

File Name: 2015/25

18 September 2015

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Dear Senior Adviser

**RE: Simplifying and reducing the harshness of the superannuation guarantee charge**

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in relation to the exposure draft Superannuation Guarantee Legislation Amendment (Simplification) Bill 2015 (draft Bill).

**About ASFA**

ASFA is a non-profit, non-politically aligned national organisation. We are the peak policy and research body for the superannuation sector. Our mandate is to develop and advocate policy in the best long-term interest of fund members. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90 per cent of the 14 million Australians with superannuation.

**General comments**

ASFA understands the Government's initiative is to simplify and reduce the harshness of the Superannuation Guarantee Charge for employers and agrees that some of the penalties are, arguably, overly harsh. On the other hand, there is significant non-compliance with Superannuation Guarantee (SG) obligations contributing to poorer retirement outcomes for thousands of employees. It is obviously necessary to reach a balance between encouraging compliance while at the same time having appropriate penalties for non-compliance.

Accompanying this submission is a report prepared by Tria Investment Partners for CBUS, AustralianSuper and REST last year with contributions from ASFA, which highlights the very high level of SG non-compliance in Australia. The key findings of the report are:

- SG non-compliance is a \$2.5 billion per annum problem
- Around 650,000 Australians are affected by SG non-compliance annually – 6.5% of the workforce
- Australians affected by non-compliance lose an average of \$3,750 per annum in SG contributions – 9 months' worth for someone on average weekly earnings, more for low income earners

- For every year someone is affected by SG non-compliance, their retirement income (ex age-pension) is reduced by around 2% on average
- This is magnified for the low income and younger members most at risk; an average 25 year old impacted by SG non-compliance for 5 years loses 14% of their retirement income - \$8,000 per annum.
- By far the most significant source of SG non-compliance is employer non-compliance.

Clearly SG non-compliance is a significant problem.

The Australian National Audit Office (ANAO) issued a report in June 2015 *Promoting Compliance with Superannuation Guarantee Obligations*. That report also highlights the high level of non-compliance, identifies certain deficiencies within the ATO regarding promotion of compliance with SG obligations and makes recommendations for improvements. We support the recommendations made by the ANAO in its June report.

ASFA considers that the proposed changes contained in the *Superannuation Guarantee Legislation Amendment (Simplification) Bill 2015* should only be made if additional resources are provided to the Australian Taxation Office to detect breaches of SG obligations and to pursue associated required payments by employers.

The passing of this legislation should not be a signal to employers that the obligation to make SG payments has in some way diminished.

In this context we consider that it is essential that dealing with SG non-compliance be more highly prioritised within the ATO and that the relevant areas within the ATO be more appropriately funded.

\* \* \* \*

If you have any queries or comments in relation to the content of our submission, please contact Policy Adviser, David Graus, on (02) 8079 0837 or by email [dgraus@superannuation.asn.au](mailto:dgraus@superannuation.asn.au).

Yours sincerely



Glen McCrea  
Chief Policy Officer



# Superannuation Guarantee non-compliance

FINAL REPORT FOR CBUS, AUSTRALIANSUPER & REST  
WITH CONTRIBUTIONS FROM ASFA  
15 SEPTEMBER 2014

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# Key Findings

- 1. Superannuation guarantee (SG) non-compliance is a \$2.5bn pa problem**
- 2. Around 650,000 Australians are affected by SG non-compliance annually - 6.5% of the workforce**
- 3. Australians affected by non-compliance lose an average of \$3,750 pa in SG contributions – 9 months' worth for someone on average weekly earnings, more for low income earners**
- 4. For every year someone is affected by SG non-compliance, their retirement income (ex age-pension) is reduced by around 2% on average**
- 5. This is magnified for the low income and younger members most at risk; an average 25 year old impacted by SG non-compliance for 5 years loses 14% of their retirement income – \$8,000 pa**

