

Chapter 3

Extent of SG non-payment

The extent of SG non-payment

3.1 It became apparent during this inquiry that due to various data gaps, it is difficult to precisely estimate the extent of non-payment of SG in Australia.¹ This issue and its ramifications are discussed in this chapter.

Industry Super Australia's estimate

3.2 According to Industry Super Australia's (ISA) submission, the report 'Overdue: Time for action in unpaid super' released by ISA and Cbus in December 2016, Australian employers failed to pay at least \$3.6 billion in SG contributions in 2013-14.²

3.3 The two components of this combined estimate are:

- underpayment of SG for Pay As You Go (PAYG) employees and sham contractors³, which ISA estimates as at least \$2.8 billion in 2013-14; and
- unpaid superannuation for workers employed in the cash economy, which research by Tria Investment Partners (Tria) for Cbus estimates added a further \$800 million to the total amount of unpaid superannuation.⁴

3.4 The report noted that this estimate equated to 30 per cent of employees (approximately 2.4 million individuals) not being paid part or all of their compulsory superannuation. The report also stated that on average, affected employees missed out on approximately \$1500 (or approximately four months of SG) of superannuation contributions.⁵

3.5 The following table is based on the submission and summarises the report's findings.

1 For the purposes of this report, the term 'non-payment of SG' also refers to the delayed or underpayment of SG.

2 Industry Super Australia, *Submission 7*, p. 3.

3 Sham contracting refers to a situation where an employer attempts to disguise an employment relationship as an independent contracting arrangement, usually for the purpose of avoiding responsibility for employee entitlements.

4 Industry Super Australia, *Submission 7*, p. 3.

5 Industry Super Australia, *Submission 7*, pp. 2–3.

Table 3.1—Estimated impact of SG non-compliance for 2013-14⁶

Estimate of:	ISA underpayment	Tria cash economy	Combined estimate
Dollars lost 2013-14	\$2.8 billion	\$0.8 billion	\$3.6 billion
Number of workers affected	2,150,000	277,000	2,427,000
Average effect on workers affected	\$1,309	\$2,888	\$1,489
Proportion of all SG employees in 2013-14	27 per cent	3 per cent	30 per cent
Average months of contributions lost for those affected	3.3	7.6	3.8

3.6 In a supplementary submission dated March 2017, ISA provided the committee with a revised estimate of the extent of SG non-payment, putting the 2013-14 figure at \$5.6 billion. The supplementary submission noted:

Our December [2016] report projected that 2.4 million Australians are being underpaid by a conservative estimate of at least \$3.6 billion. We have revised our research, removing estimates for the black economy used in December, and using only ATO tax file data for 2013-14. Our revised projections show that 2.76 million people were affected in that financial year by an average amount of \$2,025 per person, or an aggregate amount of \$5.6 billion.⁷

3.7 The supplementary submission went on to provide further detail on the predicted cumulative impact on retirement savings:

Using only official ATO data, ISA estimates the SG gap is \$5.6 billion per year; \$5.45 billion of this is for people aged 20–64 years of age. ISA estimates that 2.69 million [people] aged 20–64 are underpaid. If this continues to occur in the workforce each year from 2013-14 to 2023-24, ISA projects the cumulative impact on retirement savings would be \$102 billion. Table 8 shows this projection, which assumes wage growth consistent with the forward estimates, ABS projected growth, the scheduled rise in the SG rate and 5 per cent returns.

Table 8 – Growth in the Impact on Savings over a Decade

Year ending June	Cumulative gap
2014	\$5.59 billion
2015	\$11.84 billion

6 Industry Super Australia, *Submission 7*, p. 5.

7 Industry Super Australia, *Submission 7.1*, p. 1.

2016	\$18.62 billion
2017	\$25.98 billion
2018	\$33.98 billion
2019	\$42.68 billion
2020	\$52.16 billion
2021	\$62.45 billion
2022	\$74.09 billion
2023	\$87.21 billion
2024	\$101.95 billion

Source: ISA projections based on wage growth consistent with the forward estimates, ABS projected population growth, the scheduled rise in the SG rate and 5 per cent returns.

