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Cash-in-hand means less cash for states – the impact of tax evasion on public finances

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As we begin the 21st century, new dilemmas confront our society and our planet. Unprecedented levels of consumption co-exist with extreme poverty. Through new technology we are more connected than we have ever been, yet civic engagement is declining. Environmental neglect continues despite heightened ecological awareness. A better balance is urgently needed.

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The Institute aims to foster informed debate about our culture, our economy and our environment and bring greater accountability to the democratic process. Our goal is to gather, interpret and communicate evidence in order to both diagnose the problems we face and propose new solutions to tackle them.

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Introduction

The introduction of the Goods and Services Tax (GST) in July 2000 by the Howard Government was, we were told, likely to lead to a significant reduction in the size of the 'cash' or 'black' economy. The 2003 report to the then Tax Commissioner from the Cash Economy Task Force stated:

> *The new tax system contains many features designed to increase the integrity of the tax system and to assist the Tax Office in effectively identifying and addressing non-compliance, including evasion in the cash economy. (p. vii)* [1]

Indeed, the report went on to find that:

> *The Task Force sees strong signs that these measures are impacting significantly on the cash economy. The design features of the reformed tax system are working together to produce a more robust tax system that is harder to evade. (p. vii)*

However, in recent years there has been growing evidence that the size of the cash economy remains significant as employer and employees seek to avoid a range of tax obligations. For example:

- The Australian Tax Office warned 30,000 businesses during 2010-11 about the possibility that they were under-declaring their income.[2]
- The ATO received an average of 164 tip-offs per week relating to concerns about the cash economy.[3]

In 2010 the Commonwealth Government invested an additional $445 million in the ATO's capacity to collect revenue from the cash economy, an investment that was expected to recoup $3.2 billion in additional revenue.[4]

In recent months there have been a number of calls on the Commonwealth Government to collect more GST revenue, all of which is passed onto the States. The NSW Premier, for example, has called for consideration of an increase in the rate of the GST[5], while the National Retail Association (NRA) has linked the need to collect GST on imported goods worth less than $1,000 with the capacity to collect an additional $800 million per year in GST revenue.[6]

As the following analysis shows, however, a crackdown on the black economy and cash-in-hand work has much greater capacity to equitably and efficiently increase Commonwealth and State Government revenues. Indeed, it is likely that if the government were to increase the rate of GST or attempt to broaden its base, it would lead to either increased avoidance activity, increased administrative cost of tax collection, or both.

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[1] http://regnet.anu.edu.au/sites/default/files/publications/ATO_CashEconomy_0.pdf

[2] http://www.news.com.au/business/worklife/tradies-are-dodging-the-gst-in-a-100-billion-cash-economy/story-e6frfm9r-1226468469128

[3] http://www.news.com.au/business/worklife/tradies-are-dodging-the-gst-in-a-100-billion-cash-economy/story-e6frfm9r-1226468469128

[4] http://www.smartcompany.com.au/economy/20100511-federal-budget-2010-government-to-recover-3-2-billion-through-cash-economy-and-gst-crackdown.html

[5] http://www.theaustralian.com.au/national-affairs/state-politics/nsws-barry-ofarrell-calls-for-a-review-of-the-gst/story-e6frgczx-1226475027756

[6] http://www.news.com.au/business/worklife/retailers-call-for-gst-on-online-sales/story-e6frfm9r-1226473906440

Estimating lost tax revenue due to cash-in-hand work

In order to estimate the nature and extent of cash-in-hand work in Australia a survey by EMC was conducted in September 2012. Table 1 shows the proportion of workers who report working 'cash-in-hand' by age.

Table 1 – Survey of Australian workers: Cash-in-hand work by age

	All age groups	18-29	30-39	40-49	50-59	60+
Total cash-in-hand job	13%	24%	11%	12%	7%	-
Yes in one or more of my current jobs	5%	10%	3%	4%	3%	-
Yes for a past job in the last 3 years	8%	14%	8%	6%	4%	9%
Yes but my employer pays / paid tax before giving me the net amount in cash	1%	3%	1%	*	1%	-
No not currently nor in the last 3 years	86%	72%	88%	89%	92%	91%

As Table 1 shows, five per cent of employees report working cash-in-hand which, based on the Australian Bureau of Statistics Labour Force data, suggests a cash-in-hand workforce of approximately 574,900 people.

Survey respondents reported their cash-in-hand income. On the basis of this data it has been assumed for the following estimations of lost tax revenue that one third of those working cash-in-hand are earning the minimum wage while the remaining two thirds of cash-in-hand workers are evenly divided between those earning one third of the full time minimum wage and two thirds of the full time minimum wage. This assumption is likely to be conservative, resulting in a tendency to underestimate the foregone revenue.

Multiplying the estimated number of workers working cash-in-hand by the estimated income of those workers generates a cash-in-hand wage bill of $12.8 billion which is around 1.75 per cent of the national wage bill. If it is assumed that all cash-in-hand income is the only source of income for respondents then the Pay As You Earn (PAYE) tax payable on such a wage bill would be $703 million per annum with the reason for the low average tax rate being the existence of the tax-free threshold. If some of the respondents who report working cash-in-hand were also receiving income from legitimate sources then the income tax payable would be substantially higher.

In addition to lost PAYE tax revenue the government is also likely to be missing out on a substantial amount of superannuation contributions tax revenue. According to Table 2 only 29 per cent of cash-in-hand workers have compulsory superannuation contributions made on their behalf by their employer. If the 15 per cent superannuation contributions tax rate is applied to the compulsory nine per cent contributions that should have been made on the estimated earnings of the 71 per cent of cash-in-hand workers who reported that they were not receiving superannuation then the lost contributions tax would be equal to an additional $123 million per year. Combined with the $703 million in lost PAYE tax this equates to $826 million in underpaid income taxes.

Finally, it is unlikely that employers who are paying their workers cash-in-hand are accurately declaring their business income to the Australian Taxation Office. Indeed, a business that accurately reported its business income while concealing the size of their payroll would be likely to attract the attention of the ATO.

Economy wide the national level of non-wage income is 47 per cent of GDP at factor cost. On that basis hidden wage income of $12.8 billion suggests hidden non-wage income of $14.4 billion[7]. The business revenue on which the GST has likely been not declared would be the sum of these two incomes, that is, $27.2 billion. In turn, the underpayment of GST revenue is therefore likely to be around $2.7 billion per year.

Depending on the legal structure of the employers paying cash-in-hand wages PAYE or corporate tax would also be payable on the undeclared revenue. We have not attempted to estimate this source of revenue loss.

Based on the estimates provided above, at least $3.3 billion in revenue is being lost each year as a result of cash-in-hand work. However, given the conservative assumptions on which foregone PAYE tax have been calculated and difficulties associated with estimating lost tax on profit it is likely that cash-in-hand work is likely costing Commonwealth and State government at least $5 billion per year.

In turn, those state premiers and others such as the retail industry that have expressed concern with the benefits of collecting more GST revenue, would likely to achieve more revenue, and do so more equitably, by shifting their focus away from increasing the rate or base of the GST and towards improved collection of tax from the minority of businesses that are engaged in the cash economy.

[7] National accounts figures show that compensation of employees is 47 per cent of GDP at factor cost. The other 53 per cent is non-wage incomes. The procedure in the text assumes that the same figures apply in both the cash and non-cash parts of the Australian economy. See ABS (2011) *Australian System of National Accounts, 2010-11*, Cat no 5204.0, 28 October.