# Superannuation Guarantee non-compliance summary 1

1. **We estimate that non-compliance with superannuation guarantee (SG) obligations costs employees ~\$2.5bn pa, around 4% of total SG contributions**
2. **Construction is the most affected industry; other industries with elevated non-compliance include property services, mining, hospitality, and manufacturing**
3. **SG non-compliance has 4 main sources, in order of importance:**
  - Employer non-compliance (SG contributions are not made at all, or only in part); \$1.3bn
  - Cash economy (SG is part of avoidance of PAYG and other employment obligations); \$0.7bn
  - Sham contracting; \$0.2bn
  - Employer insolvency; \$0.2bn
4. **SG non-compliance affects the superannuation over half a million Australians every year:**
  - While calculations vary widely, we estimate that ~650,000 miss out on some or all of their super contributions
  - Given the total amount of non-compliance, this is an average of ~\$3,750 pa missing for each person affected
  - Relative to average weekly earnings, the average SG loss is equivalent 9 months of super contributions; implying that an average Australian affected by SG non-compliance will experience an average loss of income in retirement of ~2% for each year this persists (assuming 40 years of contributions)
  - These are conservative estimates; the actual contributions lost and individuals affected may be significantly higher

# Superannuation Guarantee non-compliance summary 2

4. **Some aspects of SG non-compliance are deteriorating, notably insolvency related losses, where SG losses have increased in frequency from around 1 in 3, to 1 in 2 administrations**
5. **Given their obligations to pursue arrears as part of acting in the best interests of members, there is a role for super funds in SG compliance, and for the ATO to be more supportive of such efforts:**
  - Incentives: SG outstandings are remitted to super funds rather than revenue, so the ATO has less incentive to pursue
  - Member expectations: members expect their super fund to be their primary avenue of inquiry
  - Timing: super funds are more likely to detect potential SG non-compliance issues much earlier than the ATO, making recovery more likely
  - Priority: SG non-compliance is a lower order issue for the ATO; funds are more likely to prioritise action given extent of member under-reporting, and concentration in certain industries
6. **That said, detection and enforcement is a logistical challenge for whoever takes it on – most SG non-compliance occurs in the long tail of SME and micro employers**
7. **SG compliance is one of the issues at risk in deregulation of super and awards:**
  - Award contributions currently go in large part to not-for-profit funds, which have incentives to detect and address SG non-compliance on behalf of their members
  - While all funds have the same obligations, retail funds may not have the same incentives – competition to secure default status could lead to a relaxation of SG compliance efforts

# SG non-compliance – sources and estimates



# Four main sources of SG non-compliance

## Employer non-compliance



## Cash economy



## Sham contracting



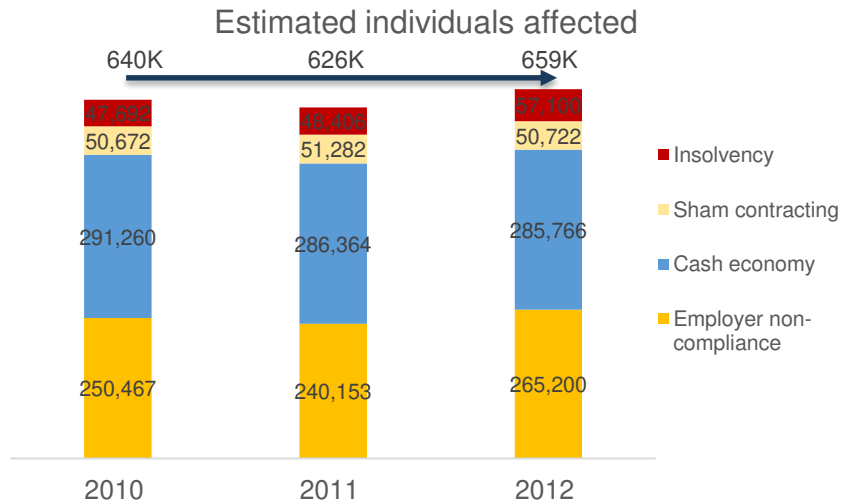
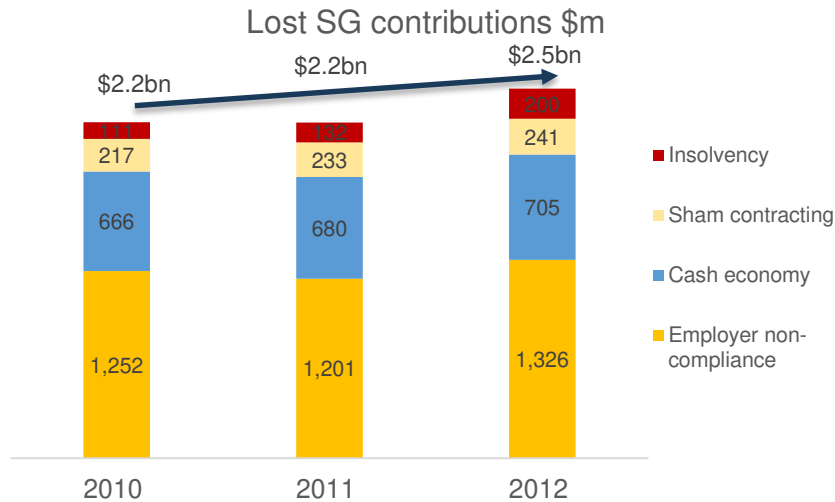
## Insolvency



