Chapter 6

Addressing SG non-compliance

The ATO's effectiveness in identifying and addressing SG non-compliance

6.1 The ATO informed the committee that in 2015-16, ATO compliance action resulted in:

- $670.4 million SG charge raised (including penalties and interest);
- $341.3 million SG charged collected;
- 2997 default assessments raised; and
- 877 Director Penalty Notices issued for SG debt of $130 million.[1]

6.2 The ATO conducts audits and reviews to ascertain SG non-compliance. Approximately 70 per cent of the cases the ATO looks into arise from employee notifications, with the remaining 30 per cent of cases stemming from ATO initiated strategies.[2]

6.3 The ATO's compliance program is comprised of three review or audit types:

- Employee Notification (EN) cases;
- ATO initiated cases – SG Proactive; and
- ATO initiated cases – Employer Obligations.[3]

6.4 As the ATO stated in its submission:

> The majority of our review and audit work is directly addressing employee notifications. We also undertake ATO initiated reviews and audits arising from case selections from high risk employers or from high risk industries. We also examine SG payments when reviews and audits are undertaken examining income tax employer obligations risks.[4]

6.5 The ATO's submission notes that over the past three years, the ATO has increased its efforts to select cases from a broader array of sources other than EN. The submission also notes that the ATO takes a risk differentiated approach to compliance activities which considers factors such as the industry and market segment of the employer, as well as prior compliance history.[5]

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1 Australian Taxation Office, *Submission 6*, p. 23.

2 Australian Taxation Office, *Submission 6*, p. 23.

3 Australian Taxation Office, *Submission 6*, p. 24.

4 Australian Taxation Office, *Submission 6*, p. 24.

5 Australian Taxation Office, *Submission 6*, pp. 24–25.

6.6 The ATO also highlighted the component of the compliance program that examines employers that are suspected not to have met their SG obligation. Analysis of ATO held data enables the identification of employers who are considered a high risk of not having met their SG obligations:

> By comparing salary and wage data from individuals income tax returns with SG payments as reported by funds in member contributions statements, a general assessment can be made as to whether an employee may have received the SG they were entitled to. This information is then aggregated to an employer level. This assessment is by no means definitive, but can highlight employers who have a high probability of underpaying SG. This strategy focuses our audit resources upon those employers.
>
> Reviews and audits undertaken under this strategy have consistently produced stronger results in terms of adjustments raised per audit than is achieve by our Employer Notification driven work.[6]

6.7 The ATO's approach to SG compliance activities can be generally characterised as reactive, rather than proactive.[7]

6.8 The committee received evidence indicating that the ATO's heavy reliance on EN to trigger compliance activities is problematic, as it places the onus on affected employees to take action. This in turn presents challenges to the timeliness of notifications and the likelihood of SG being recovered.

6.9 As the IGT outlined to the committee, even if affected employees are aware of SG non-payment, they may not take prompt action:

> The reason is that they are usually amongst the most vulnerable in our society and may be too afraid of potential repercussions such as loss of employment. This is evidenced by the fact that approximately 70 per cent of employees only notify the ATO of non-payment of their SG after the relevant employment has ended. The result is that, generally, there is a significant time lag between the non-payment of SG and when the ATO is made aware of it, by which time the offending employer may no longer be a going concern and it may not be possible to recover any such amounts.[8]

6.10 The TCFUA submitted that the approach taken by the ATO is at odds with the systematic non-compliance with SG and award superannuation obligations evident in high-risk industries:

> The system is premised on a range of questionable assumptions including:
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> - that it is appropriate, on a policy level, to impose the greatest onus on employees for ensuring that superannuation contributions are paid by

6 Australian Taxation Office, *Submission 6*, p. 28.

7 See for example Mr Ali Noroozi, Inspector-General of Taxation, *Proof Committee Hansard*, 3 March 2017, p. 54.

8 Inspector-General of Taxation, *Submission 21*, p. 8.

employers (i.e. that employees should essentially bear the primary risk in relation to non-payment of superannuation);

- that all employees have a good understanding of what superannuation is, including an employer's obligations [in regard] to payments and choice of funds;
- that all employees have the resources and capacity (including proficient English language and written skills) to effectively monitor their superannuation payments, and secondly, make a complaint to the ATO in their own name;
- that employees will pursue non-payment of superannuation (despite the risk of threats to ongoing job and income security);
- that non-compliance is confined to individual employees, rather than being an entrenched systemic problem at a particular workplace.[9]

6.11 Dixon Advisory also provided evidence that highlighted the problematic aspects of a compliance regime too reliant on employee notifications. The submission argued that placing the onus on employees to initiate the recovery action with the ATO could be too daunting an experience for some individuals, particularly in a small-medium business scenario where the fear of recrimination may be high. The submission also stated that during periods of poor business conditions where there was a strong perceived risk of foreclosure or job loss, employees may consciously make the decision not to lodge an EN, figuring that they would be better off foregoing SG if it assisted their employer to remain solvent and protected their own job.[10]

6.12 Dixon Advisory noted that this logic was detrimental to employees, as it was difficult for an individual employee to assess the complex risks to their financial situation when it was highly likely they did not possess enough information to gauge the true operating position of their employer.[11]

6.13 As an attachment to her submission, Dr Tess Hardy provided the committee with a 2014 article from the UNSW Law Journal, authored by herself and Professor Helen Anderson, which centred on issues around the detection and recovery of unremitted superannuation.[12]

6.14 The article examined 'the limitations inherent in the individual complaint/risk based approach nexus' and identified the flaws in the assumption underpinning the current SG compliance regime. In particular, the article outlined the ways in which the reality of the situation differs from the assumption that employees are in a position to detect unpaid SG and report it to the ATO. These included that:

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9 Textile, Clothing and Footwear Union of Australia, *Submission 50*, pp. 12–13.

10 Dixon Advisory, *Submission 25*, p. 3.

11 Dixon Advisory, *Submission 25*, p. 3.

12 Dr Tess Hardy, *Submission 24 (Attachment 1)*, p. 162.

- employees may be ignorant of their SG entitlements, the source of the entitlement, or how to check that correct payments are being made;
- employees may fear that questioning their employer will result in their dismissal;
- employees may be more concerned about the underpayment of wages and other entitlements;
- employees may be unaware that underpaid wages almost automatically means underpaid SG; and
- to an employee missing out on employment entitlements, the ATO may not seem the logical place to lodge a complaint over unpaid SG.[13]

6.15 The article summarised the outcome of this situation:

> Combined, these issues make it relevant to inquire whether the current approach is adequate in protecting employees and whether any of the detection and enforcement functions, which are increasingly placed on employees, can and should be shared with key government agencies.[14]

6.16 In a similar vein, the IGT submission observed:

> It is clear that the ATO heavily relies on employee complaints to uncover non-compliance with SG. However, as stated earlier such complaints are typically not made promptly and result in unpaid SG often not being recoverable. Accordingly, it is crucial that the ATO considers other proactive approaches in addressing SG risks at the earliest possible stage.[15]

6.17 The IGT noted that one option to bolster the proactive compliance activities of the ATO would be to conduct more SG specific audits based on risks identified by the ATO's risk assessment mechanism. As an alternative, the IGT also suggested that random audits could be conducted (as outlined in the 2010 IGT report), although it noted that the ATO had previously rejected such an option.[16]

6.18 The IGT provided detail on the random audit option:

> Whilst carrying out random audits may expose some compliant employers to unnecessary compliance costs, these costs and inconveniences may be minimised by the manner in which the ATO conducts these audits… Furthermore, in light of the earlier discussion on the economic impact of unpaid SG, such costs and inconveniences should be weighed against the

13 Dr Tess Hardy, *Submission 24 (Attachment 1)*, p. 168.

14 Dr Tess Hardy, *Submission 24 (Attachment 1)*, p. 168.

15 Inspector-General of Taxation, *Submission 21*, p. 9.

16 Inspector-General of Taxation, *Submission 21*, p. 10.

> potential disadvantage that the very same compliant employers face if their competitors do not pay SG and remain undetected.[17]

