil was responsible for the creation of the original version of the merged file more than a decade ago. The Treasury version of the matched file continues to be used by the Treasury and the Parliamentary Budget Office for budget costings and distributional analysis.

## The SG population

The method excludes people who are not likely to be in the SG population:

- People under 20 (which is as close to under 19 as the data allows);
- People with wages under \$5400 (as an approximation for the \$450 per month SG threshold);
- People who have less than 10% of the assessable income from wages and salaries (as one test for the self-employed); and
- People with partnership or trust income (another test for the self-employed).

In addition, records without salary and wages or without employer contributions have been excluded from the analysis.

The records on the ATO file represent 12.9 million people. The exclusions reduce the population represented in this analysis to 7,990,800 people.

## The maximum SG contributions base

In 2013-14 the annual aggregate for the maximum SG contribution base was \$192,160. With a 9.25% contribution rate, this meant that the maximum required SG contribution was \$17,775.

In the analysis, people with ordinary time wages over \$192,160 and SG or employer contributions over \$17,774 have been treated as fully SG compliant. However, people with ordinary time wages over \$192,160 and SG or employer contributions less than \$17,774 have been assessed for compliance using the ratio of their contributions to wages.

The adjustment for the maximum SG contribution base is also important because it treats very high employer contributions, which the ATO has top-coded to a limited set of values, as compliant.

## Splitting employer contributions

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<sup>3</sup> From page 3 of *A 2% sample unit record file – Methodology Used to Generate the Data*, Australian Taxation Office, 16 March 2016 accessible via



The Member Contribution Statement (MCS) portion of the records on the ATO sample file aggregate employer contributions into one field. There is no type of superfund variable on the file.

The individual tax return portion of the file has a field for salary sacrifice contributions based on the RESC data provided by employers on their payment summaries for the individual.

The ISA methodology defines SG contributions as employer contributions minus salary sacrifice contributions. If the result of the calculation is negative, the SG contribution is set to zero.

In addition, the legal definition analysis of the results includes all employer contributions in the denominator of the SG rate. Using RESC to satisfy SG obligations is legal, but not ethical.

## Estimating ordinary time earnings from the ATO salary and wage data

The ATO guidelines<sup>4</sup> and ruling<sup>5</sup> for employers for calculating ordinary time earnings give it a broad base. The main things to notice for current purposes are:

- That for workers without set work hours, all hours are regarded as ordinary time and earnings regarded as OTE;
- That shift allowances for public holidays, weekends and night shift are included in OTE, and
- That allowances which reimburse expenses are not part of OTE.

The ATO data for salary and wages is only that recorded as salary and wages by employers. It does not include allowances for expenses, director's fees or lump sum termination payments. Hence the salary and wage data on the file largely differs from the OTE base of the SG because it includes overtime. As you would expect, the ATO data does not contain hours worked, which is not recorded on payment summaries.

The current methodology calculates an ordinary time earnings adjustment factor using the ratio of the ABS measures for ordinary time earnings to total earnings for males and females separately. In May 2014 these ratios were 94.68% for full-time adult males and 98.63% for full-time adult females. These factors have been applied at all wage levels because analysis of hours of work and overtime payments from the 2013-14 ABS Survey of Income and Housing (SIH) indicates that part-time and full-time workers can be found at most income levels. The adjustment of part-time wages down raises the apparent ratio of contributions and makes the analysis conservative.

For sensitivity analysis purposes a factor differing by gender and income level has been constructed from the ABS SIH and applied it to people with wages in the ATO 2013-14 sample file by wage band. The ABS survey-based adjustment factor is the average of an adjustment based on hours worked for full-time workers and an adjustment based on overtime dollars included in wages, to get an overall adjustment close to the 95 per cent factor for persons based on ABS AWOTE data.

## Adopting conservative cutouts

In 2013-14 the SG rate was 9.25 per cent. In 2012-13 it was 9.0%.

SG is required to be paid quarterly, and be can more regular if employers choose to pay that way. It seems highly likely that the MCS employer contribution data will include SG payments from the last quarter of 2012-13. But the salary and wage data and the salary sacrifice data is likely to correspond quite closely to

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<sup>4</sup> <https://www.ato.gov.au/business/super-for-employers/how-much-to-pay/checklist--salary-or-wages-and-ordinary-time-earnings/>

<sup>5</sup> <http://law.ato.gov.au/atolaw/view.htm?DocID=SGR/SGR20092/NAT/ATO/00001&PiT=99991231235958>

the 2013-14 income year. Allowing for the measured increase in AWOTE and the 9.0% quarter, we calculate that if all SG payments were lagged by one quarter then the apparent SG rate would be 9.14%, not 9.25%.

It is also the case that our adjustment for overtime is broad and the data includes some perturbation. Therefore estimates of proportions and means will be valid for large groups, but questionable for small groups. Most estimates in this paper are for large groups of people.

Given the imprecision in the overtime adjustment individuals below 8.5 per cent are treated as not being fully SG compliant. We also present estimates for 9.0% and 9.25% cutoffs, and for the legal definition of all employers' contributions counting, as well as the moral definition which does not count salary sacrifice as SG contributions.