Estimated annual non-compliance \$m	1,326	705	241	200
Estimated individuals affected annually	265,000	286,000	51,000	57,000
Comments	<ul style="list-style-type: none"> <li>• Inspector-General of Taxation (IGT) report 4.3 scenario 1</li> <li>• Includes SG not paid as a result of job changes</li> <li>• Relies largely on employee complaints; lack of employee awareness and under-reporting makes this a larger problem than the ATO reports</li> <li>• High validation rate – employee reports are usually correct</li> <li>• Complaints are likely to lead to discovery of non-compliance for more than just the complainant, and more than just SG</li> </ul>	<ul style="list-style-type: none"> <li>• IGT report 4.3 scenario 2</li> <li>• Likely to be at low end of range</li> <li>• Australia Institute estimates involvement at 575,000 individuals</li> </ul>	<ul style="list-style-type: none"> <li>• IGT report 4.3 scenario 3</li> <li>• Very limited hard data</li> </ul>	<ul style="list-style-type: none"> <li>• Sometimes included as part of employer non-compliance</li> <li>• Includes phoenix activity</li> <li>• Administration data reported only in bands; estimates likely to be at low end</li> <li>• Though the smallest estimated source of SG loss, shows most evidence of deterioration</li> </ul>

Data for 2011-12 year

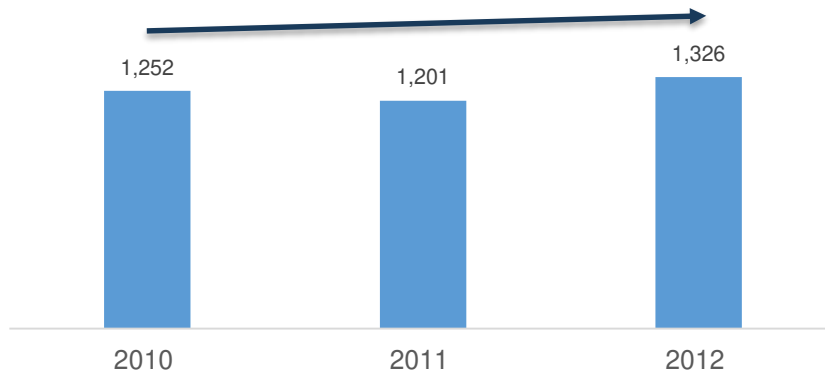
# SG non-compliance totals



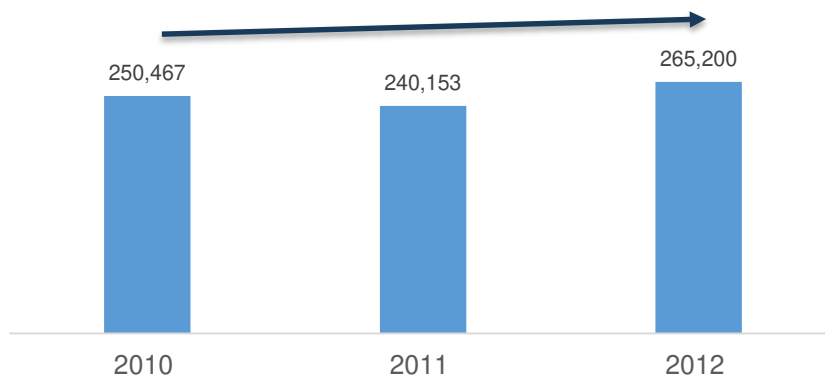
- SG non-compliance results in the loss of ~\$2.5bn in super contributions each year, a figure rising in mid single digits
- Number of individuals affected is relatively stable at ~650,000; this will include many people who are affected only for a single year or part of a year, while others (eg those persistently operating in the cash economy) may be affected for multiple years
- Employer non-compliance is the single biggest contributor to SG non-compliance, but all of cash economy, sham contracting, and insolvency make material contributions

