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24 January 2019

Mr James O'Halloran
Deputy Commissioner of Taxation
Superannuation
Australian Taxation Office
2 Constitution Avenue
Canberra ACT 2600

Dear Mr O'Halloran,

Re. Superannuation contributions on annual leave loading

We refer to our letter of 29 October 2018 expressing concern about an Australian Taxation Office (**ATO**) interpretation of the Superannuation Guarantee legislation that would narrow the circumstances under which a payment for annual leave loading is excluded from Ordinary Time Earnings (**OTE**) for the purposes of the *Superannuation Guarantee (Administration) Act 1992* (Cth) (**the SG Administration Act**). The interpretation differs from widespread industry practice.

We also refer to the teleconference that took place between the Australian Industry Group (**Ai Group**) and the ATO on 29 November 2018 during which Ai Group undertook to provide the ATO with additional material that supports the fact that the annual leave loading entitlement in awards is intended to compensate employees for the lost opportunity to work overtime and, therefore, that superannuation is not payable on leave loading for award-covered employees.

In particular, we agreed to provide material about the relevant annual leave loading provisions over time in the Metals / Manufacturing Awards. Historically, the federal Metal Industry Award has been the most important award in the award system. For many decades, amendments made to this award commonly flowed on to other awards. The 17.5 per cent leave loading present in most current awards is referable back to the incorporation of the loading into the *Metal Industry Award 1971* in 1972.

On 24 November 1971, the Commonwealth Conciliation and Arbitration Commission made the *Metal Industry Award 1971*.¹ On application by the Amalgamated Engineering Union and others, this award was varied by consent with Ai Group's predecessor organisations (i.e. the Metal Trades Industry Association of Australia, the Australian Chamber of Manufactures and the Engineering Employers Association, South Australia) on 13 November 1972 to incorporate a 17.5 per cent annual leave loading for day workers and shift workers in subclause 25(k) as follows:²

¹ (1971) 141 CAR 389.

² (1972) 146 CAR 775.

'Loading on Annual Leave'

(k) During a period of annual leave an employee shall receive a loading calculated on the rate of wage prescribed by sub-clause (j)(a)(i) of this clause.

The loading shall be as follows:

(i) *Day Workers*—an employee who would have worked on day work only had he not been on leave—a loading of 17½ per cent.

(ii) *Shift Workers*—an employee who would have worked on shift work had he not been on leave—a loading of 17½ per cent.

Provided that where the employee would have received shift loadings prescribed by clause 19—Shift Work or clause 36—Watchman and/or Gatekeeper (N.S.W. Only) had he not been on leave during the relevant period and such loadings would have entitled him to a greater amount than the loading of 17½ per cent, then the shift loadings shall be added to the rate of wage prescribed by sub-clause (j)(a)(i) in lieu of the 17½ per cent loading.

Provided further, that if the shift loadings would have entitled him to a lesser amount than the loading of 17½ per cent then such loading of 17½ per cent shall be added to the rate of wage prescribed by sub-clause (j)(a)(i) in lieu of the shift loadings.

The loading prescribed by this sub-clause shall not apply to proportionate leave on termination.'

The above provision states that the loading is to be calculated on "*the rate of wage prescribed by sub-clause (j)(a)(i) of this clause*". The annual leave payments prescribed by sub-clause 25(j) relate to the wages an employee would have received in respect of ordinary time that the employee would have worked had the employee not been on leave at the relevant time. The 17.5 per cent annual leave loading is expressed as being in excess of the amounts payable in respect of ordinary time. Therefore, it is clear that annual leave loading is not attributable to applicable earnings for ordinary hours of work.

In their influential textbook on Labour Law, Professor Breen Creighton and Professor Andrew Stewart state in relation to annual leave loading:

"The original purpose of the leave loading was to compensate employees for the notional loss of overtime earnings during periods of leave. It subsequently spread to most sectors of the workforce (including those areas where there was normally no payment in respect of overtime."³

The purpose of annual leave loading, as compensation to employees for the lost opportunity to work overtime, was also noted in the final report of the Fair Work Review Panel (which comprised Professor Ron McCallum AO, The Hon Michael Moore and Dr John Edwards), arising from a major review that the Panel were commissioned to conduct by the Labor Federal Government into the Fair Work legislation during 2012:

³ Creighton, B. and Stewart, A., *Labour Law*, The Federation Press, 5th ed., 2010) 397.

“the provision of annual leave loading was originally to compensate employees for the notional loss of overtime earnings while on leave, although the benefit then spread to most sectors of the workforce, including areas not generally subject to overtime payments.”⁴

The incorporation of the 17.5 per cent annual leave loading into the *Metal Industry Award 1971* was followed on 9 November 1973 by the awarding of a 17.5 per cent annual leave loading in Queensland State awards through a common ruling by Industrial Conciliation and Arbitration Commission of Queensland.⁵ The 17.5 per cent annual leave loading was subsequently recognised as a standard by the Industrial Commission of New South Wales.⁶ On 23 June 1974, the South Australian Industrial Commission recognised the 17.5 per cent loading as a test case standard.⁷

In a decision issued on 5 November 1974 which referred to the incorporation of the 17.5 per cent annual leave loading into the *Metal Industry Award 1971*, the Australian Conciliation and Arbitration Commission stated:⁸

“...’at this time’ it can be said that within the last year or so, a new standard has emerged, namely a 17½% loading...Given the decision of all Australian Governments and three State industrial tribunals together with movements in Federal Awards we are prepared to accept that a loading of 17½% is now appropriate”.

