CFMEU
CONSTRUCTION
AND GENERAL

Race to the Bottom

Sham Contracting in Australia's Construction Industry

A report by CFMEU Construction & General March 2011

TABLE OF CONTENTS

THE PROBLEM OF SHAM CONTRACTING IN THE AUSTRALIAN CONSTRUCTION INDUSTRY

Executive Summary

What is 'Sham Contracting'?

Sham contracting is a device that attempts to disguise an employment relationship as one of client and independent contractor. Successive inquiries and official figures show that sham contracting is a widespread problem across the Australian economy. This material also shows that the problem of sham contracting is largely concentrated in the construction industry.

Sham contracting seriously undermines employment standards and subverts the *Fair Work Act* 2009. It allows employers to avoid costs associated with standard forms of employment such as annual leave, sick leave and redundancy payments. Statutory obligations such as payroll tax, workers compensation insurance and superannuation payments are systematically ignored under these arrangements. The enforcement of statutory rights such as unfair dismissal is also made more difficult. Sham contracting shifts responsibility and cost to employees. It gives lawbreakers a competitive advantage over legitimate employers and those making use of bona fide contracting arrangements.

The Problem of Sham Contracting

According to 2009 figures, although it accounts for only 9% of total Australian employment, the construction industry accounts for 33% of all persons working as independent contractors in Australia. Thirty six percent of all persons working in the construction industry in Australia in 2009 (or 336,000 people) were working as

independent contractors. In the twelve month period 2008-09 this figure grew by 7.6%, compared with a 4.9% decline in overall employment in the industry. The proportion of the construction industry working as independent contractors was five times the rate in all other industries.

Whilst legitimate contracting arrangements occur throughout the construction industry, the CFMEU has uncovered widespread sham contracting through its extensive daily interface with the industry. On the basis of official figures it can be estimated that **the number of sham contracting arrangements in the construction industry as at November 2010, is between 92,000 and 168,000**. This represents between 26-46% of all independent contractors in the industry. These are conservative estimates. **Anecdotal evidence and industry experience suggests the real figure is much higher.**

Construction industry work is by its nature high-risk work. A serious injury can leave a person with a drastically reduced income for the rest of their lives. Sham contracting attempts to shift responsibility for workers compensation to workers themselves, leaving many with inadequate workers compensation coverage.

Sham contracting also undermines site safety as commercial pressure and lack of training impacts negatively on safe work practices.

Avoidance of superannuation associated with sham contracting reduces workers' retirement incomes and will result in a heavier reliance on taxpayer-funded pensions as workers with inadequate retirement income leave the workforce.

Sham contracting exposes workers to greater risks when employers become insolvent or use phoenix companies. As 'contractors', workers stand in line as unsecured creditors, rather than having limited priority as a wage earner for an insolvent business.

Sham contracting represents a failure to invest in the employment relation. It undermines the system of apprenticeships and discourages the development of a trained workforce. At a time when many major construction projects are already employing far fewer apprentices, sham contracting is inflicting a heavy cost on Australia's future by creating a lack of skilled tradespeople. Employers are resorting to using a temporary migrant workforce which is even more exposed to employment scams like sham contracting.

Sham Contracting – The Tax Rip-Off

Sham contracting is not just an industrial relations issue. Sham contracting and the tax treatment of revenue derived through sham arrangements have broad public policy implications. Billions of dollars of revenue have been lost in the construction industry alone because of the failure to implement effective tax laws to deal with the issue. Sham contracting results in PAYG taxpayers shouldering a disproportionate share of the overall taxation burden. The flow-on consequence of the failure to grapple with the taxation aspects of sham contracting has been the serious tax inequities for PAYE/PAYG taxpayers over many decades.

The CFMEU estimates that income **tax revenue leakage attributable to sham contracting in the construction industry may be in the order of $2.475 billion per annum**. That figure does not include revenue lost through income which is not declared at all or non-payment of payroll tax or superannuation contributions.

The ABN system has been abused and made the problem of sham contracting in the construction industry even worse. There are 336,000 independent contractors in the construction industry and 890,000 ABNs. There is a culture and misconception that possession of an ABN legitimises sham contracting arrangements and takes the ABN holder outside the reach of the PAYG system and the *Fair Work Act*.

What Employers Say about Sham Contracting

Whilst there are many legitimate contractors in the construction industry, employer and business groups including the Masters Builders Association, the Australian Industry Group and the Housing Industry Association continue to deny the existence of sham contracting. Denying or downplaying the problem puts the interests of the law breakers above those who comply with the law. Major builders and contractors stand to benefit from lower labour costs associated with sham contracting and are complicit in the practice either by actively promoting it, or pretending it does not exist. There are also contractors directly involved in the unlawful practice of sham contracting who take unfair competitive advantage of pricing jobs without having to factor costs such as payroll tax, superannuation or workers compensation premiums. Employer groups must accept there is a problem and work to combat it, in the interests of their membership who operate within the law.

Sham contracting is widespread on Commonwealth and State funded construction projects. It is unacceptable that builders who profit from taxpayer funded projects are complicit in permitting or even encouraging sham contracting on these projects.

Role of the ABCC

The ABCC has contributed to the growth of sham contracting. Since its inception in 2005, the ABCC has deliberately turned a blind eye to the issue of sham contracting. It has allowed the practice to continue unchecked for over 5 years and even prosecuted on behalf of employers engaging in sham contracting. As recently as 2009 the ABCC concluded that sham contracting was not a problem in the construction industry. The building industry laws have been used to restrict the ability of unions to represent workers and to stamp out illegal practices like sham contracting. After years of prosecuting workers and unions, the ABCC's sudden interest in the issue of sham contracting is a cynical attempt to reinvent itself as an 'impartial' regulator. The ABCC 'inquiry' into sham contracting is a sham in itself.

CFMEU Plan to Stamp out Sham Contracting

Current laws are inadequate for dealing with sham contracting. Unless changes are made, the incidence of sham contracting will continue to increase. Necessary changes include:-

(a) Changes to the *Fair Work Act* 2009 to:

(i) make employers liable for setting up sham contracting arrangements. (current laws only deal with what employers say at the time sham contracts are established and allow employers to argue that they did not know what they were saying was illegal).

(ii) tighten other laws dealing with sham contracting, including those covering misrepresentations, inducements, and dismissal and re-engagement, associated with sham arrangements.

(b) Changes to the *Income Tax Assessment Act* 1997 to ensure that the tax treatment of income that is derived from personal services is not distorted by the use of artificial business structures and sham contracting arrangements. Tax laws must be based on the simple principle that if two workers are doing the same job under the same conditions, they should be paying the same tax.

Where to Now?

The CFMEU will campaign with members and the community for legislative reform by exposing the practice of sham contracting. As the nation's largest construction union with a presence on construction sites across Australia, the CFMEU has a network of hundreds of organisers and thousands of delegates.

CFMEU Sham Contracting Offensive:

- Conduct site audits of construction sites to expose sham-contracting arrangements.
- Stand up for workers who are pushed into sham contracting arrangements, and fight for their entitlements.
- Insist that builders and developers weed out sham contractors at the tender stage and ban sham contracting from their jobs.
- Call on financiers to prove their corporate responsibility and not back projects with sham contracting.
- Demand that the Commonwealth use its power as a client to ensure that Commonwealth funded projects do not involve the use of sham contractors.

1. INTRODUCTION

1.1 What is sham contracting?

Sham contracting is a shorthand description for a variety of arrangements designed to give the appearance of a commercial contract for services between two parties when in substance and at law, the true nature of the relationship is one of employer and employee. Generally this will involve payment at some 'agreed rate' without regard to any applicable industrial award or agreement. For taxation purposes, the payments made are treated as though they were paid as part of an 'arm's length' commercial transaction between independent parties.

In some cases the parties to these arrangements may take extra steps to give the appearance that an independent contractor relationship exists. This might include a written contract setting out the terms of the agreement, 'invoicing' and, particularly in the construction industry, insistence that the worker provides an Australian Business Number (ABN). Increasingly, sham contracting is also carried out through the vehicle of an interposed entity in the form of a company, partnership or even a trust, in order to put some artificial distance between the individual providing the service and the service acquirer.

A Typical Sham Contractor

Joe is a builder's labourer. He works six days a week for a medium sized building company and has worked for that one company exclusively for the last eighteen months. He is told when to start and finish and is directed from job to job by the company. He does not supply tools, equipment or materials. He supplies his labour only. His work is overseen by a company foreman. He wears company supplied personal protective equipment and clothing with the company logo on it. Joe was told when he started he

needed to supply an ABN to get the job. He supplied an ABN to the company and has been paid weekly at the rate of $35 per hour worked, 'all-inclusive'. No tax is withheld from Joe's pay.

'All-in' Payments, Tax and Award Avoidance

The problem of sham contracting in the construction industry is widely known and well documented. The industry has had an ongoing problem with employers paying 'all-in' hourly rates going back over many decades. Under this system the employer simply ignores the various entitlements arising under industrial awards and agreements and pays a loaded all-inclusive or 'all-up' hourly rate in lieu of wages and other benefits such as annual leave, public holidays, sick leave, penalty rates and so on. Employers often seek to rely on the use of 'all-in' payments as self-serving evidence of the existence of a bona fide contract for services.

Whilst the most typical arrangement is for the 'contractor' to be paid a fixed hourly rate which is to incorporate all conditions of employment, there are variations on the theme which can include the payment of some conditions of employment such as superannuation or workers compensation, as well as the hourly rate. In other instances the employer may have some of his/her workforce on all-in payments and others as employees receiving wages, conditions and statutory benefits.

For some time the industry has also been notorious as forming a significant part of the cash economy. In 1983 the prescribed payments taxation system (PPS) was introduced in an effort to recoup large tax revenue losses that were occurring through undeclared payments for work in the construction industry and a number of other industries.[1] The PPS was a form of withholding tax requiring tax instalments to be withheld from intra-

[1] For background, see the 1975 Report of the Taxation Review (Asprey) Committee.

industry payments under contracts which involved the performance of particular types of work.