6.19 On the topic of the costs to employers for random audits, the IGT noted that one option that could be considered by the ATO is a level of remuneration or compensation for employers if they were found to be compliant.[18]

6.20 The IGT also asserted that random audits may lead to better targeting of non-compliant employers in the long term:

> Certain common characteristics of non-compliant employers may be exposed and they could be used to improve the ATO's current risk assessment tools. As the ATO's current risk assessment processes largely rely on reported data, these audits may be the only way that the most non-compliant employers can be detected. Furthermore, conducting random audits would allow the SG gap to be more accurately measured.[19]

ATO handling of employee notifications and resource levels

6.21 The committee received evidence noting concerns with how the ATO responded to employee notifications.

6.22 For example, the TCFUA voiced concerns over the ability for an employer to enter into a payment plan with the ATO for unpaid SG, without the knowledge or consent of the affected employee.[20]

6.23 The TCFUA stated:

> Typically in TCFUA's experience, the particular employer commences making payments under the ATO payment plan, but eventually falls into significant arrears again, and simply enters into another payment plan. The pattern is often repeated over years, such that the employee's superannuation is never up to date. Addressing such compliance 'churning' is time and resource intensive and rarely leads to final or full resolution.[21]

6.24 The TCFUA recommended that it be compulsory for the ATO to notify the affected employee and gain consent before entering into a SG payment plan with a non-compliant employer.[22]

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17 Inspector-General of Taxation, *Submission 21*, p. 10.

18 Inspector-General of Taxation, *Submission 21*, p. 10; see also Mr Ali Noroozi, Inspector-General of Taxation, *Proof Committee Hansard*, 3 March 2017, p. 52.

19 Inspector-General of Taxation, *Submission 21*, p. 10. For similar comments, see Mr Ali Noroozi, Inspector-General of Taxation, *Proof Committee Hansard*, 3 March 2017, p. 54.

20 Ms Vivienne Wiles, National Industrial Officer, Textile, Clothing and Footwear Union of Australia, *Proof Committee Hansard*, 14 March 2017, p. 45.

21 Textile, Clothing and Footwear Union of Australia, *Submission 50*, p. 6.

22 Textile, Clothing and Footwear Union of Australia, *Submission 50*, p. 6.

6.25 The ATO informed the committee that it contacts the individual who lodged the EN by letter or email at each stage of the investigation to provide a progress update or outcome.[23]

6.26 Another concern raised was the amount of time it took for the ATO to resolve SG cases, and the lack of information provided to employees about how investigations into their unpaid SG monies were proceeding.

6.27 Cbus observed that many of its members felt as if the ATO was not an effective player in resolving issues regarding SG arrears. In addition, its submission noted:

> 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.[24]

6.28 Similarly, the TCFUA informed the committee that many of their members were frustrated with the slow timeframes of ATO investigations of ENs. Ms Vivienne Wiles, the National Industrial Officer for the TCFUA elaborated on these concerns:

> It [the ATO] is too slow in a number of respects. It is too slow to transfer the money to the super fund when it is received. Its communication with employees is also very poor. It is really common for employees to not even know that the ATO have even recovered any money. The reporting from the ATO back to the employee often takes many, many months and sometimes years.[25]

6.29 Ms Wiles continued by providing a specific example of significant ATO delays:

> We had one case where a number of employees, members of ours, made complaints to the ATO and they literally heard nothing for three years, and then they received a letter telling them that the company was insolvent and had gone into liquidation and the ATO could do nothing further for them. It was a really significant period… They are really left in the dark, which is ironic because it is their money ultimately.[26]

6.30 As mentioned in chapter 2, according to the ATO, it aims to commence 99 per cent of ENs within 28 days of receipt, and where they proceed to audit, complete 50 per cent of compliance cases within four months (this benchmark is currently under review) and 90 per cent of compliance cases within 12 months. The ATO submission

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23 Australian Taxation Office, *Submission 6*, p. 10.

24 Cbus, *Submission 48*, p. 5.

25 Ms Vivienne Wiles, National Industrial Officer, Textile, Clothing and Footwear Union of Australia, *Proof Committee Hansard*, 14 March 2017, p. 46.

26 Ms Vivienne Wiles, National Industrial Officer, Textile, Clothing and Footwear Union of Australia, *Proof Committee Hansard*, 14 March 2017, p. 46.

pointed out that since 2013, the benchmarks for all three service standards has been met.[27]

Table 6.1—Employee Notification Service Standards[28]

EN Service Standard	Standard	Benchmark	2012–13	2013–14	2014–15	2015–16
Commenced within 28 days of EN receipt	28 days	99%	99.10%	99.40%	99.50%	99%
Closed within 4 months	4 months	50%	50.82%	70.70%	73.50%	76%
Closed within 12 months	12 months	90%	99.70%	99.80%	99.90%	100%

6.31 Although recognising the work done by the ATO to improve its complaint response outcomes, JobWatch informed the committee that callers to its helpline largely perceived the ATO's follow-up action as inadequate, and were consistently frustrated with a perceived lack of ATO activity in investigating complaints.[29]

6.32 JobWatch also emphasised that individuals who had lodged ENs often reported feeling unhappy with their interactions with the ATO:

> Anecdotally, many of our callers have complained about feeling as if they had not been listened to thoroughly by the relevant authorities, perceiving responses by the ATO as largely scripted and robotic.[30]

6.33 While recognising that providing individual updates is a time consuming, resource intensive process, JobWatch recommended that, as much as possible, the ATO take steps to personally explain the process of debt enforcement to complainants:

> The time taken to properly explain the complexities and difficulties based on a personalised assessment of a complainant's situation will go some way to ensure that, at the very least, the complainant feels listened to.[31]

6.34 In regard to ATO resource levels, the Community and Public Sector Union (CPSU) submitted that its members had observed that the ability of the ATO to effectively undertake compliance activities (both in terms of the identification and

27 Australian Taxation Office, *Submission 6*, p. 37.

28 Australian Taxation Office, *Submission 6*, p. 37.

29 JobWatch, *Submission 26*, p. 6.

30 JobWatch, *Submission 26*, p. 7.

31 JobWatch, *Submission 26*, pp. 7–8.

recovery of unpaid SG) was limited due to the decline of ongoing staffing levels in recent years.[32]

6.35 The CPSU submission further sets out the limitations of the ATO's complaints process:

> Feedback from CPSU members is that due to prioritisation of resources within the ATO, if an employee notifies that there has been a non-payment of SG, an audit of all the SG payments by that employer is not completed until a pattern of non-payment has been established. This forces the burden of proof onto the employees of the business to establish a pattern of behaviour, rather than a problem being identified by the compliance area within the ATO.[33]

6.36 On the matter of resource levels, the ATO informed the committee that the majority of resources for SG activities sit within the Superannuation Business Line, with support services provided by client accounts services, law design and practice, and customer service and solutions. The ATO stated that the fulltime equivalent (FTE) number and proportion of staff working on SG within the Superannuation Business Line remained at a similar level in 2016-17 as it had in 2015-16. The Superannuation Business Line currently has approximately 350 FTE employed in active compliance, and of the work undertaken by the active compliance staff, 170 FTE are involved in SG.[34]