# Employer non-compliance

Lost SG contributions \$m



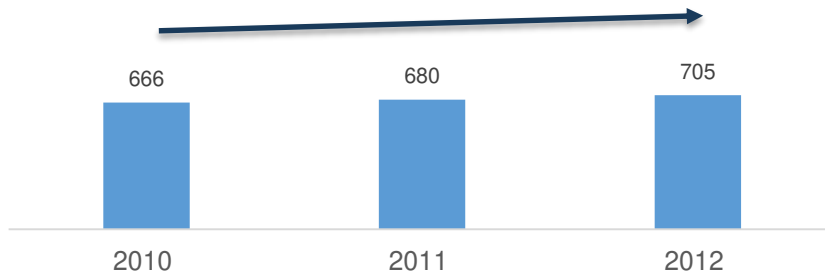
Estimated individuals affected



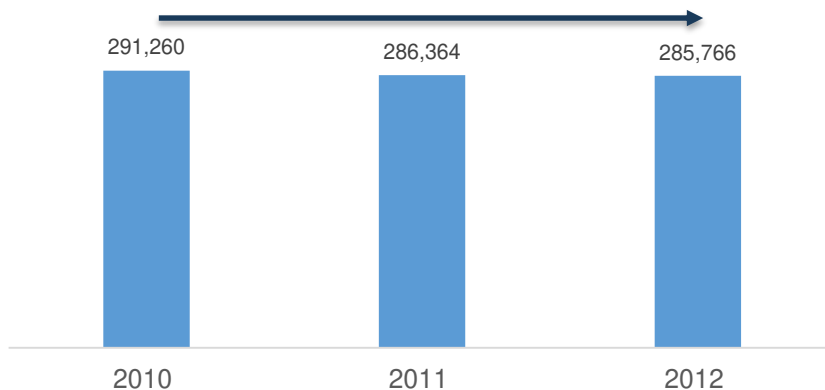
- Defined as employer being non-compliant with their SG obligations, but employee is compliant and lodges a tax return
- Relies largely on employee reporting to ATO, which is often >1 year after the event - if the employee realises there is a problem at all
- Reported employee complaints to the ATO average ~18,000 pa, ATO commissioned research suggests additional non-reported complaints of ~20,000
- This leaves employees unaware they have a complaint – we assume the same figure as the total of employee complaints (reported or not)
- 65-70% of complaints are validated by ATO with some degree of assessed non-compliance
- This indicates suggests ~53,000 underlying issues pa, which is an incidence of ~0.5% of employees
- At an average assessment of ~\$25,000, this implies missing SG contributions of \$1,326m
- Average of \$25,000 also suggests multiple affected employees are being identified by each complaint (a validated complaint is unlikely to be isolated to a single employee) – we have assumed an average of 5 employees to arrive at our estimate of individuals affected