A shortfall in retirement savings of over \$5 billion per year will have a significant impact on retirement incomes...a single year's underpayment is associated with a lower balance of \$23,860 for 60-64 year olds, but we do not have direct information on historical underpayment. In the absence of longitudinal data, it might be useful to note that a balance difference of \$23,860 would imply \$1,200 less per year in an allocated pension payment and \$388 per year more in age pension (if assessed at the higher income test deeming rate of 3.25 per cent).⁸

3.8 ISA also explained the revised modelling to the committee:

The estimates in our December report combined ISA estimates of underpayment (but not nil payment), in the SG population with estimates produced by Tria Investment Partners (for Cbus) of the black economy where workers were not receiving SG at all. These combined estimates are conservative. Addressing the Terms of Reference of the current inquiry requires the detail of a single unit record source of data.

Accordingly, ISA has revised its estimates to include people not paid any SG even though they are in the SG population (operationally defined as wage and salary earners aged 20 or more, earning about \$5,400 in wages, not having a partnership or trust income and not satisfying the ten per cent income test rule).

In our revised research, removing estimates for the black economy used in December, and using only ATO tax file data for 2013-14, we find there are more people underpaid SG and a significantly higher dollar gap...

ISA has modelled these projections using the ATO 'matched data' 2 per cent sample file of personal tax and MCS [member contribution statement] data sets. The ATO could further refine ISA projections by using the complete 'matched data' file, adjusting OTE [ordinary time earnings] on a more

granular level by industry sector, income, gender and age, adding Division 293 tax data [tax arrangements for high income earners] and removing defined benefit cases from the eligible SG population.⁹

3.9 The committee asked the ANAO whether it had any comments on the ISA methodology. Ms Isabelle Favre, Senior Director at the ANAO noted:

I am not an economist, so I will be very careful. It seems to be a very thorough and cautious methodology. The estimates put forward are systematically the most conservative of the different methodologies that they have used. Given that an estimate is just that – an estimate – and it is meant to help direct a compliance strategy for the ATO, for instance, and we know it is an estimate, there is a risk that the estimate is not correct. But it still seemed to be good enough to be used for directing a compliance strategy.¹⁰

3.10 Mr Andrew Morris, an Executive Director at the ANAO further clarified:

While we would not comment on the particular methodology, it would complement well the top down approach. The ATO has the top-down approach for the SG gap and it would also be useful for that more bottom-up approach to be able to identify the number of employees, say, or employers that are not compliant. If it is also able to target some of the industries and sectors – if it goes that far, that would complement the gap analysis.¹¹

ATO response to ISA estimate

3.11 The ATO responded to the December 2016 estimate of the SG non-payment, asserting that the ISA figure 'substantially overstates' the prevalence of SG underpayments.¹²

3.12 The ATO noted that the modelling used by ISA, while valid, is different to the proposed ATO approach to estimating the SG gap, as the ATO approach is a 'top down approach' which does not seek to estimate the number of employees underpaid.¹³

3.13 The ATO submission explains:

9 Industry Super Australia, *Submission 7.1*, p. 1.

10 Ms Isabelle Favre, Senior Director, Australian National Audit Office, *Proof Committee Hansard*, 3 March 2017, p. 32.

11 Mr Andrew Morris, Executive Director, Australian National Audit Office, *Proof Committee Hansard*, 3 March 2017, p. 33.

12 Australian Taxation Office, *Submission 6*, p. 12.

13 Australian Taxation Office, *Submission 6*, p. 12.

We do not consider the number of people identified with an amount of SG underpayment in the ISA report to be reliable as the report uses 'averages' to reach a specific estimate, rather than an estimate expressed within a 'range'.

The ATO considers that the 'tolerance threshold'; used to determine the 2.15 million people reported with an apparent SG underpayment in the report is too high. The report used a tolerance threshold of 8.5 per cent across the entire population.

A 'tolerance threshold' is an adjustment to the rate of superannuation on the salary or wage figure to account for the fact that salary or wages reported may exceed ordinary time earnings (OTE) (because of aspects such as overtime, allowance, etc.).

We therefore believe the adjustments for OTE used in the report are insufficient to account for the difference seen with employment models and work practices across various broad industries.¹⁴

Lack of alternative SG gap figure from the ATO

3.14 Although criticising the ISA estimated extent of the SG gap, the ATO was unable to provide the committee with an alternative figure.