**Table 1** shows the estimated proportion of SG contributors apparently under-paid by type of contribution, OTE adjustment and cut-off level.

Using an 8.5% cut-off for a year in which the SG was 9.25% gives an estimate that 30% of all SG contributors were under-paid SG in 2013-14, based on their estimated ordinary time earnings. The result from both methods of OTE adjustment is the same. If a 9.0% cut-off is used, we estimate that 38% of SG contributors were under-paid SG.

**Table 1: Apparent Underpayment Proportion of SG Population by Type of Contribution, OTE Adjustment and Cut-off Level**

Contribution Type and OTE Adjustment	Cumulative Proportions of People at different cut-offs		
	8.50%	9.00%	9.25%
SG SIH adjustment	30%	39%	47%
SG AWOTE Adjustment	30%	38%	46%
All Employer contributions SIH adjustment	27%	36%	43%
All Employer contributions AWOTE Adjustment	27%	35%	43%

However, legally salary sacrifice contributions can be used to satisfy an employer's SG obligation. Using an 8.5% cut-off for a year in which the SG was 9.25% gives an estimate that 27% of all SG contributors were underpaid employer contributions in 2013-14, based on their estimated ordinary time earnings. The proportion result from both methods of OTE adjustment is the same. If a 9.0% cut-off were used, we estimate that 35% of SG contributors were under-paid employer contributions.

For the reasons given earlier, we do not believe that the 9.25% legal SG rate for 2013-14 should be proposed as a cut-off in this analysis.

Table 2 shows that the SG underpayment numbers at a 9.0% cut-off are 3.1 million workers while the employer contribution method shows 2.8 million workers were under-paid contributions. At the more conservative 8.5% cut-off, the apparent under-payment is 2.4 million people for SG and 2.15 million people for all employer contributions. The most conservative definition of the legal shortfall in SG payments is 2.15 million people.

**Table 2: Apparent Underpayment Numbers of SG Population by Type of Contribution, OTE adjustment and cut-off level**

Contribution Type and OTE Adjustment	Cumulative Numbers of People at different cut-offs		
	8.50%	9.00%	9.25%
SG SIH adjustment	2,381,900	3,087,800	3,721,100
SG AWOTE Adjustment	2,363,550	3,058,450	3,668,450
All Employer contributions SIH adjustment	2,173,600	2,850,600	3,463,400
All Employer contributions AWOTE Adjustment	2,150,150	2,814,450	3,401,950

Table 3 shows that SG under-payments are estimated to be \$4.5 billion of SG and \$3.5 billion for employer contributions using a 9.0% cut-off. Using an 8.5% cut-off, the apparent dollars in SG not paid are estimated to be \$3.8 billion and for employer contributions \$2.8 billion. The last estimate is the most conservative definition of the legal gap in SG payments.

**Table 3: Apparent Billions of Dollars of Underpayment by Type of Contribution, OTE adjustment and cut-off level**

Contribution Type and OTE Adjustment	Cumulative Billions of Dollars Underpaid at Different Cut-offs		
	8.50%	9.00%	9.25%
SG SIH adjustment	\$3.7	\$4.4	\$4.9
SG AWOTE Adjustment	\$3.8	\$4.5	\$4.9
All Employer contributions SIH adjustment	\$2.8	\$3.4	\$3.8
All Employer contributions AWOTE Adjustment	\$2.8	\$3.5	\$3.9

Even if half these estimates are true underpayment, they are of significant concern. The 2014-15 Annual Report of the Commissioner of Taxation showed only \$372.4 million of underpayments transferred to employee funds. This is 13 per cent of the underpayment estimate using employer contributions and the 8.5% cut-off. The Auditor-General has already noted that only one half of underpayments identified by the ATO result in payments to employee accounts. In 2014-15, the ATO raised \$734.8 million in underpayment (and received \$372.4 million). In 2014-15 the ATO risk based audits only raised debts of \$156.4 million.

### Who is more likely to be underpaid SG?

The foregoing analysis has shown that there is little difference in results from the two methods of ordinary time earnings adjustment used. The method based on the ratio of average ordinary time earnings to total earnings by gender is simpler and a more robust statistic than the experimental method based on the ABS Survey of Income and Housing. So in examining risk of being under-paid, using the AWOTE method is sufficient.

There are large differences according to whether we consider all employer contributions, or only employer contributions minus salary sacrifice. For the compliance risk analysis, this section uses the legal definition of all employer contributions as recorded in the MCS.

There are also large differences in results from the line used to determine underpayment. So the 8.5%, the 9.0% and the 9.25% cutoffs are all worth presenting. For convenience, the 8.5% cut-off is used in the following text.

Table 4 shows that males had an apparent underpayment proportion of 29%, females 24% using the legal definition and the 8.5% cut-off. The gender difference may be because males are more likely to work in construction occupations and as consultants – two areas of known underpayment. The adjustment of part-time wages for overtime could be a factor decreasing the apparent female rate.