# Cash economy

Lost SG contributions \$m



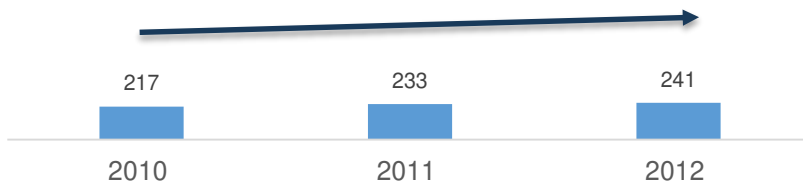
Estimated individuals affected



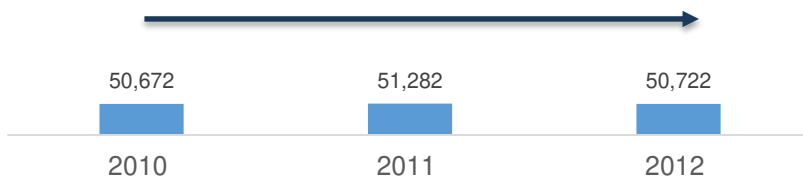
- Defined as employer non-compliant with their SG obligations and employee is also non-compliant by failing to declare salary and wage income (but excluding criminal activity such as narcotics)
- SG is typically just one part of non-compliance – also likely to include PAYG, payroll tax, workers' compensation, other employee entitlements
- Cash economy by definition is hard to measure – global estimates vary widely at 3-15% of GDP; World Bank estimate for Australia is 14%, but ABS considers such estimates to be implausible and uses an adjustment of 1.5% of GDP
- We estimate non-declared income to be ~\$8bn; at 9% SG rate, this implies missing SG contributions of \$705m
- We estimate individuals affected (ie involved in the cash economy) by allocated non-declared income at a rate of 50% of average weekly earnings (as those involved tend to be lower income individuals)
- This indicates ~3% of salary & wage earners participate in the cash economy, nearly 300,000
- This is probably conservative; eg Australia Institute estimates participation at 575,000

# Sham contracting

Lost SG contributions \$m



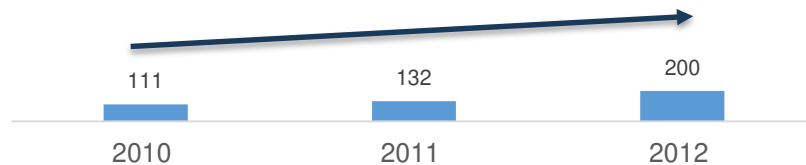
Estimated individuals affected



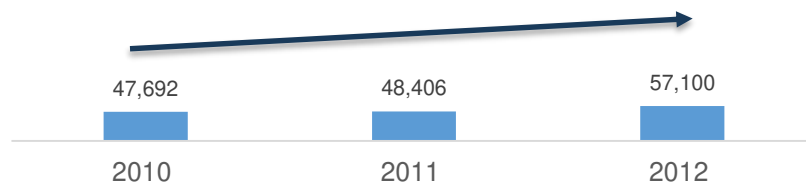
- Defined as where a person is incorrectly categorised as a contractor, rather than employee, so as to avoid a range of employer obligations including SG
- Although this is widely perceived to be a problem, particularly in certain industries including construction, there is little hard data on the topic
- Fair Work Ombudsman 2011 sham contracting study (focused on perceived high risk industries) found ~20% potential misclassifications and ~7% potential sham contracts in their sample
- Independent contractors represent ~10% of salary & wage earners in the PAYG system; we have assumed that 5% of contractor relationships should have been classified as employees
- This implies leakage of 0.5% of salary & wage income, at 9% SG rate, this implies missing SG contributions of \$241m
- We also apply 0.5% leakage rate to salary & wage earners to reach our estimate of ~50,000 individuals affected

# Insolvency

Lost SG contributions \$m



Estimated individuals affected

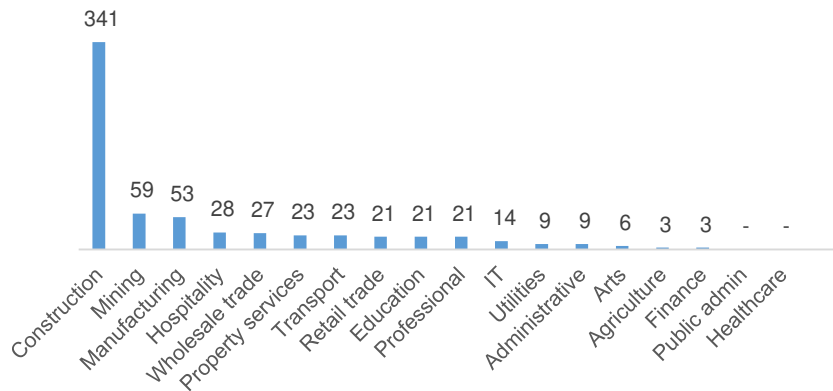


- Defined as where an employer has SG obligations to employees but employer is insolvent with no monies to pay creditors
- ASIC publishes annual insolvency statistics including external administrator reports detailing unpaid superannuation entitlements
- This groups entitlement losses into relatively broad bands (\$1-100,000; \$100-250,000; \$250,000-\$1m; \$1m+); we make estimates of average losses at lower end of the bands (\$10,000; \$150,000; \$500,000; \$1m respectively) to arrive at our estimate of lost SG contributions of \$200m
- Employees affected by entitlement losses are similarly grouped into wide bands – we again assume averages at the lower end to reach our estimate of ~57,000 individuals affected
- Although the smallest source of SG losses, insolvency shows clearest evidence of deterioration (which may reflect that it has some of the best data) – super entitlement losses have increased from occurring in ~35% of insolvencies in 2006-9 to ~45% since 2010