3.15 The ATO informed the committee that although work is currently being undertaken on the matter, the task is a challenging one and the agency is yet to establish a reliable estimate, noting 'while the methodology is considered to be sound there is in a statistical sense a low level of confidence'.¹⁵

3.16 The committee queried the ATO on its apparent reluctance to engage in and prioritise the issue of establishing an accurate estimate of the SG gap, particularly given that previous reviews, dating back to 2010, included recommendations that this be the case.¹⁶

3.17 Mr James O'Halloran, the ATO Deputy Commissioner responsible for Superannuation, responded by reiterating that the ATO had made a commitment to estimate gaps for all taxes and programs administered by the ATO. He stated:

I am not sure I would characterise it as resistance... There is a public commitment from the Commissioner, particularly to the Tax and Revenue Committee, to undertake and progress a tax gap program... I would perhaps

14 Australian Taxation Office, *Submission 6*, p. 12.

15 Australian Taxation Office, *Submission 6*, p. 11. Note: The identification of a 'tax gap' is an approach which seeks to estimate, through the use of macro analysis, the theoretical incidence of non-payment.

16 See Inspector-General of Taxation, *Review into the ATO's administration of the Superannuation Guarantee*, 2010; Australian National Audit Office, *Promoting Compliance with Superannuation Guarantee Obligations*, Audit Report No. 39, 2014-15.

suggest that the ATO is in fact progressing a full program of gaps, and at this stage we are working through those, and that includes the SG gap.¹⁷

3.18 Mr O'Halloran further noted:

In relation to the SG gap, effectively most of last year, as certainly many stakeholders knew, we have been progressing to develop a credible and reliable methodology to determine the SG gap. We certainly had been working through an appropriate methodology, but at this stage, as is I think on the public record, we do not feel we have a reliable one, that we have a high enough level of confidence. We have been taking particular advice from an ATO panel of experts which has Professor Neil Warren, Chris Richardson and Richard Highfield on it... Certainly we feel that, before we are comfortable that it is a reliable and credible gap, we need to improve some of the methodology. That has been the feedback. I would suggest that we have been progressing very strongly on the methodology, not only across SG but also more broadly, for effectively 12 to 13 months.¹⁸

3.19 When queried by the committee about why the information was not released in 2016, and who made the decision to defer the release, Mr O'Halloran explained:

I consulted with industry itself, through the Superannuation Stewardship Committee, and got some feedback on the methodology. We then took advice from that ATO expert panel. Ultimately, it went to the ATO executive, which includes the Commissioner, around the release of gaps which were identified as having a low level of confidence in a statistical sense if I can use that term. Therefore, we have been tasked to do some more work and bring in more expertise to improve that level to make sure it is reliable and also has an increased level of confidence.¹⁹

3.20 When pressed to provide a more definitive timeline for when work would be complete on the SG gap, the ATO stated in an answer to a question on notice that 'we may be in a position to release the methodology by June 2017'.²⁰

3.21 The committee also canvassed the issue of what the goal of generating the gap analysis was, and queried whether it was for the purposes of enforcement, compliance, risk assessment, or as an aggregate to drive resource prioritisation with the ATO. Mr O'Halloran responded:

17 Mr James O'Halloran, Deputy Commissioner, Superannuation, Australian Taxation Office, *Proof Committee Hansard*, 25 January 2017, p. 12.

18 Mr James O'Halloran, Deputy Commissioner, Superannuation, Australian Taxation Office, *Proof Committee Hansard*, 25 January 2017, p. 12.

19 Mr James O'Halloran, Deputy Commissioner, Superannuation, Australian Taxation Office, *Proof Committee Hansard*, 25 January 2017, p. 12.

20 Australian Taxation Office, answers to questions on notice, 3 March 2017 (received 17 March 2017), p. 2.

I would perhaps put a perspective that our intention in doing any of these gaps is to track them over time, to give us a measure over time of our effectiveness so that should see a reduction in the gap. Certainly from the literature that I had read and from obviously some positional experience, very few gaps actually give you case selection. What it does give you is a number, a trend. It then identifies some industries where they might be some characteristics that then allow you, if you like, where to look to invest and make some of the resources and investments. So it becomes a guiding measure of (1) our effectiveness over time in terms of that and (2) it certainly does, as the methodology matures – and this has happened with the GST gap, whereby it is the second and third iterations – got into the next level of trying to particularise some breakdown within the overall gap trend and often at an industry level, and certainly that would be our expectation over time.²¹