Whilst intended to be available to bona fide independent contractors, PPS was widely abused. Workers were often required to use the PPS as a condition of obtaining work while in all other respects the working arrangements were indistinguishable from that of an employee. In *Jackson v Monadelphous Engineering Associates Pty Ltd*[2] the Industrial Relations Court noted:

> *Indeed it can, in my opinion, be fairly said that the process of tender and the adoption of the terms of the agreement declaring the character of the relationship were insisted upon by Monadelphous in circumstances where neither Jackson nor Wilson had any effective choice.... Wilson moved from the PAYE system to the PPS system in circumstances where there was no change in the work he did. All that appears to have happened in that he signed a document declaring that he was an independent contractor.*

The PPS tax system was a failure and in many ways was largely responsible for an exodus of workers leaving the PAYE system and joining the superficially more attractive PPS which imposed a lower initial withholding rate of between 10% and 25%.[3] By the time of its replacement in 2002, the PPS had become a by-word for 'all-in' sham subcontracting arrangements.

The combination of 'all-in' rates of pay and the PPS taxation regime fuelled the growth of sham contracting. As well as avoiding award regulation and the payment of lawful employment entitlements, the 'contracting' facade provided by the use of the PPS allowed employers to disregard workers compensation insurance, payroll tax, industrial legislation and other administrative incidents of the employment relationship.

---

[2] [1997] IRCA 281 (17 October 1997)

[3] Some PPS payers obtained a 0% withholding rate from the ATO.

The taxation implications of this phenomenon were considered as part of the 1999 Ralph Review which recommended a series of changes to the taxation system to restore the integrity of the system which was being undermined by the flight from the PAYE system, the growth of illegitimate subcontracting arrangements and use of interposed entities. However the changes that were ultimately introduced (the APSI legislation discussed below) fell far short of what had been recommended by the Ralph Review and have proved spectacularly unsuccessful in restoring equity and integrity into the system.[4] In addition to the taxation laws themselves, the abuse of the ABN system, also described below, shares many similarities with the use of PPS in the preceding period.

[4] See below pp. 67ff.

2. SHAM CONTRACTING - THE SCALE OF THE PROBLEM

2.1 The Number of Contractors

In November 2009, there were 1.029 million 'Independent Contractors'[5] working in all industries in Australia in their main job. This figure represented 9.6% of all 'employed persons.'[6]

Of the 1.029 million independent contractors in November 2009, ABS data shows that:

- 80% (827,300 persons) had *no employees*, i.e. many were offering only their own labour to the entity engaging them as 'contractors'.
- 53% had *only one active contract* in the reference week (for the ABS survey).
- 32% were *not able to subcontract their own work.*
- 43% *did not have authority over their own working procedures*.
- 95,700 or nearly one in ten (9%) were *classified as labourers* – an occupation ineligible for ABNs since March 2009 on the basis that persons in this occupation '*by their very nature…are considered employees'* for Commonwealth taxation purposes.[7]

In the 2008 ABS survey, a further 134,000 persons were also working as 'Independent Contractors' in their second job (not their main job, i.e. the job where most hours were

---

[5] ABS *Forms of Employment Survey* (FOES), Cat 6359.0, November 2009. The ABS definition of 'Independent contractors' is 'people who operate their own business and who contract to perform services for others without having the legal status of an employee, i.e. people who are engaged by a client, rather than an employer. Independent contractors are engaged under a contract for services (a commercial contract), whereas employees are engaged under a contract of service (an employment contract). Independent contractors' employment may take a variety of forms, for example, they may have a direct relationship with a client or work through an intermediary. Independent contractors may have employees, however they spend most of their time directly engaged with clients or on client tasks, rather than managing their staff.'

[6] The ABS definition of 'employed persons' includes all persons working in any capacity, ie employees, independent contractors and other business operators.

[7] ATO website. See Section 6.7.3 below, *ABN eligibility.*

worked). Data on second jobs was not collected in the November 2009 ABS survey. But if the ratio of persons working as independent contractors in the main and second jobs remained the same in 2009 as in 2008, then there would be a further 143,000 persons working as independent contractors in their second job in 2009.

On this basis, the total number of persons working as independent contractors in November 2009 would be 1.172 million.

2.2 The Growth of Contracting

Between November 2008 and 2009, the number of persons working as independent contractors in all industries Australia-wide increased by 61,900 or 6.4%. This was much stronger than the growth in total employment (only 0.1% or just under 14,000) and also the number of persons working as employees, which grew by only 0.5% or 41,300, as shown in Table 1.

Table 1 Employed persons by form of employment, all industries, Australia: November 2008 and 2009

Form of employment	2008	2009	Change	
	000	000	000	%
Employees	8,619.6	8,660.9	41.3	0.5
Independent contractors	967.1	1,029.0	61.9	6.4
Other business operators	1,064.4	975.0	-89.4	-8.4
Total	10,651.1	10,664.9	13.8	0.1

Source: ABS FOES, Cat. 6359.0, published data.

Table 1 also shows that the growth in independent contractors coincided with a marked decline of 89,400 in the number reported as working as 'Other business operators'.

The ABS definition of this group of 'Other business operators' (who may or may not have employees) distinguishes these from independent contractors 'in that they generally generate their income from managing their staff or from selling goods or services to the public, *rather than providing a labour service directly to a client*' (emphasis added).[8]

[8] ABS FOES, November 2009. The full ABS FOES definition of *Other business operators* is 'People who operate their own business, with or without employees, but who are not operating as independent contractors. Other business operators are distinguished from independent contractors in that they generally generate their income from managing their staff or from selling goods or services to the public, rather than providing a labour service directly to a client. Other business operators spend little time working on client tasks with most of their time spent on managing their employees and/or business'.

2.3 Independent Contracting in the Construction Industry

According to the ABS, the number of persons working as independent contractors in the construction industry is high and rising. The construction industry remains by far the most significant area for 'independent contractors' as measured by ABS surveys. Whilst the ABS figures for independent contractors are cited for the purposes of the following analysis, this should not be taken as acceptance by the CFMEU that all persons counted by the ABS as being within the category of 'independent contractor' would in fact be an independent contractor as a matter of law. The ABS allows survey respondents to report whether they consider themselves to be independent contractors (as defined by the ABS).

In November 2009, there were 335,800 persons working as independent contractors in the construction industry. This was 23,800 more than in November 2008, and represented growth of 7.6% in this group in just 12 months – Table 2. One-third of total growth in independent contractors between November 2008-09 was in construction.

This growth in independent contracting occurred against a background of a 5% *decline* in total numbers working in construction, and a decline of 7% or 38,000 in the number working as employees – Table 2.

Table 2
Employed Persons by Form of Employment, Construction, Australia: November 2008 and 2009

Form of Employment	2008	2009	Change	
	000	000	000	%
Employees	548.4	510.4	-38.0	-6.9
Independent Contractors	312.0	335.8	23.8	7.6
Other Business Operators	128.3	94.3	-34.0	-26.5
Total	988.7	940.5	-48.2	-4.9

	%	%	% points
Employees	55.5	54.3	-1.2
Independent Contractors	31.6	35.7	4.1
Other Business Operators	13.0	10.0	-3.0
Total	100.0	100.0	0.0

Source: ABS FOES, Cat. 6359.0, unpublished data.

According to the ABS figures in November 2009:

- 33% of all persons working as independent contractors in Australia (in all industries) were working in construction (336,000 out of 1,029,000), even though construction accounted for only 9% of total Australian employment.[9] (see Tables 1 and 2)
- 36% of all persons employed in the construction industry in Australia were working as independent contractors as defined by the ABS (336,000 out of 941,000 persons). This was up from 32% in 2008, while the employee share declined. (Table 2)
- The proportion of the construction industry working as independent contractors was more than five times the rate in all other industries (36% vs 7%).[10]

Independent contractors in the construction industry are concentrated in three occupational groups which accounted for around 90% of Independent contractors in November 2009: Technicians and trades workers (62% of all Independent contractors), Labourers (15%) and Managers (13%)[11] – Tables 3 and 4. In raw numbers, there were 7,500 more labourers who were independent contractors in the industry than managers.

[9] ABS *Forms of Employment Survey* (FOES), November 2009, Cat 6359.0.

[10] ABS FOES data, published.

[11] The Managers category is puzzling, because the ABS definition of Independent contractors says they 'may have employees, however they spend most of their time directly engaged with clients or on client tasks, rather than managing their staff'.

Table 3

Independent Contractors in Construction Industry by Occupation, November 2008 and 2009

Occupation/ANZSCO	2008	2009	Change	
	000	000	000	%
1 Managers	38.2	41.5	3.3	8.6
2 Professionals	3.7	4.5	0.8	21.6
3 Technicians and Trade Workers	187.0	208.6	21.6	11.6
4 Community and Personal Service Workers	0.6	0.5	-0.1	-16.7
5 Clerical and Administrative Workers	12.1	13.2	1.1	9.1
6 Sales Workers	1.0	1.3	0.3	30.0
7 Machinery Operators and Drivers	17.9	17.2	-0.7	-3.9
8 Labourers	51.6	49.0	-2.6	-5.0
Total	**312.0**	**335.8**	**23.8**	**7.6**
Total employed persons, construction	988.7	940.5	-48.2	-4.9
Independent contractors as % of Total	**31.6**	**35.7**		

Source: ABS FOES, unpublished data.

Table 4

Independent Contractors in Construction Industry by Occupation, (% Share), November 2009

Occupation/ANZSCO	2008 %	2009 %	Change % Points
3 Technicians and Trade Workers	59.9	62.1	2.2
8 Labourers	16.5	14.6	-1.9
1 Managers	12.2	12.6	0.4
7 Machinery Operators and Drivers	5.7	5.1	-0.6
5 Clerical and Administrative Workers	3.9	3.9	0.0
All Others	1.7	1.7	0.0
Total	**100**	**100**	**0.0**

Source: ABS FOES, unpublished data.

Between November 2008 and 2009, in the Australian construction industry:

- The proportion of Technicians and trades workers working as Independent contractors increased from 36% to 43%.
- Even among Labourers, whose absolute numbers declined, the proportion working as Independent contractors increased slightly, to 34% - more than one-third of all construction labourers.

Table 5

Independent Contractors Share of All Employed Persons by Occupations, Construction Industry, Australia: November 2008 and 2009

Occupation/ANZSCO	2008 %	2009 %	Change % Points
3 Technicians and Trade Workers	36.3	43.4	6.9
8 Labourers	30.8	33.8	3.0
1 Managers	40.9	38.0	-2.9
7 Machinery Operators and Drivers	24.9	24.8	-0.1
5 Clerical and Administrative Workers	12.6	14.5	1.9
All Occupations Total	31.6	35.7	4.1
Total no ('000)	**312.0**	**335.8**	**23.8**

Source: ABS FOES, unpublished data.