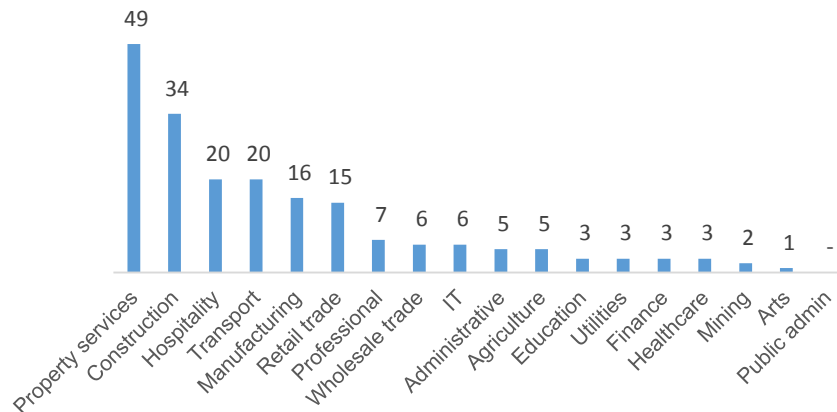
# SG non-compliance – impacts and issues

# SG non-compliance occurs in most private sector industries, but focused in a small number, especially construction

Estimated industry SG losses \$m to cash economy



Estimated industry SG losses \$m to insolvency

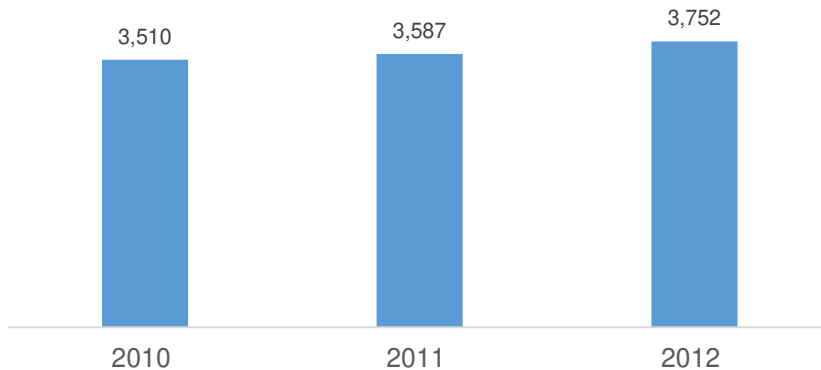


- Data supporting industry attribution of SG non-compliance is limited, but points to common themes of elevated non-compliance activity
- ABS estimates that the construction industry is by far the biggest contributor to the cash economy, and also prominent in SG losses arising from insolvency
- Industry data is not available for employer non-compliance and sham contracting, which means caution should be exercised in attributing the entire \$2.5bn SG losses by industry
- Other industries with elevated levels of cash economy activity include property services, hospitality, mining, and manufacturing
- The outlier nature of the construction industry is also supported by employee SG complaint analysis, which indicates an elevated level of non-compliance in construction (also engineering / mechanical, only outliers reported) and a high level of failure to complain

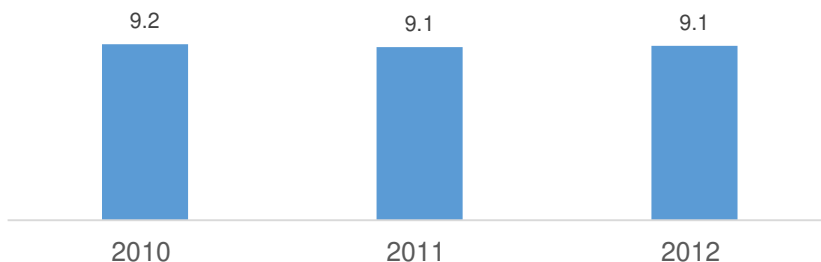


# While individual experience will vary enormously, average impact of SG non-compliance is the loss of 9 months of contributions (or more)