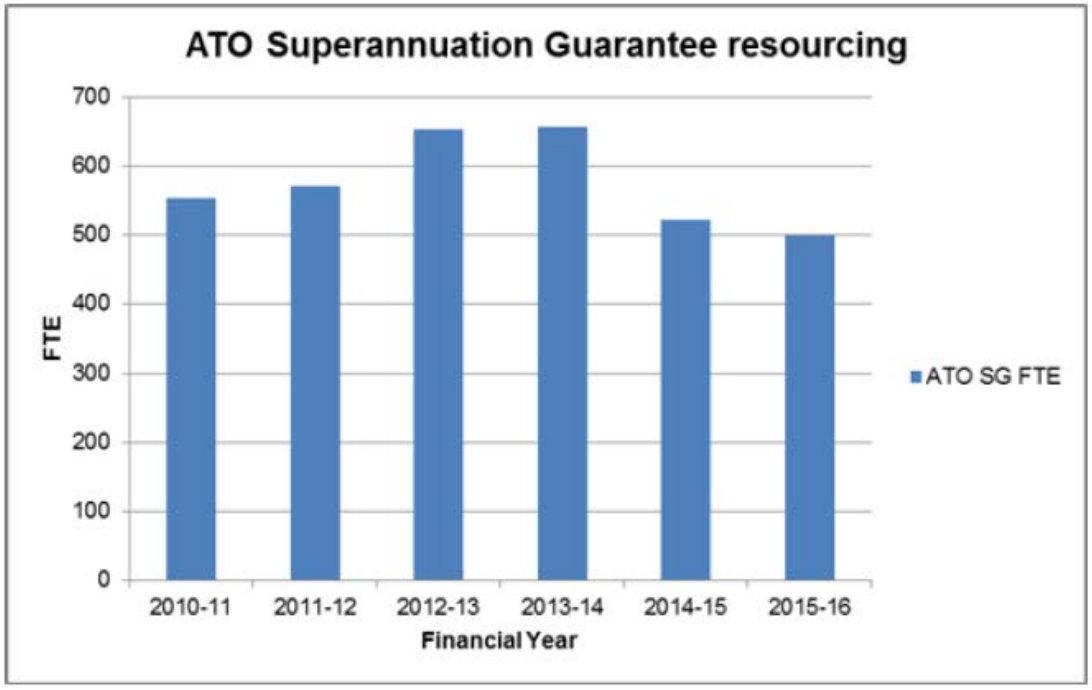
32 Community and Public Sector Union, *Submission 20*, pp. 1–2.

33 Community and Public Sector Union, *Submission 20*, p. 1.

34 Australian Taxation Office, *Submission 6*, p. 36.

6.37 A graph of ATO SG resourcing indicated, however, that the FTE levels for SG resourcing had dropped from a peak of well over 600 FTE in 2012-13 and 2013-14, to approximately 500 FTE in 2015-16.[35]

Figure 6.1—ATO Superannuation Guarantee resourcing, 2010-11 to 2015-16[36]



6.38 The Association of Superannuation Funds of Australia (ASFA) recommended that the ATO be provided with additional funding to conduct an increased number of SG specific audits of high-risk businesses.[37]

Committee view

6.39 The committee understands the concerns raised by submitters about the challenges and limitations inherent in the ATO's current SG compliance approach. In particular, the committee recognises that delays in the investigations of employee notifications, as well as a lack of information on the progress of an investigation, can cause significant frustration to individuals awaiting an outcome on their unpaid SG complaint.

Recommendation 10

6.40 The committee recommends that the ATO continue to improve its communication process with individuals to keep them promptly and meaningfully informed of the progress of their employee notification.

35 Australian Taxation Office, *Submission 6*, p. 36.

36 Australian Taxation Office, *Submission 6*, p. 36.

37 Association of Superannuation Funds of Australia, *Submission 30*, pp. 4–5.

6.41 Additionally, the committee is very concerned by evidence indicating that the ATO is able to enter into payment plans with non-compliant employers without informing the employee in question, whose money is being recovered.

Recommendation 11

6.42 The committee recommends that before entering into a payment plan to recover SG from a non-compliant employer, the ATO be required to notify the affected employee and gain their consent to the course of action.

6.43 The committee has serious reservations about the ATO's reactive approach to SG compliance. The committee sees benefits in the ATO rebalancing its current approach to SG compliance by increasing its focus on more proactive methods. The committee urges the ATO to continue to move away from the current reliance on employee notifications to trigger compliance activities.

Recommendation 12

6.44 The committee recommends the ATO give consideration to more proactive SG initiatives, such as the options put forward by the Inspector-General of Taxation to incorporate random audits into its SG compliance activities.

6.45 The committee is aware that taking a more proactive approach, or providing more detailed updates to complainants will necessarily require further ATO resources. The committee notes that ATO SG resourcing levels in terms of FTE numbers appear to have been reduced by a significant amount since 2012-13.

Recommendation 13

6.46 The committee recommends that the government review ATO resource levels to ensure that the agency is well-equipped to undertake effective and comprehensive compliance activities to combat SG non-payment.

The role of third parties in detecting and recovering unpaid SG

6.47 Some superannuation funds choose to take an active role in enforcing the payment of their members' SG.[38] For example, as mentioned in chapter 2, Industry Fund Services (IFS) provides a range of services to not-for-profit superannuation funds. IFS stated that its unpaid superannuation division, which specialises in the recovery of SG (including arrears collection, enforcement and participation in insolvency proceedings), acts on behalf of nine superannuation funds.[39]

6.48 IFS noted that a fund may appoint IFS as their agent at any point in the SG collection process and outlined:

38 Inspector-General of Taxation, *Submission 21*, p. 11.

39 Industry Fund Services, *Submission 53*, p. 1.

> Some client funds utilise all of IFS's services while others undertake arrears collection in-house (or at their outsourced administrator) and rely on IFS for legal enforcement and/or insolvency proceedings only. IFS has five funds representing more than 5.1 million accounts that utilise the full suite of unpaid superannuation services.[40]

6.49 ISA informed the committee that in the absence of an award or another kind of industrial agreement requiring the payment of a specific superannuation amount, the SGA Act may be the only legal instrument imposing a specific legal obligation on an employer to pay contributions. As such, the enforcement of the SGA Act relies upon the potential imposition of an SG charge by the ATO. In these instances, an affected employee or superannuation fund seeking to act on their behalf are unable to take any action themselves and must instead rely on the ATO.[41]

6.50 ISA noted that in an attempt to bridge this coverage gap, some superannuation funds have developed deeds of agreement with contributing employers in nominated workplace default fund agreements that explicitly provide superannuation funds with the legal standing to act on behalf of their members. Such agreements provide a record of a formal relationship confirming that an employer has nominated a default fund and set out the employer obligations to superannuation fund members.[42]

6.51 ISA explained the difficulties that arise without these default fund agreements:

> When no formal relationship exists between a fund and an employer, funds have no standing to act on behalf of a member to recover arrears or enforce debt. Employees who are exercising 'choice of fund' are not usually covered by these agreements.
>
> Noting the duty of superannuation fund trustees to recover debts (but the lack of standing that some funds may have due to an absence of an industrial award, enterprise agreement or an explicit default fund agreement), allowing employees – or funds acting on their behalf to apply to the ATO to give standing to recover arrears and pursue a debt would allow funds to fulfil this duty.[43]

6.52 ISA recommended that in order to remedy gaps in the standing of employees, or those acting on their behalf, to recover unpaid SG from an employer, consideration should be given to amending the SGA Act to allow an individual or agent (such as a superannuation fund or a service provider to the fund) to recover SG shortfalls on application to the ATO. ISA asserted that this could be achieved in a number of ways,

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40 Industry Fund Services, *Submission 53*, p. 1.