Table 6 shows changes in the number of independent contractors in selected trade and sub-trades occupations in construction. These cover 260,000 independent contractors, or nearly 80% of all independent contractors in construction and 96% of those in the occupation groups ANZSCO 3, 7 and 8 (Technicians and trades workers, Machinery and operator drivers, and Labourers).

Growth has been particularly strong among Bricklayers, and carpenters and joiners; and Floor finishers and painting trades workers (ANZSCO 331 and 332 respectively) – 22% and 19% growth respectively. In these two groups, the independent contractor workforce grew by 16,800 additional workers in the 12 months to November 2009.

Table 6

Independent Contractors in Construction Industry – Selected Occupations: November 2008 and 2009

Occupation/ANZSCO	2008	2009	Change	
	000	000	000	%
331 Bricklayers, Carpenters and Joiners	49.1	60.0	10.9	22.2
332 Floor Finishers and Painting Trades Workers	30.9	36.8	5.9	19.1
333 Glaziers, Plasterers and Tilers	36.3	37.2	0.9	2.5
334 Plumbers	28.8	27.0	-1.8	-6.3
341 Electricians	21.0	20.2	-0.8	-3.8
342 Electronics and Telecommunications Trades Workers*	2.5	7.5	5.0	200.0
362 Horticultural Trades Workers*	5.9	10.7	4.8	81.4
Subtotal	*174.5*	*199.4*	*24.9*	*14.3*
711, 712, 721 Machine Operators, Stationery and Mobile Plant Operators	15.4	14.8	-0.6	-3.9
8 Labourers	51.6	49.	-2.6	-5.0
Total, Selected Occupations	**241.5**	**263.2**	**21.7**	**9.0**

Source: ABS FOES, unpublished data.

*Estimate has high standard error.

Construction's share of independent contractors by occupation

Construction industry workers dominate the ranks of independent contractors in almost every occupational group, across all Australian industries - Table 7. In November 2009, in all but three occupational groups, independent contractors in construction represented a disproportionately high percentage of all independent contractors in all industries working in that occupational area.[12] Construction workers comprise 68% of all Technician and trades workers operating as independent contractors in all industries, 40% of all Labourers, and 29% of all 'Managers'.

Table 7

Construction Industry Share of All Independent Contractors, by Occupation: November 2009

Occupation/ANZSCO	Construction	All Industries	Construction Share
	000	000	%
1 Managers	41.5	145.4	28.5
2 Professionals	4.5	224.4	2.0
3 Technicians and Trades Workers	208.6	305.3	68.3
4 Community and Personal Service Workers	0.5	41.2	1.2
5 Clerical and Administrative Workers	13.2	76.8	17.2
6 Sales Workers	1.3	35.7	3.6
7 Machinery Operators and Drivers	17.2	75.8	22.7
8 Labourers	49.0	124.2	39.5
Total	**335.8**	**1,029.0**	**32.3**

Source: ABS Forms of Employment Survey (FOES), unpublished data.

[12] These are Professionals, Community and service workers, and Sales workers, where construction's share is less than its 9% share of total Australian employment.

Labourers

ABS FOES published data (not shown) indicates that between November 2008 and 2009, the number of persons working as independent contractors grew in nearly all occupational groupings. Of the 8 major occupational groups, 6 recorded growth in independent contractor numbers ranging from 30% growth for Technicians and trades workers to 5% growth among Sales workers (ANZSCO 3 and 6 respectively).

Most remarkably, the number of Labourers working as independent contractors in all industries grew from 115,000 to 124,200 in the 12 months to November 2009, an increase of 9,200 or 8% -see Table 8, below. This was even more than the growth in independent contracting in the economy as whole (6%). Whilst there was a small decline in construction labourers working as independent contractors (2,600) this was more than offset by the very large growth (19% or 11,800 persons) in labouring contractors in 'All other industries'.

Table 8

Labourers working as Independent Contractors, November 2008 and 2009

Industry	**2008**	**2009**	**Change**	
	000	**000**	**000**	**%**
Construction	51.6	49.0	-2.6	-5.0
All Others	63.4	75.2	11.8	18.6
Total	**115.0**	**124.2**	**9.2**	**8.0**
		% Share		**Change**
	2008	**2009**		**% Points**
Construction	44.9	39.5		-5.4
All Others	55.1	60.5		5.4
Total	**100.0**	**100.0**		**0.0**

Source: ABS (FOES), Cat. 6359.0, unpublished data.

Between November 2008-09, the total number of labourers working in all industries (in all capacities) fell by 30,000 or 3%. But the decline was much greater in construction than 'All Other industries' (13% vs 1%).[13] In relation to Labourers working as independent contractors, the ABS FOES data show that in the 12 months to November 2009, the numbers in construction fell slightly while those in 'All other industries' grew - Table 2.

The different trends in construction and other industries do not seem plausible, given that construction activity was sustained by the Federal Government's economic stimulus packages post-GFC, while labouring employment elsewhere was not. One possible explanation is that some of the growth recorded in labourers working as independent contractors involved workers in labour hire firms. The ABS classifies labour hire firms to the industry code ANZSIC 7862 'Contract staff services', regardless of the industry classification of the 'host employer' where the labour hire workers are finally engaged. It is possible therefore that while ABS data show an apparent decline in Labourers working as Independent contractors in the construction industry, more labourers could be working on construction sites as independent contractors but statistically recorded as being engaged by labour hire companies.

As noted above, from March 2009 – nearly nine months before the ABS November 2009 survey - the ATO said it was no longer issuing ABNs to Labourers on the basis that they were considered employees for taxation purposes. The ABS survey finding therefore raises serious questions about the effectiveness of the ATO's policy and procedures to screen out new ABN applications from persons working as Labourers since March 2009.

[13] ABS FOES data, unpublished.

2.4 Sham Contracting in the Construction Industry

Legitimate independent contracting arrangements are used extensively throughout the construction industry. There are many business operators who are genuinely in business on their own account. They tender for work in a competitive environment, work on a range of different projects for successive clients in the course of any one year, provide equipment and materials, control when the work is done and how it is done and bear a commercial risk in their business undertaking.

Whilst it is accepted that many bona fide contractors operate in the industry, it is nonetheless also evident from a range of official material and from the Union's extensive contact with the industry that there are significant numbers of people in the industry who present as independent contractors but who are in truth part of disguised employment or sham contracting arrangements.

Determining the exact number of sham contracts in an industry presents some inherent difficulties. Because the arrangement is designed to *disguise* an employment contract, the true nature of the relationship is not always immediately apparent. There are also contractual arrangements that fall well within the grey area between employment and a bona fide contract for services. It is however possible to arrive at reasonably accurate estimations based on available material.

In a 2006 Research Paper,[14] the Productivity Commission suggested that the categories that most accorded with ATO estimates of 'employee-like contractors' were self-employed contractors who:

(a) do not have control over their own working procedures ***and*** the terms of whose contract prevent them from subcontracting their work; ***or***

[14] Productivity Commission, *The Role of Non-Traditional Work in the Australian Labour Market,* Commission Research Paper, 2006, p138. This Paper was prepared before the ABS FOES survey was developed.

(b) do not have control over their own working procedures ***and*** whose contract prevents them from working for multiple clients.

The Productivity Commission considered that these categories were based on tests that would be applied by Australian courts and tribunals to determine 'employee-like contractors'.

The detailed unpublished ABS data needed to estimate the precise numbers in these categories in the construction industry was not available for this paper. In any case, categories suggested by the Productivity Commission are almost certainly overly restrictive and would exclude categories of persons whom courts and tribunals would find to be employees.

It is however possible to arrive at estimates based on available ABS categories.

At the lower end of the range of sham contractors in the construction industry is the number of persons classified as Labourers who reported that they worked as independent contractors (49,000) **plus** the estimated number in other occupations who reported *they had no say over their hours of work* (13% in 2008 in construction), an estimated 37,000 in 2009. This is a standard indicator of an employee-like arrangement. In this case, the total figure would be 86,000**.**

This is a very conservative figure. As noted above, since March 2009 the ATO has ruled that persons working as Labourers '*by their very nature…are considered employees'* for Commonwealth taxation purposes and cannot be granted ABNs after that date. By the same reasoning, it follows that Labourers granted ABNs *before* March 2009 should also be considered by the ATO as employees for taxation purposes and should therefore not be classified as independent contractors.

Since the ABS categories are not mutually exclusive, it should also be borne in mind when dealing with those categories that record the lower percentages such as 'no say

over hours of work', that it is likely that there would be a significant number of persons who were in fact employees from the other categories who should also be included.

The upper end of the range is more problematic. Table 9 shows the estimated number of contractors potentially in employee-like arrangements in the industry, based on a range of employee-like characteristics reported in the ABS FOES.

A figure of 154,000 is based on the proportion of independent contractors in construction reporting they *did not have authority over their own work (37% in 2008).* This figure comprises the 49,000 Labourers **plus** an estimated 105,000 persons working as Independent contractors in other (non-labouring) occupations, and *who reported they did not have authority over their own work.*

A more conservative estimate would be 110,000, comprising the 49,000 Labourers plus an estimated 61,000 persons working as independent contractors in other (non-labouring) occupations, and *who reported they were not able to subcontract their own work*. This group was 21% of all independent contractors in construction in November 2008 – Table 9.

The category used in the conservative estimate above (i.e., the proportion of independent contractors in construction who reported they were not able to subcontract their own work) is a reasonable proxy for the Productivity Commission categories.

The 154,000 figure is both reasonable and conservative. Independent contractors who themselves reported that they 'did not have authority over their own work' have *prima facie* established that they are likely to be operating in an employee-like manner.

This estimate is conservative because upper end estimates higher than 154,000 can be justified. For example, it is likely that the proportion reporting they *did not have authority over their own work (37% in 2008)* understates the true situation. ABS FOES

survey data is based on responses from persons who considered themselves to be independent contractors. This self-identified group is likely to have a propensity to overstate the extent to which they are in control of their own work. This perception has been described as 'the illusion of autonomy' among sectors of the self-employed.[15]

An estimate of up to 177,000 is also justifiable. For example, Table 9 shows that if only 60% of independent contractors '*with no employees*' were themselves effectively working as employees (60% of 214,000) and that figure were combined with the 49,000 labourers, then this would amount to approximately 177,000 workers in sham contracting arrangements on November 2009 figures.