3.22 Evidence received from the Office of the Inspector-General of Taxation indicated clear support for the collection of analysis on the SG gap. As Mr Ali Noroozi, the Inspector-General of Taxation, stated during a public hearing:

...it is good for a government to have some level of expectation in terms of both tax collected and super guarantee. It also makes the revenue [agency] think about and plan ahead in terms of what they are going to collect. If there is a gap indeed between what they had estimated and what ends up being collected then they should have an explanation. By that stage it should be clear to them why there was a difference between what they had estimated and what they have actually collected.²²

3.23 When asked whether the ATO had the capacity to make an estimation of the level of non-compliance in relation to superannuation, Mr Noroozi indicated that the capacity was available:

We have not done it before. They started doing it some time ago with GST, for example. But there is no reason why not, as a formidable tax administration – and they do well compared to revenue agencies of comparable jurisdictions. We are not sure how they are attempting to measure the gap. But one thing that may be a little unpopular is that, usually if you are measuring tax gap, you need to do some level of random audits...

The tax office need to take a random sample and a sizeable sample that can then be extrapolated to say, 'Based on this representative sample we should estimate such and such.' I do not know how the tax office are doing it, but I know that previously they have rejected our recommendations to do any

21 Mr James O'Halloran, Deputy Commissioner, Superannuation, Australian Taxation Office, *Proof Committee Hansard*, 25 January 2017, p. 14.

22 Mr Ali Noroozi, Inspector-General of Taxation, *Proof Committee Hansard*, 3 March 2017, p. 52.

kind of random audits. I am not sure how they are doing it. They are saying they are working on it.²³

Committee view

3.24 The committee is deeply concerned by the ISA's analysis that indicates that employers failed to pay an aggregate amount of \$5.6 billion in SG contributions in 2013-14. The committee is keenly aware that this amount represents 2.76 million affected employees, with an average amount of \$2025 lost per person in a single year.

3.25 The committee is surprised at the ATO's apparent reluctance to engage with the issue of producing an SG gap, particularly as the matter has been raised in numerous reviews dating back to 2010.

3.26 The committee is encouraged that all stakeholders seem to agree that non-compliance with SG obligations is a significant problem. Although there is no consensus on the size of the SG gap, the committee is of the opinion that even a low percentage of non-compliance is a serious issue. This is because the gap represents real money owed to real employees, who are detrimentally impacted upon by any instance of non-payment of SG. As discussed in chapter 4, these non-payments in turn have flow-on impacts to government finances.

3.27 Even if, as the ATO posits, the actual SG gap is somewhat lower than the ISA's estimate, the committee is of the view that a gap of this order of magnitude is unacceptably high. As such, the committee feels that the ATO must take urgent action to address SG non-compliance.

3.28 As a starting point, the committee strongly believes that having a reliable SG gap figure, able to be tracked over time, would be an extremely valuable tool in examining the rate of SG non-payment over time, analysing which policies are effective, and ultimately minimising the problem.

3.29 The committee notes that the ATO indicated it would be in a position to publish its methodology for the SG gap by June 2017. The committee further notes that this date is three months after the working group is due to report to the Minister for Revenue and Financial Services. The committee finds it surprising that the ATO is prepared to criticise the methodology and estimated SG gap of the ISA while not being in a position to produce an estimate of its own. This is particularly the case given the fact that respectable authorities such as the ANAO and the IGT have recommended the ATO produce such a figure. Nevertheless, the committee encourages the ATO to commit to this release date at the very latest.

3.30 Once the ATO has settled on its methodology, the committee expects the ATO to publish a figure for the SG gap annually in order to allow the size of the gap

23 Mr Ali Noroozi, Inspector-General of Taxation, *Proof Committee Hansard*, 3 March 2017, p. 52.

to be consistently tracked over time. The committee considers that this would allow the effectiveness of current ATO SG compliance measures, as well as the impacts of other initiatives such as Single Touch Payroll, to be properly assessed.

Recommendation 2

3.31 The committee recommends that the ATO prioritise its work on calculating and publishing an accurate, reliable estimate of the SG gap. Additionally, the committee recommends that the ATO commit to publishing the SG gap annually in order for progress to be tracked over time.

3.32 Other mechanisms to address the current level of SG non-compliance are addressed in later chapters of this report.