It is clear that by the end of 1974, the 17.5 per cent annual leave loading and the original rationale for its inclusion in the *Metal Industry Award 1971* were considered to be generally appropriate for inclusion in other awards. Numerous awards were varied to reflect the entitlement in the *Metal Industry Award 1971*. The following is a small sample of decisions issued in the wake of the introduction of the 17.5 per cent annual leave loading in the *Metal Industry Award 1971*:

- *Oven and Stove Making Award 1939* (variation in 1972);⁹
- *Agricultural Implement Making Award 1936* (variation in 1972);¹⁰
- *Carpenters and Joiners Award 1967* (variation in 1973);¹¹
- *Stonemasons (Victoria) Award 1968* (variation in 1973);¹²

⁴ Final report, page 99.

⁵ 1973 AILR 694.

⁶ Referred to in (1975) 166 CAR 610.

⁷ Ibid

⁸ Ibid.

⁹ (1972) 146 CAR 849.

¹⁰ (1972) 147 CAR 95.

¹¹ (1973) 148 CAR 1181.

¹² (1973) 148 CAR 1181.

- *Builders Labourers (Construction on Site) Award 1962* (variation in 1973);¹³
- *Engine Drivers and Firemen's (General) Award 1968* (variation in 1973);¹⁴
- *Graphic Arts Award 1957* (variation in 1973);¹⁵
- *Draughtsmen and Technical Officers CSR & Ors Award 1972* (variation in 1973);¹⁶
- *Aircraft Industry (Qantas Airways Limited) Award 1970* (variation in 1973);¹⁷
- *Ship Painters and Dockers Award 1969* (variation in 1973).¹⁸

The *Metal Industry Award 1971* was superseded by the *Metal Industry Award 1984*. The 1984 Award contained a similar clause to the 1971 Award providing for annual leave loading (extracted below). The wording is almost identical to the predecessor provision.

Loading on annual leave

(k) During a period of annual leave an employee shall receive a loading calculated on the rate of wage prescribed by subclause (j) of this clause, subject to the provisions of paragraph (ii) hereof.

The loading shall be as follows:

- (i) Day Workers - an employee who would have worked on day work only had he not been on leave - a loading of 17-1/2 per cent.
- (ii) Shift Workers - an employee who would have worked on shift work had he not been on leave - a loading of 17-1/2 per cent.

Provided that where the employee would have received shift loadings prescribed by clause 19 - Shift Work, or clause 36 - Watchman and/or Gatekeeper (New South Wales only) had he not been on leave during the relevant period and such loadings would have entitled him to a greater amount than the loading of 17-1/2 per cent, then the shift loading as prescribed in subparagraph (j)(a)(ii) of this clause shall be included in the rate of wage prescribed by subclause (j) in lieu of the 17-1/2 per cent loading.

Provided further that if the shift loadings would have entitled him to a lesser amount than the loading of 17-1/2 per cent then such loading of 17-1/2 per cent shall be added to the rate of wage prescribed by subclause (j) but not including subparagraph (j)(a)(ii).

The loading prescribed by this subclause shall not apply to proportionate leave on termination.

¹³ (1973) 148 CAR 310.

¹⁴ (1973) 148 CAR 589.

¹⁵ (1973) 149 CAR 187.

¹⁶ (1973) 150 CAR 152.

¹⁷ (1973) 150 CAR 155.

¹⁸ (1973) 150 CAR 187.

The above provision states that the loading is to be calculated on “*the rate of wage prescribed by sub-clause (j) of this clause....*”. The annual leave payments prescribed by sub-clause 25(j) relate to the wages an employee would have received in respect of ordinary time that the employee would have worked had the employee not been on leave at the relevant time. The 17.5 per cent annual leave loading is expressed as being in excess of the amounts payable in respect of ordinary time. Therefore, it is clear that annual leave loading is not attributable to applicable earnings for ordinary hours of work.

Following the passing of the *Workplace Relations Act 1996* (Cth), and the *Workplace Relations and Other Legislation Amendment Act 1996* (Cth), the Australian Industrial Relations Commission (**AIRC**) embarked on a process of award simplification. In a decision handed down on 11 March 1998¹⁹, the AIRC made the *Metal, Engineering and Associated Industries Award 1998* which contained the following clause as agreed between Ai Group and the six unions in the Metal Trades Federation of Unions:

7.1.4 Loading on Annual Leave

During a period of annual leave an employee will receive a loading calculated on the rate of wage prescribed by subclause 7.1.3.