**Table 4: Apparent Underpayment Rate by Gender**

Gender	Proportion of people under 8.5%	Proportion of people under 9.0%	Proportion of people under 9.25%
Male	29%	36%	41%
Female	24%	34%	45%
All	27%	35%	43%

If the moral definition of SG contributions had been used (not counting salary sacrifice) then 32% of males and 27% of females would have contributions less than 8.5% of ordinary time wages. As the cutoff is set closer to the statutory SG threshold females are slightly more likely to be underpaid – suggesting females are more likely to be shortchanged rather than not be paid at all.

Workers under 30 were more likely to have SG apparently under-paid. Table 5 shows a 37% rate for 20 to 24 year olds and a 31% rate for 25 to 29 year olds.

**Table 5: Apparent Underpayment Rate by Age**

Age of tax filer	Proportion of People under 8.5%	Proportion of People under 9.0%	Proportion of People under 9.25%
<b>20 to 24</b>	<b>37%</b>	<b>48%</b>	<b>57%</b>
<b>25 to 29</b>	<b>31%</b>	<b>40%</b>	<b>48%</b>
<b>30 to 34</b>	<b>28%</b>	<b>37%</b>	<b>44%</b>
35 to 39	26%	34%	42%
40 to 44	25%	33%	41%
45 to 49	24%	32%	40%
50 to 54	23%	31%	38%
55 to 59	21%	27%	34%
60 to 64	19%	25%	31%
65 to 69	18%	25%	29%
70 and over	20%	26%	32%
All	27%	35%	43%

Table 6 uses the reduced occupational classification available on the ATO file. Tria found that people in construction and consultancy were likely to be under-paid SG (see Appendix 2). The ATO file shows that trade workers, machinery operators, labourers, consultants and apprentices are more likely to be underpaid.

**Table 6: Apparent Under-payment of SG by Broad Occupation**

Occupation	Proportion of People under 8.5%	Proportion of People under 9.0%	Proportion of People under 9.25%
Occupation not listed/ Occupation not specified	<b>44%</b>	<b>52%</b>	<b>57%</b>
Managers	21%	28%	33%
Professionals	18%	24%	31%
Technicians and Trades Workers	<b>36%</b>	<b>44%</b>	<b>50%</b>
Community and Personal Service Workers	27%	37%	47%
Clerical and Administrative Workers	22%	31%	39%
Sales workers	25%	36%	48%
Machinery operators and drivers	<b>42%</b>	<b>50%</b>	<b>55%</b>
Labourers	<b>39%</b>	<b>49%</b>	<b>56%</b>
Consultants, apprentices and type not specified	<b>31%</b>	<b>39%</b>	<b>47%</b>
All	27%	35%	43%

Consistent with being younger, Table 7 shows that it is people with taxable incomes below \$37,000 who are more likely to be underpaid SG.

**Table 7: Apparent Under-payment of SG by Taxable Income in 2013-14**

Taxable Income	Proportion of People under 8.5%	Proportion of People under 9.0%	Proportion of People under 9.25%
Below \$18,200	<b>40%</b>	<b>48%</b>	<b>54%</b>
\$18,201 - \$37,000	<b>31%</b>	<b>40%</b>	<b>49%</b>
\$37,001 - \$80,000	24%	34%	42%
\$80,001 - \$180,000	24%	30%	34%
\$180,001 - \$300,000	25%	29%	31%
\$300,001 and over	20%	20%	20%
All	27%	35%	43%

# APPENDIX 2



Superannuation Guarantee non-compliance:

Cash economy & sham contracting

Prepared for Cbus

October 2016



# Agenda

1. Key findings

2. SG non-compliance summary

3. Detailed insights

4. Methodology

# Key findings

1. **Superannuation guarantee (SG) non-compliance due to the cash economy and sham contracting continues to be a significant and growing problem, now affecting an estimated 326,000 Australians (over 3% of the workforce eligible for SG contribution)**
2. **Total estimated SG losses are \$1.1bn in 2014 and have grown at 5% per annum over four years**
3. **The cash economy is the larger contributor to SG losses, \$0.8bn in 2014**
4. **Australians affected by these two sources of non-compliance lose an average of ~\$3,300 pa in SG contributions – just over 7 months' worth for someone on average weekly earnings**
5. **This amounts to an annual loss in the future retirement incomes of Australian workers of \$90m (in real terms)**