Table 9

Independent Contractors in Construction, by Selected Employee-Related Characteristics Australia, November 2009

		No
Total Independent Contractors	000	335.8
Labourers	000	49.0
Total EXCLUDING Labourers ('Others')	*000*	*286.8*

Employee-Related Characteristic	**%**	**Others 000**	**Labourers 000**	**Total 000**
% with no employees (a)	74.7	214.2	49.0	263.2
% working on only one active contract (a), (b)	51.0	146.3	49.0	195.3
% NOT have authority over own work (a)	36.5	104.7	49.0	153.7
% NOT usually able to work on more	20.8	59.7	49.0	108.7

[15] Stephen Edgell, *The sociology of work: continuity and change in paid and unpaid work*, (2006), attributes the phrase to Hakim, p130.

than one active contract (c)				
% NOT able to subcontract own work (a)	21.3	61.1	49.0	108.7
% had NO say over hours of work (a)	12.9	37.0	49.0	86.0

Source: CFMEU estimates based on ABC FOES data, published and unpublished.

(a) November 2008 ABS FOES data, unpublished. Refers to all independent contractors in construction industry.

(b) In ABS survey reference week, November 2008.

(c) November 2009.

On the basis of these figures a conservative estimate of the number of persons in sham contracting arrangements in the construction industry in November 2009 would be in the range of 86,000 to 154,000 workers. This is the estimated number working in employee-like arrangements but describing themselves as independent contractors. This represents between 26-46% of all independent contractors in construction, and 9-16% of total persons working in the industry in all capacities.

Growth in Sham Contracting Since November 2009

The estimates in the preceding section are based on November 2009 data, and relate to the situation at that time. The numbers engaged in sham contracting in construction have almost certainly increased significantly since then. This is despite the ATO's statement that since March 2009, Labourers are no longer eligible for new ABNs.

The evidence to support this assessment is in two separate data sources. First, as this section has pointed out above, ABS FOES data shows that independent contracting in construction grew by 7.6% between November 2008-09. Even after the March 2009 ATO ruling intended to refuse new ABNs to Labourers, Labourers working as independent contractors grew by 8% across all industries – Table 8.

Second, ATO data on ABNs issued in construction reveal that between 30 June 2009 and 30 June 2010, the ATO issued an additional 57,000 ABNs to construction entities, representing growth of 7% in just 12 months. Of these, a staggering 80% (46,000 out of 57,000 new ABNs) were issued to *individuals* in construction, rather than to companies or 'other entities'. This represents growth of 9% in the number of ABNs issued to individuals in the 12 months to June 2010, raising the total number of ABNs registered with individuals in construction to nearly 560,000.

These figures imply that independent contracting in construction has grown by between 7-9% in the year to November 2010[16]; and that the numbers working in sham contracting arrangements in this sector will have grown by the same amount.

These estimates imply that between November 2009 and 2010, the sham contracting workforce in construction has grown by 6,000-10,000 persons on the lower estimate, and 8,000-14,000 on the higher growth estimate.

Table 10

Estimates of Independent Contractors Working in Employee-Like Arrangements in Construction, Australia

	Lower End	**Upper End**
	000	**000**
2009, November (a)	86	154
2010, November Assuming –		
6.6% growth (b)	92	164
8.8% growth (c)	94	168
Increase		
6.6% growth (b)	6	10
8.8% growth (c)	8	14

[16] The ABS FOES conducted in November 2010 is due for release in April 2011.

Source: CFMEU estimates, based on ABS and ATO data.

(a) CFMEU estimate – see text.

(b) ABS FOES. Actual growth in Independent contractors in construction, November 2008-09

(c) ATO data. Actual growth in ABNs issued to individuals in construction between 30 June 2009 and 30 June 2010.

On this basis, as Table 10 shows, the estimated number of persons in sham contracting arrangements in the construction industry in November 2010 would be between 92,000 and 168,000 persons (27% - 50% of independent contractors and 10% - 18% of the industry, respectively).

2.5 Temporary Migrants, Undocumented Workers and Sham Contracting

Temporary migrants with a legal right to work in Australia are especially vulnerable to sham contracting arrangements. Even more so are undocumented workers, defined as those with no valid visa entitling them to work in Australia or those working in breach of their visa work conditions. Workers in these groups have greatly reduced bargaining power against employers prepared to offer work only on the basis that the workers enter into sham contracting arrangements. Similarly, these arrangements will be financially more attractive to some temporary migrants and undocumented workers because they can avoid paying tax on their employment earnings.

Temporary Migrant Workers

There were around one million persons in Australia in June 2009 who held temporary visas with the legal right to work in Australia, including New Zealand citizens.[17] This represents 8.7% of the total Australian work force of just under 11.5 million people at the time. If this group had the same workforce profile as the Australian workforce generally, then there would be:

- Around 620,000 working[18], of whom around 9% would be working in the construction industry, or 56,000 persons.
- Of these 56,000 persons, some 36% would be working as Independent contractors in construction (around 20,000 persons).
- Of these 20,000 Independent contractors, between 26%-46% would be working in sham contracting arrangements, i.e. between **5,200** and **9,200** persons.

This estimate can be compared with ABS FOES data showing that in 2008, 28% of Independent contractors in construction were born overseas (77,100 workers in 2008); and of these, 10,600 (14%) had arrived between 2001-08,[19] superficially the closest proxy for 'temporary migrants'.

But many of the 525,000 temporary visa holders (excluding New Zealanders) working in Australia in November 2010[20] will not necessarily show up in ABS labour force survey data. This is because ABS surveys exclude short-term visitors (intending to stay

---

[17] DIAC data, from presentation on *2010-11 Migration Program Consultations* by Kruno Kukoc, First Assistant Secretary, Migration Strategies, DIAC, December 2009 . New Zealand citizens have unrestricted work rights in Australia and different temporary residence visas have differing work rights, ranging from unrestricted (eg, Graduate Skills 485 visas and spouses/partners of 457 primary visa holders) to overseas students (restricted to 20 hours/week work during term, unrestricted outside study term).

[18] Assuming same labour force participation rate (65%) and employment rate (95%) as the Australian population and workforce in June 2009 (ABS Labour Force Survey data). But actual labour participation rates are likely to be higher for many groups; and the proportion working in construction is higher in some groups, e.g. New Zealanders.

[19] ABS Cat.3416.0*, Perspectives on Migrants*, 2010.

[20] CFMEU estimate, based on DIAC figure of total stock of 763,000 temporary visa holders in Australia in November 2010, in specific visa categories (457 visas, Working holiday visas, overseas students and overseas student graduates)

less than 12 months), which covers for example many of the 100,000 in Australia on Working Holiday visas at any one time.

Undocumented workers

DIAC estimates that as at June 2009, there were 'between 30 000 to 76 000 non-citizens' who 'may be working illegally', not including overseas students working beyond their maximum permitted weekly hours:

> *This estimate includes both unlawful non-citizens and lawful non-citizens who work contrary to the conditions of their visa but does not include lawful non-citizens working in excess of their allowable hours.'* [21]

DIAC also reports that construction is one of the three main industries where the bulk of undocumented workers have historically been identified.[22] In the first nine months of 2009-10, 16% of all undocumented workers recorded by DIAC were working in construction.[23]

If 16% of the DIAC estimate of 'undocumented workers' was working in construction in June 2009, this would mean between **4,800 to 12,200** undocumented workers in the Australian construction industry. If the profile of these matched the Australian construction workforce generally:

- Between 1,700 to 4,400 would be working as Independent contractors and **up to 2,000** in sham contracting arrangements,.

---

[21] DIAC, Discussion Paper, *Review of Employer Sanctions*, op cit., p5.

[22] DIAC*, Discussion Paper - Review of Employer Sanctions Legislation – Combating Illegal Work in Australia*, June 2010, p4. The other two sectors are Agriculture, forestry and fishing; and Accommodation and food services.

[23] DIAC, *Immigration compliance – at a glance (2009-10 as at 31 March 2010)*, May 2010.

This almost certainly understates the numbers of undocumented workers in the construction industry engaged under sham contracting arrangements, for the following reasons:

- The DIAC estimate of the undocumented workforce *excludes* overseas students working in breach of their allowable hours. But this group is very large[24] and frequently identified on construction sites as working on ABNs under sham contracting arrangements. For example, see Box re Gold Coast case study 2010 p34.
- A higher proportion of undocumented workers working in the construction industry is likely to be in sham contracting arrangements than in the general construction workforce (36%). The employers they are working for are already breaking the law (by employing undocumented workers)[25], and are more likely to insist on these sham arrangements, to evade their tax and wages liabilities and maximize their commercial benefit.
- The DIAC estimate of the numbers working illegally in the specific categories may understate the true numbers. As the CFMEU has pointed out, the method by which these estimates were derived has not been disclosed and therefore cannot be properly assessed.[26]
- There has recently been high growth in one category making up undocumented workers, namely visa 'overstayers', defined as persons who entered Australia on a valid visa but stayed on after their visa expired.
    - At 30 June 2010, there were 53,900 visa overstayers in Australia, an increase of 11% or 5,200 in 12 months; and DIAC has predicted that these numbers will continue to increase.[27]

Policy responses

The Immigration Minister can declare certain occupations to be 'exempt occupations' and allow 457 visa-holders in these occupations to work as independent contractors, and not as employees. This declaration simply requires a legislative instrument signed by the Minister.

---

[24] There were over 400,000 overseas students in Australia at 30 September 2010.

[25] The *Migration Amendment (Employer Sanctions) Act 2007* covers undocumented workers engaged as either employees or contractors.

[26] CFMEU *Submission to Review of Employer Sanctions legislation*, July 2010, p15.

[27] DIAC Annual Report2009-10, Program 4.1 Visa compliance and status resolution.

In November 2010, the ACTU requested a written assurance from the Immigration Minister that no trade or nursing occupation will be declared an 'exempt occupation', and that the Minister will consult the unions on any proposal to declare any occupation an exempt occupation. At the time of preparing this Paper, the Immigration Minister had not given such an assurance. But this is clearly needed.