Average individual SG loss \$



Months of lost contributions based on average earnings



- Individual experience ranges from small amounts of underpayment to multiple years of non-payment, making it difficult to describe a typical or average individual impact of SG non-compliance
- That said, a comparison of the estimated dollar amount of SG non-compliance and the number of individuals affected produces an average SG loss of ~\$3,800, a figure which is rising over time
- For an individual on average weekly earnings, on which 9% SG would normally be paid, average SG loss represents ~9 months of missing contributions; however many affected individuals are low income earners, implying a bigger effect in months of contributions terms
- In reality, members will experience losses ranging from part of one quarter's SG contribution, through to all of multiple quarters
- However our "average" affected individual is losing a year of contributions: assuming 40 years of contributions, which indicates a loss of ~2% of their expected super balance and / or non-age pension retirement income

# There is limited co-ordination between funds and the ATO due to privacy concerns, but a clear case for more collaboration exists

- In addition to their trustee obligations, funds have stronger incentives than the ATO: SG contributions recovered by the ATO are remitted to the fund (rather than consolidated revenue)
- Member expectations: members associate most strongly with their fund as an inquiry channel (52%), and more so than the ATO (43%)
- Time counts: Member complaints to the ATO on average do not occur until nearly 2 years after the perceived non-compliance event; with any ATO action will be 2-4 years after the event. By comparison, funds may detect potential non-compliance within months making recovery more likely
- Prioritisation: given that the ATO reports SG complaints from only ~0.2% pa of employees, this is not seen as a high priority activity. However this measure understates the issue, and for funds, estimated total SG non-compliance of \$2.5bn pa is significant against \$60bn in total SG contributions; particularly so as net inflows come under pressure.

This is especially so funds in industries with elevated levels of non-compliance activity, most notably for funds focused in the building and construction industries, including Cbus and BUSS(Q)

# Methodology

# Methodology notes 1

Factor	Sources / approach
Overview	<p>The overall approach was critiqued by Ross Clare, Director of Research, ASFA, the importance of whose input is acknowledged.</p> <p>The four sources of SG non-compliance were drawn from the 2010 report of the inspector-General of Taxation into the ATO's administration of the SGC</p>
SG rate	For the period of the analysis (2010-12), the SG rate was 9%. Since then the rate has increased to 9.5%.
Cash economy	We used the ABS approach to estimating the cash economy, which is 1.5% of GDP. This is at the bottom end of global estimates. ~60% of this figure is allocated by the ABS to gross mixed income, and we allocated 60% of this figure to missing employee earnings (\$7.8bn om 2012), based on ABS share of employee earnings vs returns to capital. Estimated individuals affected was derived by spreading the missing employee earnings figure across half weekly average earnings, based on the evidence that low income earners are disproportionately represented in the cash economy.
Employer non-compliance	This includes both deliberate and inadvertent non-compliance. The ATO Compliance Program reports ~18,000 complaints. A research report by GFK Research for the ATO indicates a slightly higher rate of complaints which go unreported. There is no data for employees who remain unaware that they have an SG issue; we assumed a 50% complaint unawareness rate for a total of ~78,000 pa underlying SG complaints. The IGT report referred to above notes a complaint validation rate of ~68%. The ATO's 2011-12 Compliance Program noted an average SG assessment of \$25,000, indicating multiple employees affected; we assumed 5 on average.
Sham contracting	Primary source is Fair Work Ombudsman Sham Contracting study November 2011. This was a limited study of high risk industries which found 20% misclassification and potential 7% shams in independent contractor sample population. Independent contractors represent ~10% of employees, and we assumed 5% leakage; this implies leakage of 0.5% of salary & wage income

## Methodology notes 2

Factor	Sources / approach
Insolvency	<p>Primary source is ASIC Insolvency Statistics, External Administrators Reports. This details the loss of super entitlements by industry, grouped in bands of lost amounts and company FTE size. We made the following assumptions:</p> <p>Average assumed unpaid super \$1-\$100,000 band: \$10,000 Average assumed unpaid super \$100K - \$250K band: \$150,000 Average assumed unpaid super \$250K - \$1m band: \$500,000 Average assumed unpaid super &gt;\$1m band: \$1m</p> <p>Assume FTE Companies &lt;5 FTE band: 2 FTE Assume FTE Companies 5-19 FTE band: 10 FTE Assume FTE Companies 20-199 FTE band: 50 FTE Assume FTE Companies 200+ FTE band: 200 FTE</p>