# Agenda

1. Key findings

2. SG non-compliance summary

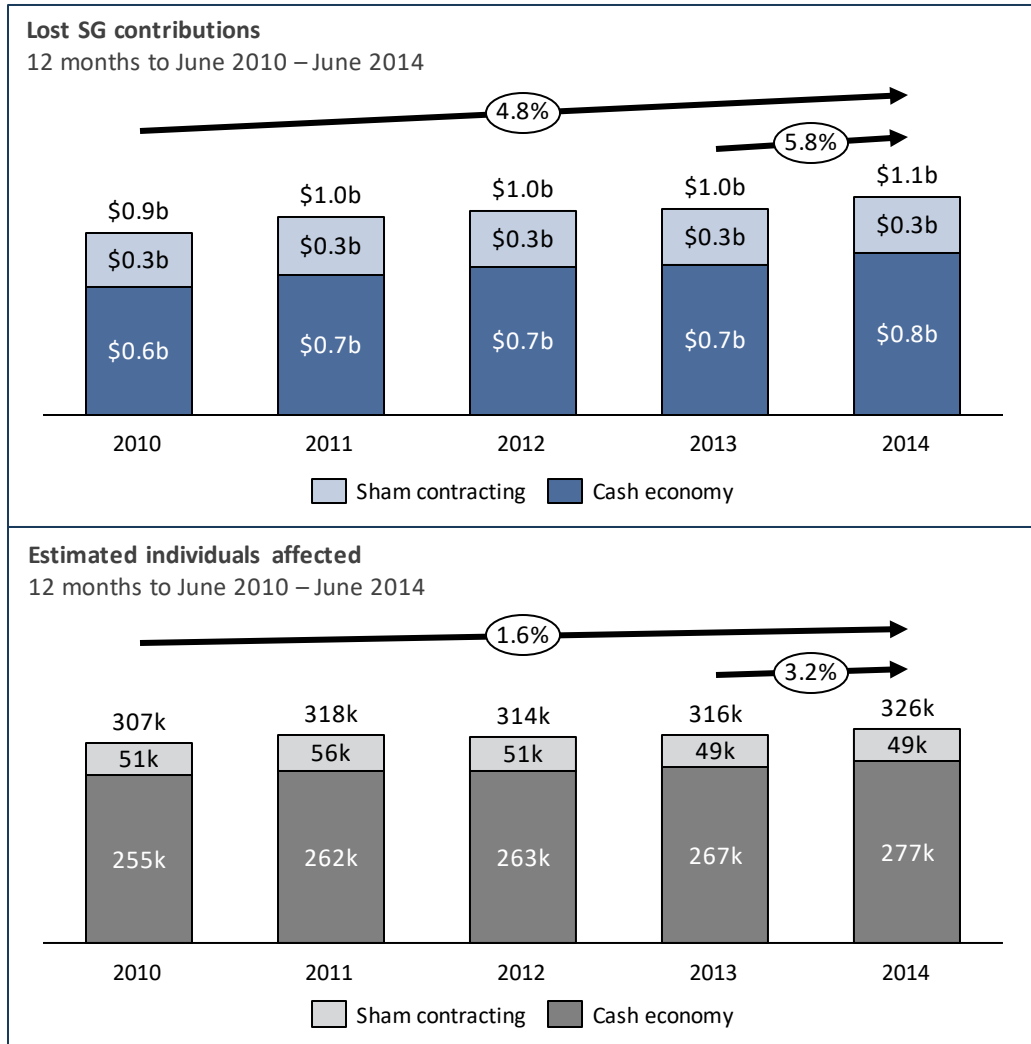
3. Detailed insights

4. Methodology

# Superannuation Guarantee non-compliance

1. **This report focuses on two of the four main sources of SG non-compliance, in order of importance:**
  - Cash economy; \$0.8bn
  - Sham contracting; \$0.3bn
  - Employer non-compliance and employer insolvency are not in scope for this report
2. **We estimate non-compliance with superannuation guarantee (SG) obligations due to the cash economy and sham contracting is costing employees ~\$1.1bn pa, or 1.6% of total SG contributions**
3. **At current growth rates, total losses to the superannuation system resulting from these two causes of SG non-compliance will be close to \$18b over the ten years to June 2024**
4. **Construction is the most affected industry within the cash economy; other industries with elevated non-compliance include mining, manufacturing, hospitality and wholesale trade**
5. **SG non-compliance due to these two sources affects the superannuation balances of over 3% of the workforce eligible for SG contribution:**
  - We estimate that ~326,000 miss out on some or all of their super contributions
  - Given the total amount of non-compliance, this is an average of ~\$3,300 pa missing for each person affected
  - Relative to average weekly earnings, the average SG loss is equivalent to over 7 months of super contributions;
  - These estimates are based on conservative assumptions; the actual contributions lost and individuals affected may be significantly higher
6. **The biggest change has been within the cash economy, with lost SG contributions increasing by 7% from 2013 to 2014**
  - SG contribution loss due to the cash economy has grown by almost 6% per annum on average since 2010, from \$630m in 2010 to \$792m in 2014
  - The number of individuals affected has also grown by 1.6% per annum on average, from ~255,000 in 2010 to ~277,000 in 2014