Secondly, current immigration policy and Regulations allow certain temporary visa-holders to claim work done in Australia as an 'Independent contractor' as 'Australian experience' that counts towards various permanent residence (PR) visas, including employer-sponsored visas. For example, a subclass 485 or 417 (WHM) visa-holder can claim work undertaken as an independent contractor in Australia in their PR visa applications.

This policy needs to be reviewed for industries such as construction with a high-risk of sham contracting, and only work undertaken as an employee by temporary visa-holders should be considered for the purpose of PR visa consideration.

Visa Types Held by Construction Workers on One Site Involving Sham Contracting, 2011			
Visa Subclass	**Visa Title**	**Work Entitlement**	**No**
Permanent Residence (PR) Visas			
801	Spouse/Partner Permanent Visa	Unlimited	1
856	Employer Nomination Schme (ENS)	Unlimited	1
857	Regional Sponsored Migration Scheme	Unlimited, but must stay with sponsoring employer for 2 years	3
Temporary Residence Visas			
457	Business Long-Stay	4 years, with sponsor/employer	0
417	Working Holiday	12 months, 6 months max with one employer	2
485	Graduate Skills Visa	Unlimited, up to 18 months	2
487	Skilled – Regional Sponsored (Provisional)	Unlimited, for 3 years – but work only in specified regional area	1
572	Overseas Student, Vocational Education and Training (VET) Sector OR Partner of 572 Visa Hodler	20 hours week in term, unrestricted outside study term	5
Total			**15**

Source: DIAC Visa entitlement Verification Online (VEVO), accessed by CFMEU with workers' permission.

2.6 Effect on Skills and Training

It is common knowledge that the building and construction industry is facing the possibility of severe skill shortages over the coming years. These shortages will be a result of a number of factors including the increased workload in the industry, the aging of the workforce with significant numbers retiring and an apparent decline in the industry training rate. Recent reports claim to show an existing skills shortage of 11,000 construction tradespersons.[28] While the size of the current shortfall is debatable, shortages are expected to increase significantly over the coming years as major infrastructure projects commence and rebuilding work in flood damaged areas of Queensland is undertaken. Sham contracting is contributing to the industry's skills shortage.

Many legitimate contractors do the right thing by the industry and employ apprentices and trainees. Contractors that use sham contracting arrangements however will not help ease these skill shortages and indeed will only make the problem worse. This is because there are two pre-requisites for an apprenticeship or traineeship, firstly an employment relationship and secondly a contract of training approved by a relevant training authority. As the sham subcontractors are not employees, they cannot be an apprentice or trainee. The use of sham subcontracting therefore reduces the employment opportunities for apprentices and trainees and increases the skills deficit in the industry. Employers will then turn towards alternative sources of skilled workers including resorting to the importation of skilled migrant workers.

The problem was neatly summarised in a recent UK report which identified the same issues arising from sham contracting.

> *False self-employment in the UK construction industry is the most visible and tangible symptom of a much deeper malaise. False self-employment reflects a failure to invest in the employment relation, and especially a failure to build the*

[28] Clarius Skills Index September 2010
http://www.southtech.com.au/getwhitelabelfile.aspx?whitelabelfileid=8924

necessary skills from within the UK, to support and maintain a technologically innovative and modernising industry. The skills gap has been widely evident ever since the decline in employment-based apprenticeships, and underlies much of the demand for migrant labour. Mass false self-employment is shown to directly contribute the low levels of training, leading to the UK having less than half the level of construction skills to be found in Germany, France, The Netherlands or Denmark. There is now ***an annual deficit of over 20,000 apprenticeships and trainees****, with cumulative effects from previous decades. In order to close the historic skills gap, the need has been identified for between three and four times the annual deficit to be trained over the next decade.*[29]

[29] *The Evasion Economy False Self-Employment in the UK Construction Industry* – Harvey and Behling loc cit pg v - vi

3. The ABCC and the Sham Contracting 'Inquiry'

3.1 ABCC's Record of Inactivity

The ABCC makes no secret of its neglect of the sham contracting problem in the construction industry. In its '*Sham Arrangements and the use of Labour Hire in the Building and Construction Industry'* Discussion Paper of December 2010 the ABCC says:

> *Until recently, the ABCC had not pursued FW Act sham contracting matters or underpayments, including those associated with sham arrangements.*[30]

The fact that employer breaches were not pursued was the result of the ABCC's decision to disregard its clear statutory mandate to investigate suspected contraventions of industrial laws and instruments by ***all*** building industry participants[31] and instead concentrate on allegations against workers and trade unions. By administrative agreement between the ABCC and the FWO (and its predecessors), sham contracting allegations and other employee-related matters such as underpayments were to be referred to the FWO to investigate. The ABCC did not investigate, let alone prosecute, even the most obvious sham contracting arrangements.

However, even under this internal arrangement the ABCC turned a blind eye to the issue of sham contracting. This is evident from the fact that by the ABCC's own account and notwithstanding their extensive direct contact with the industry through inspectors and others, they *referred* a total of only five such matters to the FWO in almost five years.[32]

The ABCC were also the subject of criticism by the courts for failing to take action against sham contracting and tax avoidance. In *Lovewell v O'Carroll, the Plumbers and*

---

[30] Discussion Paper Page 55

[31] Section 10(b) BCII Act

[32] Estimates 10 Feb 2010 pg 85

Gasfitters Employees' Union of Australia Qld Branch (PGEU), and the Communications Electrical and Plumbing Union (CEPU)[33] the Federal Court of Australia criticised the ABCC in the strongest possible terms for not just bringing a baseless and unmeritorious action against a union and its official, but for bringing the case of behalf of someone who should have themselves been the subject of an investigation.

> *The commercial arrangements that Underground entered into with its workers is a species of a black economy, which, unfortunately, seems to exist in the building industry, and equally, that it is to be stamped out if at all possible in the payment to workers in such a way as to avoid the obligations of the income tax legislation and the superannuation legislation. It is not to be ignored or a blind eye cast when it is engaged in by employers.*
>
> *The set-up by Underground of its workers as independent subcontractors is and was a matter requiring thorough investigation. The arrangement is very similar to that which prompted the employment advocate, Nigel Clive Hadgkiss, to bring proceedings against the Construction, Forestry, Mining and Energy Union and Ors, QUD 165 of 2004, which after two days of hearing on 12 and 13 September 2005, led to the filing of a notice of discontinuance by the employment advocate on 23 September 2005. That application was an application under section 298T of the Workplace Relations Act 1996, Commonwealth, and involved a similar corporate arrangement where workers of a tiling company on a project in Cairns were styled independent contractors, notwithstanding that they were, in truth, employees. The present arrangement in the present proceedings, on the material presently available to me, strongly suggests that the arrangement of the workers as "independent subcontractors" was a sham, a bogus arrangement. It was an example of dishonest or fraudulent financial engineering by Underground, whose intended purpose was to avoid the payments made under the certified agreement which bound*

[33] See transcript QUD427/2007.

Underground at the time. In addition, the arrangement, which Underground pursued was, in my view, a dishonest attempt to evade payment by the employer to the ATO of the income tax which the employer was obliged under the law of the Commonwealth to pay to the office in respect of the income tax obligations of its employees. It was also an attempt to evade the obligation on the employer to pay into the superannuation funds of the employees the 9 per cent that is mandated by Commonwealth legislation.

3.2 ABCC 'Audit'

Following some media exposure of the sham contracting issue in 2009, the ABCC conducted its first and only 'audit' into the practice in NSW and Queensland during that year. It reported on the outcome of its 'audit' in answers to question on notice from the Senate Standing Committee on Education, Employment And Workplace Relations from October 2009 and at the subsequent hearing of that Committee in February 2010.

According to the answers given in Estimates the ABCC's 'audit' consisted of investigating 39 companies in NSW and 19 in Queensland. The investigations consisted of interviews which ranged from between 20 and 60 minutes. However most of the interviews consisted of discussions only with those businesses that had engaged the so-called contractors, not the 'contractors' themselves. Only 13 so-called 'contractors' were interviewed about the arrangements that were in place. Moreover, each of the businesses that used these 'contractors' were given a full 20 days notice that the ABCC would be investigating the contracting arrangements.[34] Not surprisingly, the ABCC concluded that there was no evidence of sham contracting and gave the industry a clean bill of health at the end of its audit.

[34] DEEWR Question No. EW643_10

Case Study

A major project in South Australia which is funded by Commonwealth and State governments is 'audited' a number of times by the ABCC and no compliance problems are found. The CFMEU is called to the project by its members with concerns about sub-letting of formwork contract to interstate contractors. A sub-contractor absconds overseas with large progress payment leaving workers unpaid. Union investigation shows formwork company not registered in any industry funds (long service, superannuation, and redundancy), workers on ABN all-in payment sham contracting arrangements, cash-in-hand being paid and many workers using false names and apparently working in breach of visa conditions.

On the same project the gyprock contract is sub-let to two subcontractors who engage about 30 gyprock workers on ABNs and an all-in rate of $25 per hour. A union investigation shows that one company was not contributing to or registered in any industry fund and the other had been 'inactive' and no contributions had been paid for some time.

Case Study

A formworker is engaged on a major road construction project on the NSW North Coast being undertaken by one of the largest construction companies in the country. He works on an 'all-in' hourly rate and uses an ABN. He works for a labour-only contractor who in turn is contracted to the formwork subcontractor. In November 2010 he suffers a severe back injury and is unable to return to work. His employer originally claims he was a contractor and that they had no responsibility for workers compensation. The worker is unable to work and remains unpaid for approximately 10 weeks. After union intervention the company agrees that he was in fact an employee and advises the insurance company. Workers compensation payments begin to be paid at the lower award rate rather than the enterprise agreement rate that would ordinarily apply to

employees on such jobs. The worker has not received any superannuation contributions for the duration of his employment.

3.3 ABCC – Enforcer not Policy Maker

The ABCC is a statutory office–holder whose main functions are the enforcement of current industrial laws in the building industry and advising building industry participants as to their rights under existing laws.[35] Where the ABCC is not competent to deal with a matter, its role is to refer that matter to the appropriate government agency or body.[36] Relevantly, however, the *BCII Act* does not provide for the ABCC to initiate or engage in projects of law reform or provide policy advice to the Australian Government.