41 Industry Super Australia, *Submission 7.1*, p. 16.

42 Industry Super Australia, *Submission 7.1*, p. 20.

43 Industry Super Australia, *Submission 7.1*, p. 20.

including by permitting the ATO to delegate an agent (e.g. the superannuation fund or a service provider to them) to recover unpaid SG on application.[44]

6.53 When asked by the committee whether there was a place for superannuation funds to recover unpaid SG, Mr Mark Korda, a partner at KordaMentha observed:

> Obviously, they are incentivised to do that. They want to look after their members first, but also the more you have the funds under management the more you can defray your costs – the expense ratio.[45]

6.54 The TCFUA informed the committee that unions are unable to make complaints to the ATO on behalf of individual employees or groups of employees, and noted that it is a complicated process for employee representatives to obtain information on behalf of the individuals they represent. The TCFUA also indicated that while third parties can provide information to the ATO regarding circumstances of SG non-payment, the ATO does not consider these tip-offs to be formal complaints (i.e. employee notifications). The TCFUA submitted that this represented a significant barrier to unions effectively assisting workers in relation to SG non-payment and recommended that union representatives are acknowledged as legitimate representatives of affected workers.[46]

6.55 JobWatch told the committee that many of its callers are frustrated to learn that as employees they lacked the standing to sue their employer for unpaid SG if their entitlements come from the SG legislation and not from a common law contract, modern award, or registered agreement. As a result, employees cannot take private legal action and must instead rely on the ATO to enforce the SG legislation on their behalf.[47]

6.56 JobWatch recommended that there be a legislated option for employees to take private legal action against their employers for unpaid SG, and noted that this could be done by amending the National Employment Standards contained in the Fair Work Act to include an entitlement to SG. JobWatch stated that this would allow employees to issue proceedings to recover unpaid SG, including by way of the small claims procedure outlined in the Fair Work Act.[48]

6.57 The IGT noted that when examining whether the law should be changed to provide employees better direct access to avenues of redress, consideration should be given to whether such a legislative change would be an effective solution when often employees may not have the resources or funds to pursue the matter themselves.[49]

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44 Industry Super Australia, *Submission 7.1*, pp. vi, 19; see also Australian Super, *Submission 9*.

45 Mr Mark Korda, Partner, KordaMentha, *Proof Committee Hansard*, 14 March 2017, p. 24.

46 Textile, Clothing and Footwear Union of Australia, *Submission 50*, pp. 13–14.

47 JobWatch, *Submission 26*, p. 9.

48 JobWatch, *Submission 26*, p. 10.

49 Inspector-General of Taxation, *Submission 21*, p. 8.

Committee view

6.58 The committee is of the view that third parties could play an important role in detecting and recovering unpaid SG. The committee believes that the current arrangement, whereby an individual cannot take private legal action against their employer if their SG entitlements stem purely from the SGA Act, is inadequate.

Recommendation 14

6.59 The committee recommends that the government consider a legislated option for employees, or third parties acting on their behalf, such as unions or superannuation funds, to take private legal action in the relevant courts against their employers for unpaid SG.

Default fund criteria

6.60 Related to issues surrounding the role of third parties in recovering unpaid SG, the committee received evidence from Cbus recommending that superannuation funds seeking default status in industry awards be required to have a rigorous arrears collection process in place. Cbus noted that the current default fund criteria in the Fair Work Act does not include the issue of SG compliance, and stressed that only funds with stringent processes in place for dealing with unpaid SG should be considered when assessing funds for default fund status.[50]

Committee view

6.61 The committee considers it pertinent that any superannuation fund seeking default status in an industry award be required to have a proper arrears collection process in place. This would ensure that a fund member who encounters unpaid SG is able to access appropriate assistance in recovering the money.

Recommendation 15

6.62 The committee recommends that superannuation funds seeking default status in industry awards be required to have a rigorous arrears collection process in place.

Effectiveness of the SG Charge

6.63 As outlined in chapter 2, if an employer does not pay the correct SG contribution to an employee's nominated fund by the quarterly payment due date, they may be liable for the SG Charge (SGC), payable to ATO..[51]

6.64 An employer subject to the SGC must lodge an SGC Statement with the ATO, calculate the amount payable, and pay the charge by the due date for the relevant

50 Cbus, *Submission 48*, pp. 3, 10–11.

51 Australian Taxation Office, *Submission 6*, pp. 6–7.

quarter. The ATO then forwards the shortfall and nominal interest component to the employee's superannuation fund.[52]

6.65 Evidence received by the committee indicated that the ATO is reliant upon employers self-reporting to trigger awareness of non-compliance cases. As the ATO submission stated:

> The lodgement of an SGC Statement informs the ATO that an employee has not met their SG obligations. It allows the ATO to follow-up and ensure compliance and payment.
>
> If an employer does not lodge an SGC statement, the ATO has powers to raise the SG Charge assessment and the employer can be liable for a penalty of up to 200 per cent of the charge amount.[53]

6.66 It would appear that under this arrangement the ATO only becomes aware that an employer has not lodged a SGC Statement when an employee lodges an EN, or if the non-compliance is picked up during ATO initiated compliance activities (e.g. through SG proactive audits or the analysis of data to identify SG high risk employers).[54]

6.67 Given that only 30 per cent of the cases of SG non-compliance the ATO looks into are ATO initiated, it could be reasonably concluded that an employer who does not lodge an SGC Statement does not face a high risk of being detected by the ATO.

6.68 One of the three components of the SGC is a nominal interest amount (currently set at 10 per cent from the beginning of the period). This component is designed to compensate an employee for lost investment returns on the unpaid SG amount. However, ISA asserted that as non-compliant employers obtained a cash flow benefit from not paying SG on time (for example interest savings on business loans, credit cards or overdrafts), those interest rate benefits may in effect offset the nominal 10 per cent interest charge. This in turn reduces the impact of the SGC penalty on an employer.[55]

6.69 ISA also argued that the SGC penalty regime overall does not provide a strong enough disincentive to non-compliant employers:

> On balance, the existing penalty regime for employers who are failing to meet their SG obligations is not effective. The risk of detection, by either proactive audit or employee complaint, is very low. The SGC penalty

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52 Australian National Audit Office, *Promoting Compliance with Superannuation Guarantee Obligations*, Audit Report No. 39, 2014-15, p. 14, www.anao.gov.au/sites/g/files/net2766/f/ANAO_Report_2014-2015_39.pdf (accessed 15 March 2017).

53 Australian Taxation Office, *Submission 6*, p. 7.

54 See Australian Taxation Office, *Submission 6*, pp. 28–29, 31.

55 Industry Super Australia, *Submission 7.1*, p. 16.

> regime appears to have been designed merely to provide a modest disincentive for making late payments. It is not a deterrent to employers wilfully ignoring the SG liability.[56]

Committee view

6.70 The committee is concerned that the SGC regime relies heavily on non-compliant employers self-reporting. While the committee acknowledges that many employers seek to do the right thing and do lodge SGC statements, there are also some unscrupulous employers who attempt to circumvent the system.

6.71 The committee is mindful of the view put forward by the IGT that when assessing the effectiveness of the SGC, there is a need to strike a balance between the deterrent aspects of the charge, as well as appropriate consideration of the employer's circumstances.[57] However, the committee is of the opinion that the current SGC does not amount to a strong enough deterrent for employers who purposefully seek to evade their SG obligations. The committee considers there is a need for stronger penalties for deliberate and repeated non-compliance as such behaviour severely disadvantages individual workers, damages the competitiveness of compliant employers, and ultimately undermines the system as a whole.

Recommendation 16

6.72 The committee recommends that the government review the SGC regime and its management by the ATO to ascertain whether it is adequate, with a view to increasing penalties for deliberate and repeated acts of non-compliance by employers.

ATO and FWO compliance responsibilities

6.73 The committee received evidence regarding the division of responsibilities for superannuation entitlements between the ATO and the Fair Work Ombudsman (FWO) and the impact of this division on SG compliance efforts.

6.74 The Department of Employment outlined the role of the FWO in relation to superannuation entitlements as follows:

> Under the *Fair Work Act 2009* (FW Act), the Fair Work Ombudsman (FWO) has limited direct functions relating to superannuation entitlements, generally confined to providing advice about and enforcing compliance with modern awards and enterprise agreements requiring employers to make superannuation contributions, and record keeping and payslip requirements relating to superannuation contributions.
>
> The FWO responds to complaints of underpayment made by employees by gathering payment information from both the employee and the employer.