# Lost SG contributions total \$1.1b and affect over 3% of working Australians eligible for SG contribution

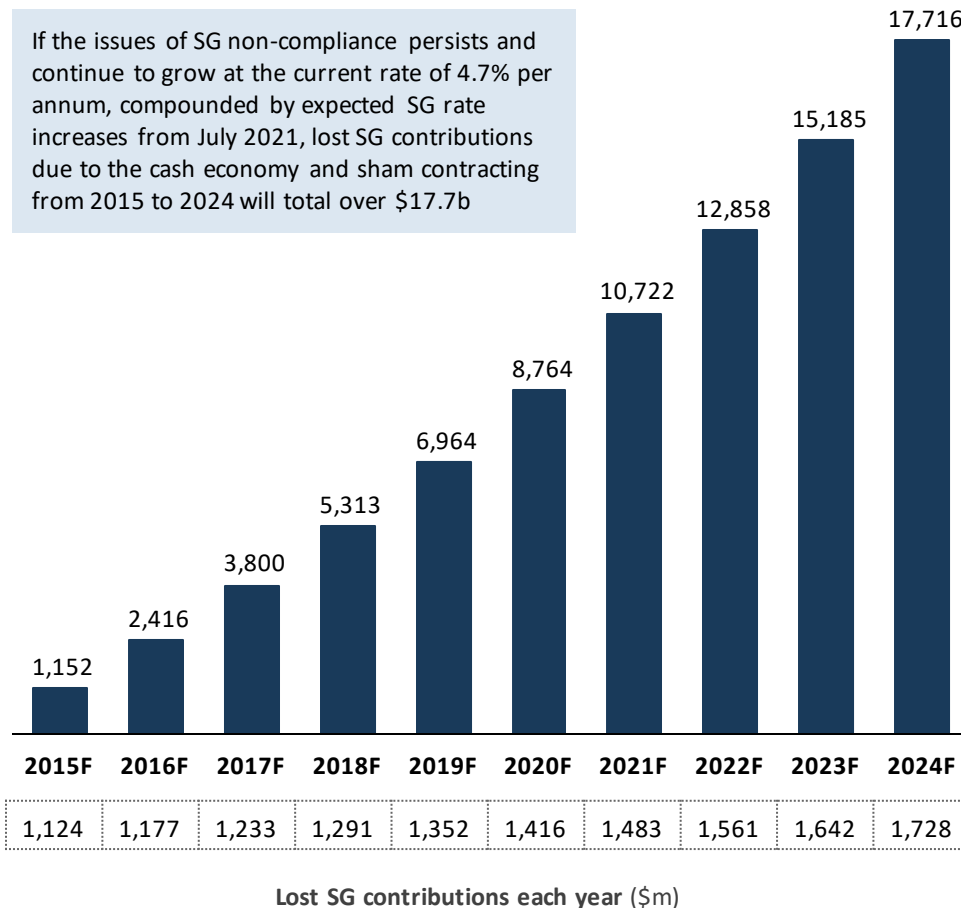


- Estimated lost SG contributions from sham contracting and the cash economy have increased by 4.8% p.a. over the four years since 2010 to a total figure of \$1.1b per year in 2014
- This is equivalent to 1.6% of all SG contributions, unchanged from 2013
- The estimated number of individuals affected has continued to increase to 326,000, or 3.2% of the workforce eligible for SG contribution, up from 3% in 2013
- An increased SG rate (9.25% in 2014 compared to 9.0% in 2013) has driven small increases in SG losses through sham contracting and the cash economy
- SG losses due to the cash economy affects the most individuals, while the number of individuals affected due to sham contracting is linked to the size of the independent contracting segment of the workforce, and appears to have stabilised after steady decline since 2011

# If lost SG contributions continue to grow at the current rate, it will result in an \$18b superannuation gap in 2024

**Accumulated total SG contributions lost**  
(June 2015F – June 2024F, \$m)

If the issues of SG non-compliance persists and continue to grow at the current rate of 4.7% per annum, compounded by expected SG rate increases from July 2021, lost SG contributions due to the cash economy and sham contracting from 2015 to 2024 will total over \$17.7b



## Forfeited SG contributions due to the cash economy and sham contracting are costing Australians \$90m in retirement income every year

- Each dollar coming into the system will be invested for 14.1 years until a members' retirement (on average). Assuming a long-term investment return of 5% pa and 2.5% pa inflation, this year's \$1.1b loss will grow to \$1.5b over that time (in today's dollars)
- Assuming a 6% drawdown rate, this indicates a loss of \$90m (in today's dollars) in Australians' retirement incomes as a result of the 2014 lost SG contributions alone