The loading shall be as follows:

7.1.4(a) Day Workers - employees who would have worked on day work only had they not been on leave - a loading of 17 1/2 per cent or the relevant weekend penalty rates, whichever is greater but not both.

7.1.4(b) Shift Workers - employees who would have worked on shift work had they not been on leave - a loading of 17 1/2 per cent or the shift loading (including relevant weekend penalty rates) whichever is the greater but not both.

The loading prescribed by this subclause does not apply to proportionate leave on termination.

On 28 March 2008, the then Minister for Employment and Workplace Relations, the Hon Julia Gillard made a request to the AIRC under 576C(1) of the *Workplace Relations Act 1996* (Cth) for the Commission to undertake an award modernisation process.

On 1 August 2008, in the course of the award modernisation proceedings, Ai Group and the Metal Trades Federation of Unions submitted a joint draft modern manufacturing industry award which was based on the terms of the *Metal, Engineering and Associated Industries Award 1998*. The joint draft included the following clause 6.1.6 which was based on clause 7.1.4 of the *Metal, Engineering and Associated Industries Award 1998*:

¹⁹ Print P9311.

6.1.6 Annual leave loading (AGREED)

During a period of annual leave an employee will receive a loading calculated on the rate of wage prescribed in [INSERT].

The loading shall be as follows:

6.1.6(a) Day work

Employees who would have worked on day work only had they not been on leave – 17 ½ per cent or the relevant weekend penalty rates, whichever is the greater but not both

6.1.6(b) Shiftwork

Employees who would have worked on shiftwork had they not been on leave – a loading of 17 ½ per cent or the shift loading (including relevant weekend penalty rates) whichever is the greater but not both

Clause 6.1.6 of the joint draft was very similar to the following clause 41.5 (Annual leave loading) that was included in the *Manufacturing and Associated Industries and Occupations Award 2010*. In a Statement handed down on 12 September 2008, the Full Bench of the AIRC affirmed that the manufacturing award “substantially reflects” the draft award prepared by Ai Group and the union parties to the *Metal, Engineering and Associated Industries Award 1998*.²⁰

41.5 Annual leave loading

(a) During a period of annual leave an employee must also be paid a loading calculated on the wages prescribed in clause 41.4.

(b) The loading must be as follows:

(i) Day work

An employee who would have worked on day work only had they not been on leave must be paid a loading equal to 17.5% of the wages prescribed in clause 41.4 or the relevant weekend penalty rates, whichever is the greater but not both.

(ii) Shiftwork

An employee who would have worked on shiftwork had they not been on leave must be paid a loading equal to 17.5% of the wages prescribed in clause 41.4 or the shift loading including relevant weekend penalty rates, whichever is the greater but not both.

The above clause remains in the current version of the *Manufacturing and Associated Industries and Occupations Award 2010*. The Award retains a clear division between the annual leave loading and earnings in respect of ordinary hours of work.

²⁰ [2008] AIRCFB 717, [57].

Clause 41.1 in the Award sets out the payment that is to be made for the period of annual leave:

41.4 Payment for period of annual leave

- (a) Instead of the base rate of pay as referred to in s.90(1) of the Act, an employee under this award, before going on annual leave, must be paid the wages they would have received in respect of the ordinary hours the employee would have worked had the employee not been on leave during the relevant period.
- (b) Subject to clause 41.4(c), the wages to be paid must be worked out on the basis of what the employee would have been paid under this award for working ordinary hours during the period of annual leave, including allowances, loadings and penalties paid for all purposes of the award, first aid allowance and any other wages payable under the employee's contract of employment including any overaward payment.
- (c) The employee is not entitled to payments in respect of overtime, special rates or any other payment which might have been payable to the employee as a reimbursement for expenses incurred.

It can be seen that payments made pursuant to clause 41.4 are distinct from the annual leave loading in clause 41.5. Clause 41.4(a) refers to "*the wages they would have received in respect of ordinary hours the employee would have worked had the employee not been on leave during the relevant period*". At clause 41.4(c), payments for annual leave are expressed not to include "payments in respect of overtime".

The inclusion of the 17.5 per cent annual leave loading in most of the 122 modern industry and occupational awards that are in operation today can be traced back to the Commission's initial decision to include an annual leave loading in the *Metal Industry Award 1971*.

Throughout the period since 1971:

- The purpose of annual leave loading provisions in awards is to compensate employees for the lost opportunity to work overtime;
- Annual leave loading provisions in awards have typically been differentiated from the provisions which set out the payment to be made for the period of annual leave;
- Award provisions which set out the payment to be made for the period of annual leave typically include only payments for ordinary hours, and not overtime.

Accordingly, the annual leave loading provisions in current awards are demonstrably referable to the lost opportunity to work overtime. It follows that annual leave loading paid to award covered employees is not ordinary time earnings for the purposes of the Superannuation Guarantee Administration Act.



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We are happy to endeavour to provide any further information that you may require about the above matters.

Yours sincerely

Stephen Smith
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