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56 Industry Super Australia, *Submission 7.1*, p. 17.

57 Inspector-General of Taxation, *Submission 21*, p. 12.

> FWO does not have statutory access to payment information from employers or superannuation funds in the same way as the ATO. Therefore [the] FWO is not able to proactively monitor SG and in the majority of circumstance, will forward on complaints regarding SG contribution to the ATO for action…
>
> The FWO has powers to seek court orders for the underpayment or non-payment of wages, including court orders for a contravention of a modern award term or enterprise agreement. If a court finds that an employer has breached its obligations to pay wages or superannuation, the employer may be liable to a pecuniary penalty, in addition to repayment of unpaid wages and unpaid superannuation guarantee contributions.[58]

6.75 Mr Michael Campbell, the Deputy Fair Work Ombudsman (Operations), clarified that:

> Our power to enforce a superannuation payment would only arise through a modern award and it would depend on how that clause is drafted to determine what our enforcement possibilities would be. If it is specific and it requires a percentage payment then we can enforce that as part of our regular work.[59]

6.76 Dr Tess Hardy provided the committee with an example illustrating that the FWO does have the ability to pursue superannuation entitlements in some situations:

> Certainly, although the Fair Work Ombudsman has a practice of dealing with underpayments of minimum wages and referring the superannuation shortfall issues to the ATO, there are a number of cases where it has pursued superannuation entitlements as part of a broader proceeding in relation to underpayment of wages. It is certainly within their ambit to pursue superannuation entitlements where, of course, they arise within their jurisdiction, which is under a modern award, under an enterprise agreement or as a safety net contractual entitlement. They have done so.[60]

6.77 Dr Hardy went on to give a specific example of such a situation:

> There was a recent case in the Federal Court of the Fair Work Ombudsman and Grouped Property services, which involved the underpayment of wages, various other entitlements and superannuation contributions. There were 48 award-covered employees and three award-free employees. For the 48 award-covered employees the Fair Work Ombudsman was able to seek compensation for lost superannuation and lost interest. The three award-free employees would have to rely on the ATO to take action on their behalf. That is kind of an illustration of the way in which the award coverage has

58 Department of Employment, *Submission 24*, p. 7.

59 Mr Michael Campbell, Deputy Fair Work Ombudsman, Operations, Fair Work Ombudsman, *Proof Committee Hansard*, 3 March 2017, p. 36.

60 Dr Tess Hardy, private capacity, *Proof Committee Hansard*, 14 March 2017, p. 3.

> implications for the Fair Work Ombudsman's jurisdiction and recovery of those underpayments through the courts.[61]

6.78 The FWO informed the committee that of the formal requests for assistance finalised by the FWO in 2015-16, approximately 5 per cent (1242 requests) involved a reference to superannuation.[62]

6.79 Mr Andrew Fogarty, Executive Director of Policy, Media and Communications at the FWO clarified that:

> …we really structure ourselves at the moment so that, at the front end, if someone comes to our contact centre, for instance, or calls us, we are, right at the beginning, referring them to the ATO if their question is about superannuation or taxation.[63]

6.80 When the committee sought further information on when the FWO does act to enforce SG, Mr Campbell outlined that although the jurisdiction of the FWO was enlivened when an award provided for a specific percentage SG payment and it was an award entitlement, in practice, the FWO method of operation was to refer SG to the ATO. As Mr Campbell noted 'they [ATO] have a broader coverage and greater powers to conduct this work and, ultimately, it is more effective than our seeking to do it.'[64]

6.81 Mr Campbell went on to provide the committee with further detail around the approach of the FWO to superannuation non-payment:

> In simple terms, the work we focus on is that which is clearly within our jurisdiction. The ATO has a broader jurisdiction than ours. It reaches more employees and employers and it has a better toolkit and set of powers to seek out and recover unpaid superannuation. So we refer it to them and we think that is an appropriate approach. It is not that we do not prioritise or think that it is important, but the mechanism that we have in place works. That is how we treat that work.[65]

6.82 When questioning other witnesses on what might be behind the apparent reluctance of the FWO to engage in the superannuation compliance issues, the committee received the following evidence:

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61 Dr Tess Hardy, private capacity, *Proof Committee Hansard*, 14 March 2017, pp. 3–4.

62 Fair Work Ombudsman, answers to questions on notice, 3 March 2017 (received 15 March 2017), p. 2.

63 Mr Andrew Fogarty, Executive Director of Policy, Media and Communications, Fair Work Ombudsman, *Proof Committee Hansard*, 3 March 2017, p. 36.

64 Mr Michael Campbell, Deputy Fair Work Ombudsman, Operations, Fair Work Ombudsman, *Proof Committee Hansard*, 3 March 2017, p. 37.

65 Mr Michael Campbell, Deputy Fair Work Ombudsman, Operations, Fair Work Ombudsman, *Proof Committee Hansard*, 3 March 2017, p. 39.

> **Chair:** In your view, what explains the Fair Work Ombudsman's reluctance to engage in this area? Are there some administrative difficulties for them which make it easier for them to refer to the ATO or is it simply that the ATO is recognised within government as being the relevant enforcement agency? Is there something other than just an informal division of responsibilities?
>
> **Dr Hardy:** I certainly think there is the perception that the ATO is the principal regulator in this space. The other obvious issue would be one of resources. The more time they spend on enforcing superannuation entitlements, the less resources they have for addressing other issues that they might perceive as more squarely within their jurisdiction or not within someone else's jurisdiction.[66]

6.83 The memorandum of understanding between the ATO and the FWO as it relates to information sharing between the two agencies is covered in chapter 7.

Committee view

6.84 The committee is of the view that the FWO should be more active in the SG compliance space. Rather than simply referring SG matters to the ATO, the committee believes that the FWO should actively assist employees in resolving unpaid SG matters where appropriate under their jurisdiction.

Recommendation 17

6.85 The committee recommends that the ATO review all current compliance and recovery activities related to unpaid SG to determine which ones should remain with the ATO, and which ones could be transferred to, or shared with, the Fair Work Ombudsman. As a starting point, the committee recommends that the Fair Work Ombudsman begin to receive and act on SG non-payment complaints where appropriate, rather than simply referring the affected employees to the ATO.

Recommendation 18

6.86 The committee recommends that the government consider increasing the resource levels of the Fair Work Ombudsman to ensure it is properly equipped to carry out any additional SG compliance or recovery activities it may acquire from the ATO.

Unpaid SG in the event of insolvency

6.87 Employer insolvency poses a serious challenge to the payment of SG. In addition to the loss of wages, annual leave and other redundancy entitlements, the loss of unpaid SG is of great concern to affected employees, particularly in a situation where SG entitlements have not been remitted for a significant period of time, if at all.

66 Dr Tess Hardy, private capacity, *Proof Committee Hansard*, 14 March 2017, p. 4.

6.88 As Professor Helen Anderson and Dr Tess Hardy noted in an academic article in the UNSW Law Journal submitted by Dr Hardy part of her submission:

> Corporate insolvency exacerbates the recovery of unpaid employment entitlements, including any unremitted superannuation contributions, because the main target of enforcement action – the company– is likely to have insufficient assets to meet the claim.[67]

6.89 JobWatch stated that many of its callers reported being dissatisfied with their inability to recover unpaid SG when their employer had gone into liquidation or been declared bankrupt. JobWatch also stated that in some situations, although an employee had lodged an EN with the ATO before their employer's bankruptcy or liquidation, by the time the ATO conducted an investigation the insolvency process had already begun. JobWatch noted 'the lengthy and secretive investigation process for recovery through the ATO is inadequate in these situations as rapid resolution is essential to prevent employee entitlements from being subjugated by other creditors'.[68]

6.90 According to the ATO's submission, 36 per cent of EN cases were raised against employers displaying an insolvency indicator on ATO systems, which made debt collection unlikely. This in turn meant that the ATO was generally unable to collect any SG payment for affected employees.[69] In addition, the ATO observed that due to the time lag in reporting the non-payment of SG contributions, insolvency was a significant issue in the recovery of SGC debt, with $113.2 million irrecoverable at law in 2015-16.[70]

Effectiveness of Director Penalty Notices

6.91 The ATO informed the committee that administrative improvements to the recovery of unpaid SG could potentially be achieved by improving the systems that support the issuing of Director Penalty Notices (DPNs). Since 2012, the Director Penalty regime (enacted through Division 269 of Schedule 1 of the *Taxation Administration Act 1953*) has been applicable to company SGC liabilities. As a result, the ATO Commissioner is able to recover SGC liabilities by pursuing a parallel liability imposed on the company directors in the form of a penalty.[71]

6.92 For example, the ATO would issue a notice requiring a director to pay any unpaid SG, and if the director did not comply with the notice by the due date, the director becomes personally liable for the penalty amount until it is paid in full.[72]

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67 Dr Tess Hardy, *Submission 24 (Attachment 1)*, p. 162.