Further, in announcing the scheme of the Inquiry and Round-table at the *Biennial Australian Labour Law Association Conference* on 19-20 November 2010, the ABC Commissioner outlined a number of steps his office "might" pursue as a result of his proposed inquiry. Apart from investigating suspected contraventions which come to light during these events (that is, in accordance with its otherwise long-flouted obligations under the *BCII Act*), the ABC Commissioner also went on to proclaim that the office "might" be moved to develop a "Code of Conduct and Practice for Labour Hire", to make recommendations as to legislative reform, or to publish details in relation to non-compliance by building industry participants. In all of these instances, the ABCC would be acting beyond any power it has under the *BCII Act*.

In relation to the development of a "Code of Conduct and Practice for Labour Hire", under section 27 of the *BCII Act*, it is for the Minister to issue a 'Building Code' and there is no corresponding provision for the ABCC to develop any such instrument.

---

[35] S 10 BCII Act

[36] S 10(a)(iii)

Further, the CFMEU has deep reservations about the ABC Commissioner's proposal to 'publish' details in relation to non-compliance by building industry participants as a result of the Round-table and Inquiry without affording due process to those participants. The publication of details of non-compliance as determined by a court is one thing, a mere declaration of opinion by a statutory office-holder that a party has engaged in illegality, is another. The ABCC appears intent on usurping not only the executive powers of the Minister, but also the judicial functions of the courts. This is on top of its assuming the mantle of law reform agency.

Not surprisingly, given the ABCC's track record, the CFMEU takes an extremely cynical view of the ABCC's Inquiry and Round-table process. This process is little more than an opportunistic 'power grab' to cut out a niche role for the ABCC and give itself on-going relevance as an industry-specific regulator. In any event, even an enforcement agency that genuinely intended to tackle the problem of sham contracting would face serious obstacles given the current legislative regime.

4. EMPLOYER RESPONSE TO SHAM CONTRACTING

4.1 MBA

Of the eighteen published submissions received by the ABCC[37] for its Inquiry and Roundtable into sham arrangements, seven are from employer organisations lining up to deny the existence of widespread sham arrangements in the industry –notably this includes Master Builders Australia ("MBA").

From the outset of their submission MBA assert:

> *..Master Builders does not believe that there is sufficient objective evidence to label sham contracting as "rife" or a "threat to the economic and social fabric of this country." Evidence is not present to support those who believe sham contracting is institutionalised...*

In making such an assertion, MBA point to the November 2009 'audit'[38] into sham arrangements on building and construction sites as though this was an objective assessment by a committed and impartial regulator. Their submission then goes on to recommend that the union movement's concerns about sham arrangements be "thoroughly discounted" for not participating in the ABCC's Inquiry and Roundtable.

The only conclusion which can be drawn from all this is that employer groups such as the MBA – for all their talk about the rule of law and the importance of an enforcement role for the ABCC – are not serious about compliance in relation to this important issue since it would involve scrutinising the practices of at least some of their members.

The MBA is hopelessly compromised by the conflicting interests of its own membership on the issue of sham contracting. On the one hand there are major builders and

[37] As at 11 March 2011

[38] Op cit page...

contractors who stand to benefit from the lower labour costs associated with sham contracting and are complicit in the practice either by actively promoting it, or pretending that it does not exist. There are also contractors directly involved in the unlawful practice of sham contracting who take the unfair competitive advantage of pricing jobs on the basis of not having to factor in costs such as payroll tax, superannuation or workers compensation premiums.

One the other hand there are many MBA members who are trying to operate legitimate businesses and who have difficulty competing with those flouting industrial, taxation and other laws.

Unfortunately for this latter group of MBA members, a submission such as has been made here, that denies the reality and extent of sham contracting, only puts the interests of the law-breakers above those who are prepared to comply with the law.

Case Study

On a commercial project in Roseberry in Sydney two 2 workers performed labour only gyprock work and used the ABN system. They had not received payment for some time when the union became involved. The union found another 20 workers hired as painters under ABN system. A substantial amount of back pay for unpaid wages and entitlements is recovered by the union.

4.2 Major Contractors

A number of employer submissions to the ABCC maintain that the *Fair Work Act* adequately deals with the issue of sham contracting. Foremost amongst those putting this view is the AIG and the ACA (representing a number of the industry's major contractors).

As will be discussed below, this position is untenable. The fact is the *Fair Work Act* does not prohibit sham contracting but only contains penalty provisions for misrepresentations that are made knowingly or recklessly about the terms of engagement. It is unusual to say the least that a piece of legislation prohibit misrepresentations about an act without making the act itself unlawful. Nonetheless the AIG/ACA position is tantamount to arguing that it would be acceptable for there to be no law against car-jacking provided you did not coax the owner out of the vehicle with a misrepresentation.

CFMEU audits of so-called contracting arrangements on the worksites of many of the major contractors in the industry has uncovered widespread sham contracting on virtually every site where the investigation has been undertaken. Major contractors in the Australian construction industry have been complicit in the practice of sham contracting for many years by either deliberately ignoring it or actively promoting it. They have accepted any benefit that might flow to them through the use of this system without any regard to the wider impact the practice has on workers, legitimate business operators, the public revenue or the industry generally.

Case Study

A plasterboard contractor engages workers using ABNs on a major residential construction project in the ACT with the knowledge and consent of the head contractor, a major national construction company. The union alleges that the contracting arrangements are a sham. A dispute arises after which the contract between the head contractor and the subcontractor is brought to an end. The subcontractor complains to

the ABCC and the matter is referred to the ACCC who bring proceedings in the Federal Court against the union and the head contractor alleging that they had an arrangement to terminate the subcontractor's services in breach of the *Trade Practices Act* 1974. In the course of the trial the subcontractor gives evidence that he had told the head contractor "I'll only do it on a subcontractor basis" and that the head contractor said that there were no problems with that arrangement and the union wouldn't be involved because "It's not a commercial site. It's a residential site." There is also evidence that the 'contractors' had no workers compensation insurance and that a WorkCover ACT officer had concluded that they were in fact employees and that the company should have taken out workers compensation insurance. The case against the union is ultimately dismissed and the ACCC is required to pay substantial costs to the union.

4.3 The ICA

Independent Contractors Australia ("ICA"), the brainchild of activists with connections to the pro-business HR Nicholls Society, presents itself in the media and in submissions to government inquiries as being representative of some 2.03 million 'self-employed persons' it otherwise describes as 'small and micro-business people'. Yet in truth, despite ICA's claim to be a legitimate representative body, there is no evidence to suggest the existence of a rank-and-file membership of any significance and little information as to precisely where it draws its funding from.

The ICA is run by pro-business lobbyists, including Ken Phillips (a regular contributor to the HR Nicholls Society), Bob Day (past president of the Housing Industry Association, former Family First Senate candidate and owner of a large national home building company) and Norman Lacy (former Liberal minister from Victoria).

Current President Mr. Lacy makes the following point in relation to the membership of ICA:

> *ICA is a unique organisation in so far as it seeks to represent the interests of both independent contractors and the businesses that engage them.*[39]

The categories of membership of the ICA includes 'company membership' for those ***companies that engage*** independent contractors and even 'industry membership' for ***industry associations*** whose members engage independent contractors. No doubt balancing the competing commercial interests of these bodies and the smaller independent contractors who ICA also claims to represent, presents its share of challenges.

Typical of the views promoted by the ICA is this piece from Bob Day:

> *Independent contracting has other benefits too which small business owners are rapidly discovering. It avoids the time-consuming practice of contributing to long service and superannuation schemes and, most importantly, the responsibility to deduct tax. Independent contractors send their own tax payments to the ATO via quarterly BAS statements. The advantage of simplicity in these matters cannot be underestimated and anyone who's had to do this paperwork (or pay someone else to do it for them) will understand the substantial benefit it offers.*[40]

As one commentator observed, "It is hardly likely that someone who genuinely represents independent contractors would want them to have such a burden placed on them."[41]

When pressed about the organisation's membership at a federal parliamentary inquiry into independent contracting, Ken Phillips (Executive Director of ICA) could only point

---

[39] http://www.contractworld.com.au/pages/PDFs/ICABrochure2010.pdf

[40] http://www.contractworld.com.au/pages/PDFs/Bridge.pdf

[41] http://solidarity.redrag.net/2006/06/21/independent-contractors-australia/

to a number of subscribers to the organisation's electronic mailing list, which he claimed was "in the hundreds". In more contemporary parlance, that is akin to pointing to one's 'friends' on Facebook or 'followers' on Twitter: it does not give any indication of the makeup of the organisation, or indeed the level of genuine public support it attracts.

On 11 October 2010, ICA president Norman Lacy wrote an op-ed piece in the *Australian Financial Review* to deride recommendations made by the Board of Taxation in 2009 to reform Personal Services Income ("PSI") taxation laws that are aimed at stamping out high levels of tax avoidance as a result of interposed entities and sham arrangements. Lacy then proceeded to follow-up his op-ed with correspondence to the Assistant Treasurer Shorten, demanding he make some kind of official Government declaration that the PSI tax laws would remain unchanged. Government and the public should, however, remain conscious of the provenance of such demands: ICA is an ideologically-driven, unrepresentative political lobby group which consistently downplays the prevalence of sham arrangements – particularly in the building and construction industry.

The ICA should be taken as one of the best examples as 'astro-turfing' seen in the Australian political system for some time and its public views on this issue viewed in that context.

5. FAIR WORK ACT REGULATION OF SHAM CONTRACTING

5.1 Prohibition on Sham Contracting

The *Fair Work Act* provisions relating to sham contracting (and the predecessor provisions under the *Workplace Relations Act* 1996) have proved wholly ineffective in dealing with the issue of sham contracting. Firstly, there is nothing in the current legislation that prohibits sham contracting per se. The existing provisions are confined to circumstances involving misrepresentation, dismissal and inducements relating to sham arrangements. The ABCC Discussion Paper correctly notes:

> *Simply being party to a sham arrangement attracts no consequences for an employer, other than exposure to a limited range of actions for underpayment of wages and other entitlements.*[42]

Whether the sham arrangement involves a concerted and conscious effort to disguise the relationship and/or to avoid industrial regulation or merely wilful indifference to the consequences of the means by which a person is engaged, the *Fair Work Act* should recognise that the fact that a sham contracting exists is, in itself, enough to warrant a serious sanction. The absence of this type of provision allows the entire regulatory regime established by the *Fair Work Act* to be subverted by the single device of sham contracting.