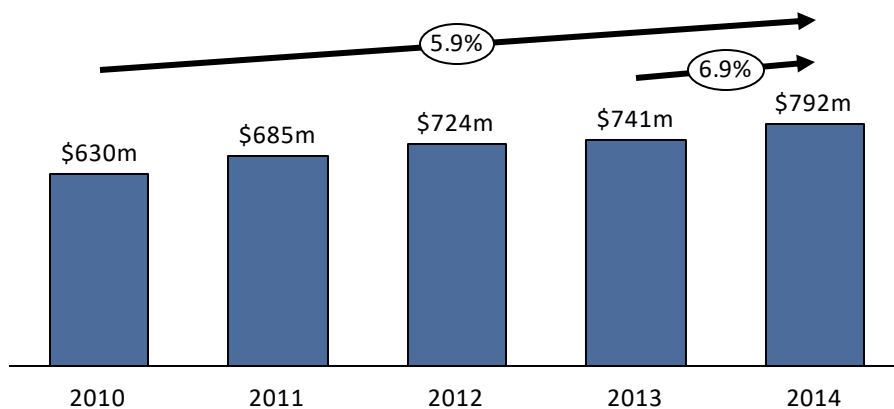
# Agenda

1. Key findings
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# Cash economy

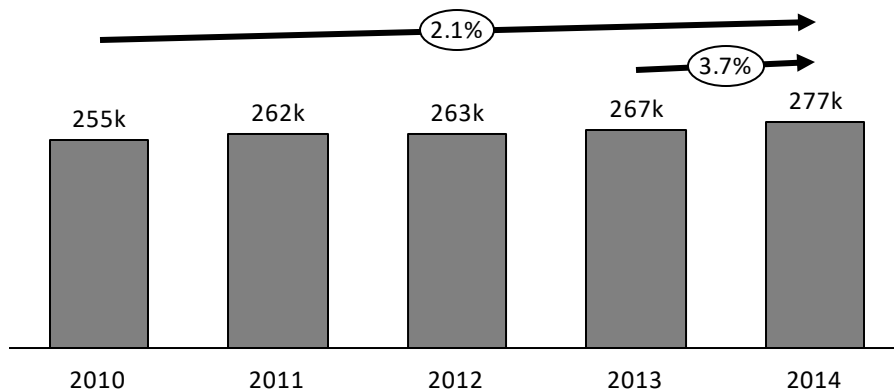
## Lost SG contributions

12 months to June 2010 – June 2014



## Estimated individuals affected

12 months to June 2010 – June 2014



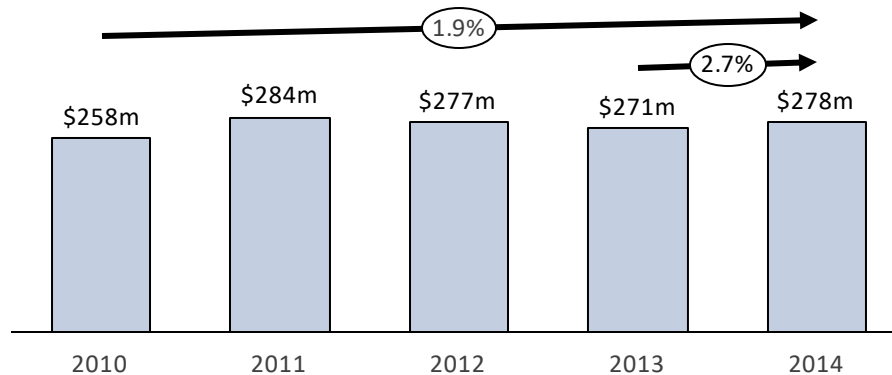
**Employer and employee both non-compliant with their SG obligations, failing to declare salary and wage income (but excluding criminal activity such as narcotics)**

- SG contributions lost from the cash economy have grown by almost 6% per annum since 2010, however the number of affected individuals has been growing at a slower pace
- Of the two categories of non-compliance covered in this report, the cash economy make up the larger portion of lost SG contributions and affects the most individuals
- The ABS has estimated the cash economy to be 1.5% of GDP
- Non-compliance due to the cash economy does not solely involve SG, it also includes PAYG, payroll tax, workers' compensation and other employee entitlements
- Missing PAYG salary and wages is estimated to be ~\$8,562m in 2014 (source: RBA Statistics of Output and Labour; ABS 5204.0.55.008 – Information Paper: The Non-Observed Economy and Australia's GDP, 2012), and at the SG rate of 9.25%, implies missing contributions of \$792m