68 JobWatch, *Submission 26*, p. 10.

69 Australian Taxation Office, *Submission 6*, p. 28.

70 Australian Taxation Office, *Submission 6*, p. 33.

71 Australian Taxation Office, *Submission 6*, p. 34.

72 Cbus, *Submission 48*, p. 14.

6.93 However, the effectiveness of this framework is limited in situations involving an insolvent company. For example, if the ATO sends a DPN to the director of an insolvent company, the director is able to escape personal liability by simply liquidating the defaulting company within 21 days of receiving the notice. This means that any unpaid SG amounts are not recoverable.[73]

6.94 The ATO elaborated on this point:

> ...the liquidation or voluntary administration of the company automatically extinguishes any director penalty which was not already the subject of a Director Penalty Notice (s 269-25 of the TAA [*Taxation Administration Act 1953*]) issued more than 21 days prior to the commencement of the insolvency administration or where the associated SGC liability was not reported for more than three months at the time that the administration commenced. Given that the reporting date for SGC is two months following the end of the quarter, it is often the case that the eventual liquidation of the company extinguishes the director penalties related to the past eight months of the company's unpaid superannuation obligations.[74]

6.95 Similarly, in an article in the University of New South Wales Law Journal by Dr Tess Hardy and Professor Helen Anderson, the two academics outlined their concerns with the adequacy of the DPN system:

> Companies wishing to avoid these (and possible other) liabilities can simply liquidate or enter voluntary administration before three months has elapsed without reporting or paying their SGC liabilities. In such circumstances, the directors will face no personal consequences, even if the ATO later identifies the lack of superannuation payment. The business may then be reborn through a 'phoenix' company and the behaviour continues.[75]

Committee view

6.96 The committee is concerned by the apparent deficiency of the current DPN framework as it relates to unpaid SG by companies that become insolvent. The committee is of the view that this unintentional loophole must be urgently addressed in order to stop unscrupulous employers from engaging in fraudulent phoenix activity and avoiding their superannuation obligations.

Recommendation 19

6.97 The committee recommends that the government investigate potential legislative amendments to strengthen the ATO's current ability to recover SGC liabilities through the Director Penalty Notice framework in order to stop company directors undertaking fraudulent phoenix activity and avoiding their SG obligations.

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73 Professor Helen Anderson, *Submission 5*, p. 3.

74 Australian Taxation Office, *Submission 6*, p. 34.

75 Dr Tess Hardy, *Submission 24 (Attachment 1)*, p. 178.

Impact of illegal phoenix activities

6.98 Phoenix activity is generally based upon the failure or abandonment of one company, only to have a second company 'rise from the ashes' of the first, with the same controllers and business. Such activity is illegal when, in a breach of directors' duties, the intention of the company's controllers is to shed debts while continuing what is essentially the same business through the new entity. The non-payment of taxes and employee entitlements, including SG, is often the core objective of illegal phoenix activity.[76]

6.99 A February 2017 report by Professor Anderson and colleagues at the Melbourne Law School entitled 'Phoenix Activity: Recommendations on Detection, Disruption and Enforcement' recommended the use of director identification numbers (DIN) for all company directors to allow ASIC and other regulators to monitor and track repeat offenders engaging in illegal phoenix activity.[77]

6.100 It is currently possible to register an Australian company by simply providing ASIC with the name, address and date of birth of each proposed officeholder. ASIC does not ask for the prior corporate history of the proposed directors, nor does it independently verify the information provided to it. This is problematic as repeat offenders in illegal phoenix activity can attempt to conceal their previous multiple directorships under the guise of a 'dummy director' (for example, by providing the name of a relative or fictitious character, deliberately misspelling their name, or listing an incorrect date of birth.[78]

6.101 To combat this behaviour, Professor Anderson's report proposed the following details for a DIN scheme:

> The limitations of the existing company registration requirements could be overcome through the relatively simple and cheap process of requiring directors to establish their own identity via 100 points of identity proof, which would accord with the well-accepted and uncontroversial practice for opening bank accounts and obtaining passports. Directors would then be allocated a unique DIN, which would enable tracking of company directors

76 Professor Helen Anderson, *Submission 5*, p. 1.

77 Professor Helen Anderson, Professor Ian Ramsay, Professor Michelle Welsh and Mr Jasper Hedges, *Phoenix Activity: Recommendations on Detection, Disruption and Enforcement*, February 2017, http://law.unimelb.edu.au/__data/assets/pdf_file/0020/2274131/Phoenix-Activity-Recommendations-on-Detection-Disruption-and-Enforcement.pdf (accessed 24 April 2017).

78 Professor Helen Anderson, Professor Ian Ramsay, Professor Michelle Welsh and Mr Jasper Hedges, *Phoenix Activity: Recommendations on Detection, Disruption and Enforcement*, February 2017, p. 2.

> who have been involved in multiple corporate failures and who may be likely to engage in armful phoenix activity.[79]

6.102 In her inquiry submission Professor Anderson also suggested that a DIN scheme could assist credit reporting agencies in acting as market-based regulators. If given information about unremitted SG and those directors responsible for it (identified through the DIN), credit reporting agencies could in effect make it more difficult for unscrupulous directors to obtain finance for their future companies.[80]

6.103 The Australian Restructuring Insolvency and Turnaround Association (ARITA) informed the committee that it supported a DIN scheme as set out in the research by Professor Anderson, noting that it is a policy they have strongly advocated for to reduce instances of illegal phoenix activity.[81]

Committee view

6.104 The committee considers that a DIN initiative has merit as it would go some way to preventing directors engaging in illegal phoenix activity and repeatedly avoiding SG obligations with impunity. The committee also considers that the potential for a DIN initiative to assist credit reporting agencies in identifying individuals who engage in illegal phoenix activity is worth further investigation.

Recommendation 20

6.105 The committee recommends that the government consider implementing a Director Identification Number scheme to prevent individuals engaging in illegal phoenix activity and repeatedly avoiding SG obligations.

Impact of trusts on unpaid SG during liquidation

6.106 The committee received evidence indicating that the method in which an employee is employed (i.e. via a company structure or via a trust) can impact the priority of employee entitlements during the liquidation of a company. This in turn impacts on the ability for employees to recover unpaid SG amounts.

6.107 ARITA informed the committee that in the event of the liquidation of a company, employee entitlements (such as unpaid SG) are given priority over ordinary

79 Professor Helen Anderson, Professor Ian Ramsay, Professor Michelle Welsh and Mr Jasper Hedges, *Phoenix Activity: Recommendations on Detection, Disruption and Enforcement*, February 2017, p. 2.