[42] Page 48

Case Study

Nine ceiling fixers are engaged as 'contractors' using the ABN system and are paid an all-inclusive hourly rate ranging from $12 to $27 per hour with no other conditions or entitlements. The employer quote for the contract is in the order of 30% less than his nearest competitor. Union recovers approximately $30,000 in unpaid employee entitlements.

Where it can be demonstrated that a sham arrangement has been put in place by an employer this should be sufficient to attract a penalty under the *Fair Work Act*. The *Fair Work Act* should be amended to include such a provision. A proposed amendment is set out below.

DIVISION 6 – SHAM ARRANGEMENTS

[Clause] 357 Engaging an employee as an independent contractor

(1) A person (the ***employer***) must not engage, or propose to engage, another person (the ***employee***), whether through an interposed entity or otherwise, as an independent contractor where the true character of the engagement, or proposed engagement, is that of ***employment***.

Note: This subsection is a civil remedy provision (see Part 4-1).

(2) For the purposes of sub-section (1) 'interposed entity' includes a corporation, partnership or trust.

5.2 'Misrepresentation' and Sham Contracting

The Fair Work Act

Section 357 of the *Fair Work Act* prohibits an employer from misrepresenting that an employment contract under which an employee is or would be employed is a contract for services. However sub-section (2) provides that if the employer can prove that they *'did not know or were not reckless as to whether'* the contract was a contract of employment, the prohibition does not apply. Under this provision proof as to the employer's state of mind becomes a critical factor in determining whether a breach has occurred.

The scope of this defence and its significance was exposed in a case taken by the CFMEU under the equivalent provisions of the *Workplace Relations Act.* Although the wording has altered slightly under the FW Act, the decision in that matter made it clear that the exception in the FW Act is so wide as to make the provisions almost worthless. In *CFMEU v Nubrick Pty Ltd*[43] the employer, a large and well-resourced corporation, successfully relied on the defence by showing that at the time of the representations they did not know or were not reckless as to whether the contracts in question were contracts of employment.

It seems that on the basis of this decision and the current wording of the FW Act, if an employer can prove for example that they did not turn their mind to the legal distinction between a contractor and employee, they cannot be found to be in breach of the sections. This means that the less knowledge of the legal distinctions between contractor and employee and the less attention given to the issue, the more likely the employer is to be able to raise a successful defence.

[43] (2009) 190 IR 175

Other Laws Dealing with Misrepresentations

The provisions of the *Fair Work Act* relating to misrepresentation may be contrasted with the provisions of the former *Trade Practices Act* 1974 and now the *Competition and Consumer Act* 2010 (CC Act). Under both s 53 of the TPA and now s 29 of Schedule 2 of the CC Act, corporations (now persons), are prohibited from making false representations in relation to the supply of goods and services. In neither case is the intent of the party making the representation relevant.[44] Section 151 of CCA (Schedule 2) also creates an offence of strict liability in relation to misrepresentations.

When such provisions are considered it is evident that there is a clear anomaly at present in that companies dealing with each other (and consumers dealing with companies and other business entities) are subject to stronger protections from false representations than workers dealing with employers about their employment status. This is so because it is the accuracy of the representation that is the focus of the inquiry and not the state of knowledge of the person making it. This anomaly could be addressed by deleting the exception in s 357(2) of the FW Act.

Misrepresenting employment as independent contracting arrangement

*(1) A person (the **employer**) that employs, or proposes to employ, another person (the **employee**) must not represent to the employee that the contract of employment under which the employee is, or would be, employed by the employer is a contract for services under which the employee performs, or would perform, work as an independent contractor.*

***Note:** This subsection is a civil remedy provision (see Part 4-1).*

[44] Re s 53 see *Darwin Bakery v. Sully* (1981) 51 FLR 90, *Given v. C V Holland (Holdings) Pty Ltd* (1977) 29 FLR 212

The former sections 53B and 75AZE of the *Trade Practices Act* also dealt with the issue of misrepresentations in relation to employment. Those provisions are now reproduced as s 31 and s 153 of Schedule 2 to the CC Act which contains the civil and criminal sanctions for employment-related misrepresentations. Section 31 provides:

> ***31 Misleading conduct relating to employment***
>
> *A* person *must not, in relation to employment that is to be, or may be, offered by the* person *or by another* person*, engage in conduct that is liable to mislead* persons *seeking the employment as to:*
>
> *(a) the availability, nature, terms or conditions of the employment; or*
>
> *(b) any other matter relating to the employment.*
>
> *Note: A pecuniary penalty may be imposed for a* contravention *of this section.*

A similar but amended provision should be included in the *Fair Work Act* to deal with the problem of misrepresenting that holding an ABN is a condition of obtaining employment, a practice that is widespread in the industry. Trade unions would then be able to institute proceedings on behalf of persons affected by the misleading behaviour.

> ***357A Misleading conduct relating to employment***
>
> *(1) A person must not, in relation to employment that is to be, or may be, offered by the person or by another person, engage in conduct that is liable to mislead persons seeking the employment as to:*
>
> *(a) the availability, nature, terms or conditions of the employment, terms or conditions upon which the employment may lawfully be offered ; or*
> *(b) any other matter relating to the employment.*
>
> ***Note:** A pecuniary penalty may be imposed for a contravention of this section.*

5.3 Dismissal and Re-engagement

This clause, like the current section under the FW Act, provides that an employer must not dismiss an employee in order to re-engage that employee for the 'same or substantially the same' work under a contract for services. The amendments are aimed at extending the current section 358 to situations in which individuals are dismissed and re-engaged as a contractor under a labour hire arrangement, as well as where individuals are dismissed to be re-engaged by a related entity, in order to avoid employment obligations and entitlements.

> ***358 Dismissing to engage as independent contractor***
>
> *An employer must not dismiss, or threaten to dismiss, a person who:*
>
> *(a) is an employee of the employer;*
>
> *(b) performs particular work for the employer;*
>
> *in order to engage the person as an independent contractor, or through a labour hire arrangement, to perform the same, or substantially the same, work under a contract for services, whether with the employer, a related employer or labour hire firm.*
>
> *Note: This subsection is a civil remedy provision (see Part 4-1).*

5.4 Misrepresentation and Inducements

Section 359 adopts an even stricter test than s 357 in that the misrepresentation to persuade or influence an employee to perform the same work as an independent contractor must be one that the *employer knows is false.* This imposes an almost insurmountable evidentiary burden on those seeking to rely on the section. Section 359 requires amendment in the following terms:

359 Misrepresentation to engage as independent contractor

*A person (the **employer**) that employs, or has at any time employed, a person (the **employee**) to perform particular work must not make a false statement in order to persuade or influence the employee to enter into a contract for services under which the employee will perform, as an independent contractor, the same, or substantially the same, work for the employer.*

Note: This section is a civil remedy provision (see Part 4-1).

5.5 A Third Category of Worker?

Various commentators have suggested that the creation of a new category of working relationship located somewhere between traditional employment and independent contracting would more accurately reflect reality and make regulation of this relationship simpler. This category has been described as 'dependent contracting' which is said to reflect the relation of dependency between the person providing the service and the person acquiring services.

Inherent in such an approach would be the creation of two 'grey areas' at the dividing line between the three categories instead of the one that currently exists between employee and contractor. It also seems to be an integral part of this third category proposal that dependant contractors would have work rights that fell short of those applying to employees. In the absence of detail about possible statutory definitions of a third category of working relationship or the type or substance of any separate provisions which might apply to this category, the CFMEU considers that the focus of the debate should remain on amending the laws as they apply to employees and contractors.

6. TAXATION

6.1 Significance of Taxation for Sham Contracting

It is self-evident that the taxation treatment of income will have a bearing on the way that individuals seek to structure their working arrangements.

Taxation laws are currently acting as an important incentive to the use and abuse of contracting arrangements, particularly in the construction industry. In order to ensure taxation equity as between individual taxpayers, to staunch the flow of lost public revenue and to ensure that illegitimate tax advantage does not encourage and promote the practice of sham subcontracting, it is necessary to make a number of key changes to the existing taxation regime as it relates to the alienation of personal services income (APSI).

It is clear that the existing legislative regime has not been effective in meeting the policy objective of reigning in revenue lost through the alienation of personal services income. The APSI provisions which have applied to the construction industry for almost ten years now have manifestly failed to ensure that the personal services income of those who are not in substance and reality working as contractors on their own account, receives comparable taxation treatment to the income of employees who are subject to the PAYG system.

6.2 An International Phenomenon

There is a significant body of material that demonstrates that sham contracting is an international phenomenon of growing importance. The use of sham contracting in the construction industry is also a global phenomenon.[45] Allied to the growth of sham contracting is the problem of lost tax revenue.

The UK Experience and the Treasury Inquiry

The UK construction union UCATT recently commissioned a report on the practice of 'false self-employment' in the UK construction industry.[46] The report estimated that there were between 375,000 and 433,000 falsely self-employed persons in the industry resulting in a revenue leakage of between £1.4b and £1.9b per annum.

In July 2009 HM Treasury issued a consultation paper on the issue of false self-employment in the UK construction industry - "*False self-employment in construction:*

---

[45] See for example Saboia J., "Contract Labour in the Brazilian Construction Industry" at p.16 in "*Contract Labour: Looking at Issues – nine Country Cases*" No.106 & 107 Labour Education 1997/1-2, International Labour Office, Geneva; Patel B.B., "Contract Labour in India in manufacturing, construction, plantations and forestry" at p.38 in "*Contract Labour: Looking at Issues – nine Country Cases*" No.106 & 107 Labour Education 1997/1-2, International Labour Office, Geneva; Lee Kiong Hock & Sivananthrian A., "Contract Labour in Malaysian Plantation, Construction and Sawmilling Industries" at p.45 in "*Contract Labour: Looking at Issues – nine Country Cases*" No.106 & 107 Labour Education 1997/1-2, International Labour Office, Geneva; Birch, J., "Contract Labour in the British Construction Industry", at p.69 in "*Contract Labour: Looking at Issues – Nine Country Cases*" No.106 & 107 Labour Education 1997/1-2, International Labour Office, Geneva; "*Contract Labour – Why Do We Need an ILO Convention?*" Prepared by the International Federation of Building and Wood Workers for the International Labour Organisation 86th Conference, 2-18 June 1998, Geneva, Switzerland; "*The construction industry in the twenty-first century: Its image, employment prosects and skill requirements"* International Labour Organisation, Geneva 2001.