# Sham contracting

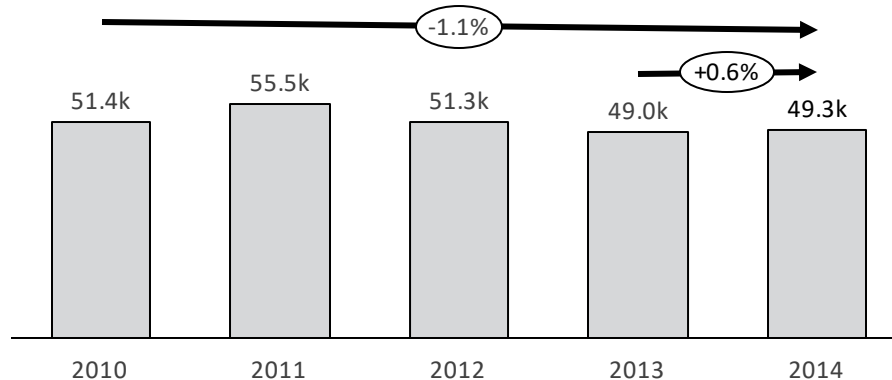
## Lost SG contributions

12 months to June 2010 – June 2014



## Estimated individuals affected

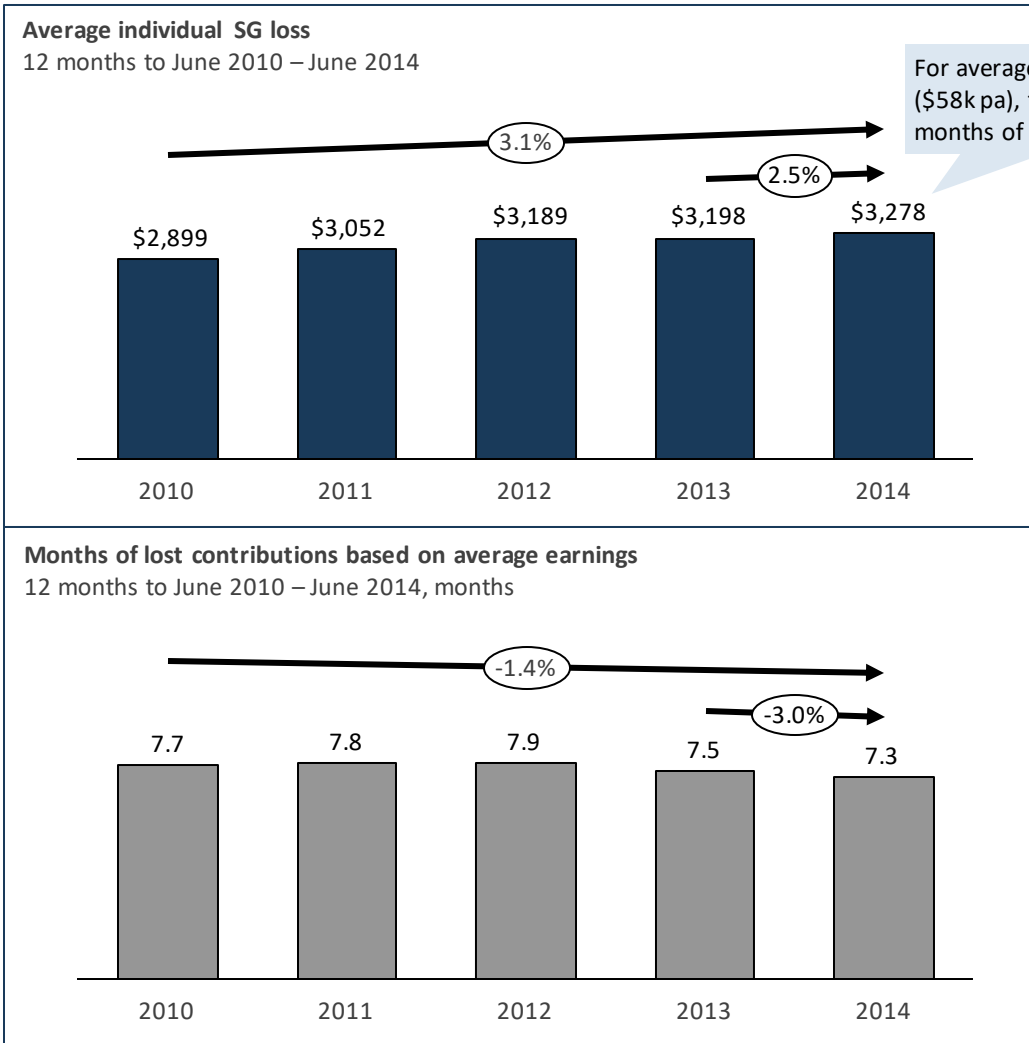
12 months to June 2010 – June 2014



Individuals incorrectly identifying as (or being categorised as) a contractor rather than an employee, to avoid a range of employee obligations including SG

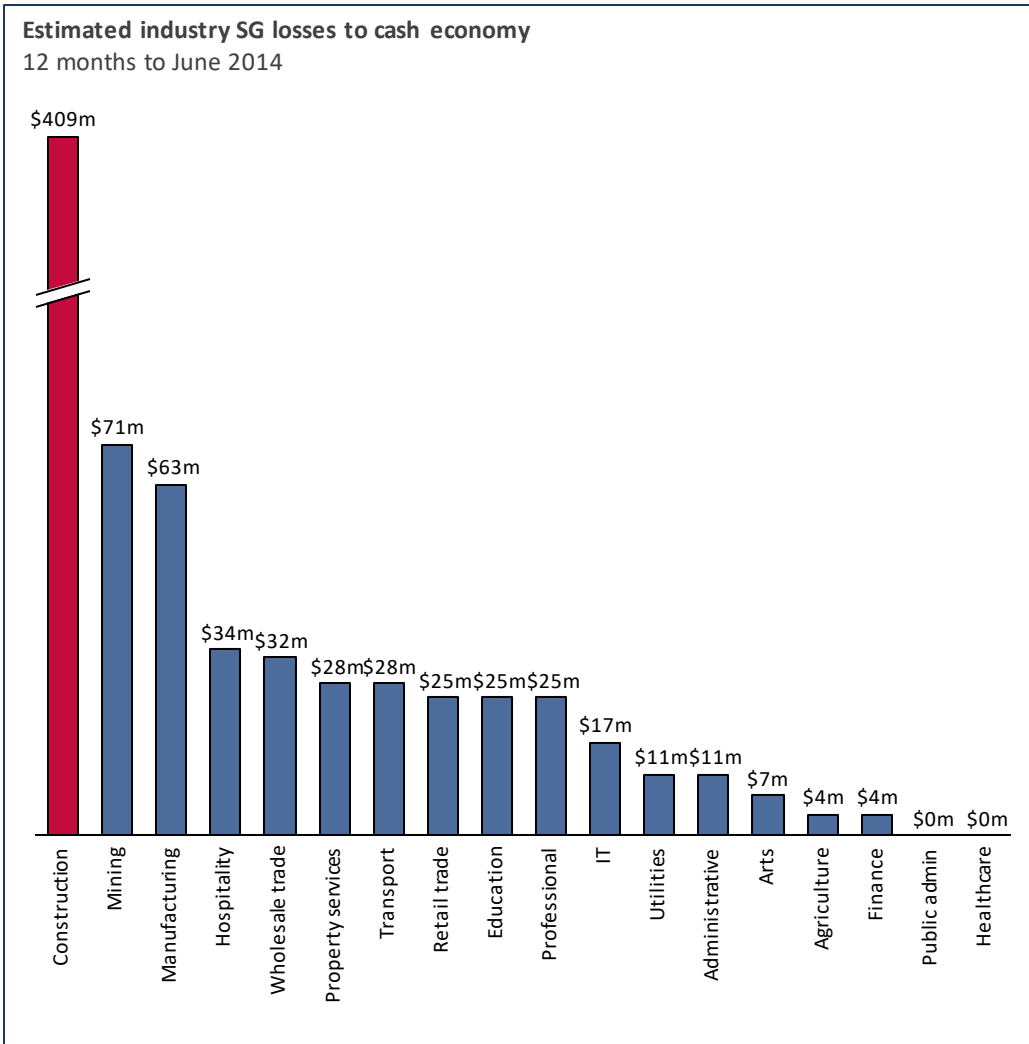
- Lost SG contributions and the number of individuals affected by sham contracting fluctuates with the size of the independent contracting workforce, up 2% per annum since 2010
- The increase in lost SG in the 12 months to June 2014 can be mostly explained by the increase in the SG rate (to 9.25%) and an increase in average weekly earnings
- Independent contractors currently represent ~9% of salary & wage earners in the PAYG system (in steady decline from ~11% in 2010); it is assumed that ~5% of these contractors should have been classified as employees, implying a ~0.5% leakage rate of salary and wage income
- With a 9.25% SG contribution rate, lost SG contributions in the 12 months to June 2014 is estimated at \$278m
- Applying the same assumption that ~5% of reported independent contractors are in a sham contracting arrangement yields an estimated ~49,000 affected individuals