80 Professor Helen Anderson, *Submission 5*, p. 3.

81 Mr John Winter, Chief Executive Officer, Australian Restructuring Insolvency and Turnaround Association, *Proof Committee Hansard*, 13 March 2017, p. 28.

trade creditors. ARITA observed, however, that recent court decisions[82] have determined that if the business is traded and employed through a trust, all creditors rank equally when it comes to the distribution of available funds.[83] Specifically, if a business is operated through a trust structure, it is outside the operation of section 556 (relating to priority payments) of the *Corporations Act 2001* (Corporations Act).[84]

6.108 ARITA provided the committee with the following example to explain the impact on the recovery of unpaid SG amounts of employees of an insolvent company:

> …if a butcher trades using a company structure, employee entitlements owing to the apprentice would be paid in priority to the debts owing to the butcher's meat supplier. If the same business was instead traded through a trust structure, the apprentice and the meat supplier would rank equally. Where there are insufficient funds available to pay all outstanding amounts, this reduces the amount of outstanding entitlements that the employee would receive, including any superannuation…[85]

6.109 In a submission in his private capacity, Mr Geoff Green, a chartered accountant and former registered liquidator, argued that as the use of discretionary trusts is widespread in commercial practice, many thousands of employees could be impacted. Mr Green stated that if the level of protection afforded to employee superannuation and other priorities is dependent on the type of structure used by the employer, then in practical terms it was firstly inequitable (because there is no business or commercial justification for such a difference); and secondly impractical (because employees cannot be expected to identify the type of structure by which they are employed, or to understand the consequences of the structure).[86]

6.110 Mr Green suggested that a solution to this problem would be to amend the Corporations Act so that section 556 priorities apply in all liquidations. Mr Green noted that this would implement the recommendation set out in paragraph 265 of the Australian Law Reform Commission's 1988 Harmer report.[87] Mr Green also observed that as an alternative to amending section 556 of the Corporations Act, a new provision that operates to create priority for employee entitlements and SG debts ahead of trust creditors (in the same way that section 561 currently gives priority to employee entitlements and SG debts ahead of circulating security interests) could be created. In addition, Mr Green noted that any changes should be drafted to allow for

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82 ARITA referred to recent decisions in the New South Wales Supreme Court (in the matter of Independent Contractor Services (Aust) Pty Limited ACN 119 186 971 (in liquidation) (No 2) [2016] NSWSC 106); and the Federal Court (in Woodgate, in the matter of Bell Hire Services Pty Ltd (in liquidation) [2016] FCA 1583).

83 Australian Restructuring Insolvency and Turnaround Association, *Submission 23*, p. 3.

84 Mr Geoff Green, *Submission 4*, p. 1

85 Australian Restructuring Insolvency and Turnaround Association, *Submission 23*, p. 3.

86 Mr Geoff Green, *Submission 4*, p. 1.

87 Mr Geoff Green, *Submission 4*, p. 2.

the possibility that corporate entities might be the trustee of more than one trust, or might also employ staff in their own right.[88]

Committee view

6.111 The committee considers it inequitable that individuals employed in businesses operating through a trust structure with unpaid SG are not considered to have priority over ordinary creditors in the event of employer insolvency.

Recommendation 21

6.112 The committee recommends that the government consider amending the Corporations Act to ensure that the priorities in section 556 apply during all liquidations, regardless of whether the business being liquidated was operated through a trust structure.

Other issues relating to payment and calculation of SG during liquidation

6.113 The committee received evidence on other issues relating to the payment and calculation of SG during liquidation processes.

6.114 For example, ARITA highlighted the inconsistency in the calculation of the nominal interest component of the SGC between the SGA Act and the Corporations Act. ARITA stated that under the Corporations Act, creditors are entitled to include interest up to the date of liquidation in their claim, if the terms of their debt provide for interest to accrue. However, when the ATO calculates the nominal interest of the SGC on unpaid super, the nominal interest is calculated up to the date of lodgement of the SGC statement. This date of lodgement is generally after the date of liquidation.[89]

6.115 ARITA argued that this inconsistency could potentially disadvantage other creditors in the liquidation due to the priority status of the SGC amount:

> In our view, this is inappropriate, as creditors in the liquidation should enjoy the same rights and privileges unless specifically differentiated by the Corporations Act… In our view, all interest should be treated equally and the right to interest should be calculated as at the date of liquidation.[90]

6.116 ARITA also informed the committee that feedback from its members showed there were often lengthy delays between when an SGC payment is made to the ATO as part of an insolvency process, and when those funds are remitted to an employee's superannuation fund. To solve this, ARITA suggested that power be given to insolvency practitioners to pay dividends for unpaid SG directly to an employee's superannuation fund (where details of the fund are known). Any payments could then

88 Mr Geoff Green, *Submission 4*, p. 2.

89 Australian Restructuring Insolvency and Turnaround Association, *Submission 23*, pp. 3–4.

90 Australian Restructuring Insolvency and Turnaround Association, *Submission 23*, p. 4.

be reported to the ATO, and the associated administration component of the SGC be paid directly to the ATO.[91]

Committee view

6.117 The committee is of the view that both these issues warrant further investigation in order to ascertain whether any changes could be made to allow employees to promptly receive their SG entitlements in the event that their employer becomes insolvent.

Recommendation 22

6.118 The committee recommends that the government consider amending the SGA Act so that nominal interest on SGC in the case of insolvencies apply up to the date of liquidation, in alignment with other creditors as set out in the Corporations Act.

Recommendation 23

6.119 The committee recommends that the government consider amending the SGA Act to allow insolvency practitioners to pay outstanding SG contributions directly to an employee's superannuation fund.

Fair Entitlements Guarantee scheme

6.120 The Fair Entitlements Guarantee (FEG) is a publicly funded safety net scheme of last resort designed to protect accrued basic employment entitlements administered by the Department of Employment under the *Fair Entitlements Guarantee Act 2012* (FEG Act). FEG commenced as a legislated scheme in December 2012, replacing the previous administrative version of the scheme, the General Employee Entitlements and Redundancy Scheme (GEERS).

6.121 FEG allows employees who have lost their jobs due to the liquidation or insolvency of their employer and who are unable to recover particular entitlements, to apply to receive financial assistance, with all payments subject to a capped weekly amount.[92]

6.122 Unpaid SG is specifically excluded from FEG. The five basic employment entitlements covered under the scheme are as follows:

- unpaid wages (capped to 13 weeks)
- unpaid annual leave
- unpaid long service leave
- payment in lieu of notice (capped to five weeks)

91 Australian Restructuring Insolvency and Turnaround Association, *Submission 23*, pp. 2–3.

92 Department of Employment, *Submission 24*, pp. 2–3.

- redundancy pay (capped to four weeks per full year of service)[93]

6.123 The Department of Employment provided the committee with some background on the policy design of FEG:

> In policy design, FEG and its predecessor schemes were not intended to be an all-encompassing form of insurance to compensate employees for any and all unpaid amounts owed by their employer. The design of FEG provides for protection of limited categories of 'employment entitlements' aligned to those entitlements that an employer is obligated to provide in the National Employment Standard under the *Fair Work Act 2009*.[94]

6.124 The Department of Employment also elaborated on why SG was not covered under FEG:

> Despite the earlier commencement of Australia's compulsory employer superannuation regime, unpaid compulsory superannuation contributions owed by an insolvent employer have never been included in the policy design of FEG or its predecessor schemes. Superannuation has a different policy genesis and intent than the employment entitlements covered under the FEG. Employer superannuation contributions under the Superannuation Guarantee (SG) are not an item paid directly to employees as they fall due, nor do they become payable directly to an employee on redundancy. Rather, SG contributions are accumulated in a superannuation fund and accessed at a later time on an employee's retirement from the workforce.[95]

6.125 The Department of Employment also stated that the FEG scheme presents a 'moral hazard' as it potentially shifts the cost of employer accountability for employee entitlements obligations to tax payers. The department noted that as FEG has become more generous over time, the moral hazard risk that insolvent employers rely on the scheme to meet employees entitlements has increased.[96]

6.126 Numerous submitters recommended that FEG be expanded to cover unpaid SG. For example, Cbus, the ACTU and United Voice all recommended that consideration be given to expanding FEG to include SG entitlements.[97]

6.127 ISA argued that even though an expansion of FEG to include SG would create costs to government, these costs may be offset over time through a decrease in the number of affected employees reliant on the age pension years later. ISA also stated

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93 Department of Employment, *Submission 24*, p. 4.