# While individual experience may vary enormously, average impact of SG non-compliance is the loss of 7 months of contributions



- Individuals' experience of SG non-compliance can vary. One may experience a single occasion of lost SG contributions, whilst others may be subject to multiple years of non-payment
- The average impact of SG non-compliance due to sham contracting and the cash economy on an individual has steadily risen over time, increasing by 3% per annum since 2010 to \$3,278 for 2014
- For an individual earning the average wage, this is equivalent to just over 7 months of lost contributions during 2014.
- This figure has been in decline since a peak of just under 8 months in 2012, driven by
- However, most people affected by SG non-compliance tend to have lower incomes, which further exaggerates this effect (i.e. more months of lost contributions)

# SG non-compliance occurs in most private sector industries, but is heavily concentrated in construction



- Data supporting industry attribution of SG non-compliance is limited, but points to common themes of elevated non-compliance activity
- ABS estimates that the construction industry is by far the biggest contributor to the cash economy
- Industry data is not available for sham contracting, which means caution should be exercised in attributing the entire \$1.1bn SG losses by industry
- Other industries with observed elevated levels of cash economy activity include mining, manufacturing, hospitality and wholesale trade
- The outlier nature of the construction industry is also supported by employee SG complaint analysis, which indicates an elevated level of non-compliance in construction (also engineering / mechanical, only outliers reported) and a high level of failure to complain

# Agenda

1. Key findings
2. SG non-compliance summary
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# Methodology

Factor	Sources / approach
Overview	<p>The overall approach was critiqued by Ross Clare, Director of Research, ASFA, the importance of whose input is acknowledged.</p> <p>The four sources of SG non-compliance were drawn from the 2010 report of the Inspector-General of Taxation into the ATO's administration of the SGC; this report focusses on only two sources, cash economy and sham contracting.</p>
SG rate	<p>The SG contribution rate was 9% until July 2013, at which point the rate increased to 9.25% for the remaining period covered by this report (June 2014).</p>
Total SG losses after 10 years and Impact on Retirement Incomes	<p>The average duration of each dollar was first calculated by expressing the change in balance of the super account as a percentage of the balance at the point of retirement. This percentage was then used to weight the number of years each contribution remained in the system. The sum of these weighted durations yields an average dollar duration of 14.1 years. Assuming this grows by a real return rate of 2.5% per annum this amounts to \$1.5b after 14.1 years. At 6% drawdown this represents \$90m (in today's dollars) in retirement income at that point in time.</p>
Cash economy	<p>We used the ABS approach to estimating the cash economy, which is 1.5% of GDP. This is at the bottom end of global estimates. ~60% of this figure is allocated by the ABS to gross mixed income, and we allocated 60% of this figure to missing employee earnings (\$8.6bn in 2014), based on ABS share of employee earnings vs returns to capital. Estimated individuals affected was derived by spreading the missing employee earnings figure across the 75<sup>th</sup> percentile of earnings, based on the evidence that low income earners are disproportionately represented in the cash economy.</p>
Sham contracting	<p>Primary source is Fair Work Ombudsman Sham Contracting study November 2011. This was a limited study of high risk industries which found 20% misclassification and potential 7% shams in independent contractor sample population. Independent contractors currently represent ~9% of employees, and we assumed 5% leakage; this implies leakage of 0.5% of salary &amp; wage income</p>



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