94 Department of Employment, *Submission 24*, p. 3.

95 Department of Employment, *Submission 24*, p. 6.

96 Department of Employment, *Submission 24*, pp. 5, 8.

97 See Cbus, *Submission 48*; Australian Council of Trade Unions, *Submission 51*; United Voice, *Submission 66*.

that including SG in FEG would create an incentive for government to administer an effective SG compliance regime.[98]

6.128 JobWatch informed the committee that although superannuation and wage entitlements have equal standing in insolvency legislation when it comes to prioritising payments, if an employee is unable to access superannuation due to employer insolvency, there is no other option for remuneration available to them.[99]

6.129 The Association of Super Funds Australia (ASFA) recommended that unpaid SG entitlements be included in the unpaid employment entitlements covered by FEG. ASFA stated that there was merit in reviewing the treatment of unpaid SG entitlements in insolvency cases as, according to ASIC data, a substantial number of insolvency cases involved unpaid SG entitlements.[100]

6.130 The Association of Financial Advisors (AFA) pointed out that unpaid SG liability can be a cause of employers entering insolvency arrangements in the first place, meaning employees could potentially miss out on substantial sums of retirement funds rightfully owed to them. AFA suggested that the FEG scheme be reviewed to consider the protection of SG entitlements in liquidation.[101]

6.131 The committee also received evidence from the IGT indicating that the inquiry was not the first time that the expansion of the last resort employee entitlement scheme has been canvassed. In the 2010 IGT Super Guarantee Charge review, the IGT recommended an expansion to both GEERS and the Director Penalty Notice (DPN) regime to cover unpaid SGC liabilities.[102]

6.132 The recommendation read as follows:

> Recommendation 11
>
> To better protect employees' SG entitlements and improve both deterrence against SG non-compliance and provide greater transparency of the cost of SG non-compliance on future age pension outlays, the Government consider:
>
> - Expanding the director penalty regime to apply to unpaid SGC liabilities of the company; and

98 Industry Super Australia, *Submission7.1*, p. 21.

99 JobWatch, *Submission 26*, p. 11.

100 Association of Australian Super Funds, *Submission 30*, p. 5.

101 Association of Financial Advisors, *Submission 58*, p. 3.

102 Inspector-General of Taxation, *Submission 21*, p. 13.

- Expanding GEERS to cover unpaid SGC liabilities where a company has been placed into liquidation and the ATO has not been able to recover against the directors personally.[103]

6.133 Although the suggestion to expand GEERS was not actioned, the DPN regime was expanded to include unpaid SGC liabilities in June 2012. As a result of this, if a company fails while owing SG to employees, directors of the company may become liable for any unpaid superannuation entitlements. The policy intent behind the expansion was to establish a deterrent against non-compliance and improve the ATO's ability to recover unpaid SG even after a company had been declared insolvent.[104]

6.134 However, according to the IGT submission, this expansion was supposed to be complemented by an expansion of the last resort employee entitlement scheme:

> The IGT explained in his 2010 SGC Review that the expansion of both DPNs and GEERS to cover unpaid SGC complementary. Where a company has not met their SG obligations, the ATO should have the ability to recover unpaid SGC amounts from the directors of companies personally. Only when the ATO has not been able to recover unpaid SGC liabilities from the company and the directors should GEERS, now FEG, cover unpaid SG.[105]

6.135 The Department of Employment (the department) argued that FEG not be expanded, asserting that notwithstanding the availability of FEG as a last resort safety net, the government had clearly stated that it is the responsibility of an employer to meet its employee entitlement obligations. The department also stated that taxpayers should not have to provide a comprehensive and unlimited source of funding to compensate employees where the employer fails to make adequate provision for the accrued entitlements of its workers.[106]

6.136 The department asserted that including unpaid SG contributions in FEG would:

- significantly increase the cost of the scheme;
- exacerbate the existing moral hazard inherent in the scheme; and
- create unnecessary policy and administrative complexity.[107]

6.137 In particular the department argued that expanding FEG to include unpaid SG would result in an increase of around 47 per cent in the number of claims to the

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103 Inspector-General of Taxation, *Review into the ATO's administration of the Superannuation Guarantee*, 2010, p. 93.

104 Inspector-General of Taxation, *Submission 21*, p. 13.

105 Inspector-General of Taxation, *Submission 21*, p. 13.

106 Department of Employment, *Submission 24*, p. 8.

107 Department of Employment, *Submission 24*, pp. 8–10.

scheme. This would in turn result in additional administered expense for the government, which the department estimated to be $801 million over the forward estimates. The department also claimed that changes to business systems would be needed to administer assessment and payment of the superannuation component of claims, at a cost of an extra $39 million to departmental expenses over the forward estimates.[108]

6.138 The following table was provided by the department to illustrate the additional expenditure:

Table 6.2—Summary of additional expenditure flowing from an expansion of FEG[109]

Item	2017-18	2018-19	2019-20	2020-21	Total
Administered expense (million)	$180.6	$193.2	$206.6	$220.9	$801.2
Departmental expense (million)	$5.41	$8.49	$8.47	$8.52	$39.34

6.139 The department also flagged that expanding FEG would require legislative amendment to the FEG Act, as well as possibly the SGA Act and other legislation:

> It can be anticipated that significant complexity will be encountered in effectively straddling the overlap between FEG and the ATO in managing non-payment of SG contributions. The ATO already has regulatory and compliance responsibility for SG contributions. Including SG contributions in FEG will work at cross purposes to the existing compliance regime including the SG Charge arrangements, possibly resulting in a higher level of non-compliance.[110]

6.140 Rather than expanding FEG, the department recommended that the committee consider measures to strengthen the powers available to the ATO to manage SG compliance. The department stated that expanding FEG to include SG would not likely achieve the desired result of improving compliance in employers meeting their ongoing SG obligations.[111]

108 Department of Employment, *Submission 24*, p. 9.

109 Department of Employment, *Submission 24*, p. 9.

110 Department of Employment, *Submission 24*, p. 10.

111 Department of Employment, *Submission 24*, p. 10.

Committee view

6.141 The committee is mindful of the concerns put forward by the Department of Employment in regard to the additional expenditure that would be required to expand the FEG scheme to cover unpaid SG entitlements. The committee is aware that any change to FEG would need to be carefully considered and undertaken only when there is scope in the federal budget to adequately fund it.

6.142 However, as mentioned earlier in this report, the committee is strongly of the view that SG forms an integral part of an employee's remuneration and is akin to deferred wages. As such, the committee does not agree with the Department of Employment's argument that the different policy genesis of superannuation, as well as the fact that SG is not paid directly to employees as it falls due, nor payable directly to employees on redundancy, are valid reasons for excluding SG from the FEG scheme. The fact the SG contributions are deferred wages does not diminish their importance. The FEG scheme has always covered unpaid wages, and therefore it is logical that SG, as deferred wages, should also be covered.

6.143 Additionally, the committee notes that although including SG in the FEG scheme would increase current costs to government, the likelihood is that government expenditure would instead be decreased in later years due to a reduced reliance on the age pension from those affected employees. The committee is also of the view that if the ATO undertakes more proactive work to prevent SG non-payment as recommended, this will partially offset the increased costs to the FEG scheme should SG be included.

Recommendation 24

6.144 The committee recommends that the relevant government agencies undertake further research into the fiscal and legislative impacts of an expansion of the current Fair Entitlements Guarantee scheme to cover unpaid SG entitlements.