[46] Appendix 4

taxation of workers"[47]. The paper quotes results from the European Labour Force Survey that showed 34% of workers in the construction industry are self employed. In respect of this finding HM Treasury stated (par 2.5);

> *Even given the range and variety of skills used by the industry, there is no obvious reason why the proportion of self-employed workers in the construction industry should be so high.*

It is noteworthy that this figure is very close to current Australian figure (see above). Of the 34% 'self-employed' HM Treasury estimated that one third of those operating as sole traders were in fact working under employment terms. In terms of numbers this represented 300,000 persons. HM Treasury estimated that 350 million pounds per year was the cost to revenue.

HM Treasury reviewed previous compliance measures and concluded as follows (pars 4.7-8;)

> *While some of these measures have had a positive effect, this has tended to be temporary or confined to a small number of cases. There has been no significant lasting effect on levels of false self-employment within the industry. Measures designed to encourage voluntary compliance have in some cases resulted in workers and engagers seeking other ways to disguise employment, which is evidenced by the growing use of intermediary structures. The only option currently available to tackle this problem is for HMRC to carry out an increasing number of compliance reviews.*
>
> *The Government has concluded that deploying a significantly higher level of compliance activity for this industry compared to others, with the additional cost of resources that would be involved, is not a viable long-term solution. In*

[47] HM Treasury Consultations & legislation website, http://www.hm-treasury.gov.uk/d/consult_falseselfemploymentconstruction_200709.pdf

any case, further compliance activity by itself may not be sufficiently effective, given the increasing use of intermediaries. Instead the Government believes that legislation to deem income received by workers in the construction industry to be employment income is the best way to tackle this problem.

HM Treasury proposed that deeming criteria should be used to determine the nature of the income. These criteria were to be objective, simple and easy for the payer to apply. They proposed three criteria that would show the worker to be genuinely in receipt of self-employment income (par 5.11);

- *Provision of plant and equipment – that a person provides the plant and equipment required for the job they have been engaged to carry out. This will exclude the tools of the trade which it is normal and traditional in the industry for individuals to provide for themselves to do their job;*
- *Provision of all materials – that a person provides all materials required to complete a job; or*
- *Provision of other workers – that a person provides other workers to carry out operations under the contract and is responsible for paying them.*

The proposal called for a worker to meet one or more of these criteria in order not to be deemed in receipt of employment income. HM Treasury viewed each of these criteria as representing a significant element of a contract for services.

HM Treasury concluded that labour and product market efficiency would increase with the removal of two distortions to competition. First, between firms in the construction industry who use false self-employment and those who do not, and second, between the construction industry as a whole and other industries where false self employment is not as widespread.

Consideration was given to avoidance measures that would be used to circumvent the proposal through the use of various intermediary structures. HM Treasury concluded

that the proposed legislation would need to contain specific provisions to counter such arrangements.

6.3 Revenue Losses in the Australian Construction Industry

1998 ACIRRT Paper

In 1998 the Australian Centre for Industrial Relations Research and Training published a paper titled *'The Growth of Contractors in the Construction Industry – Implications for Tax Revenue.'*[48] The paper analysed the growing use of contractors/own account workers in the construction industry and the different tax treatment of the income earned by such workers as opposed to PAYE wage earners. It found that much of the growth in contracting was attributable to the rising number of 'dependent contractors', namely those who derived their income from a very limited number of sources and who were in fact *de facto* employees. The report concluded:

> *The only available data for calculating average taxes paid by contractors and employees that allows for controlling for the effects of labour market and demographic characteristics such as hours of work is the ABS's Income Distribution Survey Sample File. Analysis of this source by Apps (1998b) reveals that on average contractors in construction pay $6,217.22 per annum less tax than their PAYE equivalents. As such they only contribute 42 percent of what they would have had they been classified as PAYE employees.* ***It is estimated that in 1996/97 if PPS workers had contributed taxation at the same rates as PAYE employees on their gross income an extra $2.2 billion in taxation income would have been raised.*** *Given the growth in contractor employment this situation is deteriorating as time passes. If such trends continue it is conceivable the potential losses in*

[48] John Buchanan, University of Sydney and Cameron Allen Centre for Research into Employment and Work, Griffith University.

revenue could be run to many more billions of dollars per annum by the end of next decade. (original emphasis)

The Report referred to the availability of work-related expenses as business deductions to those styling themselves as contractors as having a major impact on the tax ultimately paid.

Cole and Beyond

Evidence provided to the Cole Royal Commission disclosed that tax evasion was a serious problem in the construction industry. The mischaracterisation of employees as contractors and the misuse of the tax regime, including Australian Business Numbers, was a major contributing factor to the massive public revenue losses identified by Cole.

The Royal Commission recorded that from 1998 to 2002 the ATO recovered $370m in unpaid taxes from the industry. Cole found that for every dollar spent on compliance the ATO recovered $6 in unpaid tax revenue.

In 2003, the ATO said that in relation to general (not APSI-specific) tax compliance activity in the construction industry:

> *Between July 2002 and October 2003, we completed 6600 enquiries, investigations and audits, and raised in excess of $240 million in tax and penalties.*[49]

In May 2004, a senior ATO official gave evidence to a Senate Inquiry stating that non-compliance in the building and construction industry 'remains a significant problem', and agreed that there was 'a large slab of tax forgone.' [50] The evidence related to all tax in the industry (phoenix activity, fraud and evasion) and not specifically to APSI-related

[49] ATO, *Tax and the building and construction industry booklet,* NAT 10245-11-2003, p6.

[50] Deputy Commissioner, Small Business ATO, Mr Mark Konza, Senate Committee on Employment, Workplace Relations and Education (EWRE) p69/70, 19 May 2004.

tax. However it would be remarkable if compliance with one taxation measure was satisfactory in an industry characterised by generally unsatisfactory compliance.

In 2005 the Deputy Commissioner said:

> *There has been a large increase in the number of taxpayers declaring that they are in receipt of personal services income, although we consider that there are many others who are not correctly reporting personal services income in their tax returns. Many of these incorrectly report their income as business income instead of personal services income, and there is also some confusion among tax agents in distinguishing between personal services income and income from a business structure.*[51]

The Deputy Commissioner also said in the same evidence that:

- The ATO had done about 2,000 audits and 'there are about 300,000 people affected by the measure.'
- The number of people applying for a personal services business determination declined markedly over the preceding four years. In first year, 2000-01, there were 1,861 applications for a determination. In 2004-05, only 147 were received (to 16 June 2005) making a total of around 3,500 since 2000. Of these, about 13% were in the construction industry, or only around 455. The top 4 groups were construction, finance and insurance, HR and management consultancy and IT, with between 10 and 16 per cent each. (p 6/7 - 16 June, 2005).
- 'In view of the overall position in relation to the personal services income measure as outlined, the ATO has considerably reduced the level of resources it commits to a level commensurate with its relative risk.' [52]

---

[51] Deputy Commissioner, Small Business ATO, Mr. Mark Konza, House of Representatives Standing Committee on Employment, Workplace Relations and Workforce Participation, 16 June 2005, p EWRWP 3.

[52] Ibid, p3.

When the APSI measures were introduced in 2000 the then Treasurer Peter Costello said:

> *The government estimates that the alienation measure will result in increased revenue of $190 million in 2000-01 financial year, $290 million in 2001–02, $435 million in 2002–03 and $515 million in 2003-04.*[53]

In July 2009 the CFMEU requested from the ATO data on the actual tax collected through the alienation measure compared with the projected increased revenue estimates made at the time the legislation was introduced. The ATO declined to supply any information other than that publicly available on the ATO's website.[54]

Non-Reporting of APSI Income

The Board of Taxation's 2009 Report on the Alienation of Personal Services Income Tax (APSI) rules found that there was a serious problem of persons misunderstanding and/or misrepresenting their status for taxation purposes and therefore underreporting on personal services income in their tax returns. The Board of Taxation noted that the ABS recorded over 1 million[55] independent contractors as at November 2008, but ATO data showed only 'about 368,000 individuals and entities declared personal services income in their income tax returns in 2008'[56]. Of this number, a massive 268,000 or 73% assessed themselves as being personal services businesses; entities to whom the APSI rules did not apply. This means that the APSI rules was potentially being applied to a mere 100,000 or less than 10% of the contractor population across all industries. The Board's report concluded that:

---

[53] Treasurer Costello, Hansard 13/4/00 pg 15977

[54] Email communication from ATO official, 9 July 2009.

[55] Figure includes 134,000 people who were independent contractors in their second job.

[56] Or about one-third of the total.

> *While acknowledging the differences in definitions and methodology between the ABS and the ATO data, the data does nevertheless suggest that there is significant underreporting of personal services income in income tax returns.*[57]

The Board's report therefore suggests that a significant number and/or proportion of the remaining 600,000+ persons/entities could be misrepresenting their status for taxation purposes, across all industries in the economy.

Taking a very conservative approach to what the Board described as 'significant' underreporting, it might be argued that a realistic assessment of the proportion of those who *should* be reporting personal services income could be 50% of the total pool of independent contractors. If that proportion were applied to the construction industry, that would represent in the order of 168,000 persons[58] in the industry who should be declaring personal services income and whose working arrangements are therefore more closely aligned to that of employees. The actual number of APSI returns for the construction industry was not able to be ascertained for the purposes of this paper.

Other Estimates of Revenue Loss

The ABCC Discussion Paper also refers to a study commissioned by the AMWU in 2005 by the National Institute of Economic and Industry Research (NIER) which found that growth in contracting generally was leading to a $14.38 billion (or $13,897 per non-employee) per annum risk to the tax base. That Report characterised the loss as:

> *a mixture of tax evasion and tax avoidance, including the failure to report substantial amounts of income, claims for fictional or improper deductions and ability to split income with families and relatives and lower the average tax rate.*

---

[57] Board of Taxation, *Post Implementation Review into the Alienation of Personal Services Income Rules*, October 2009, pp20/21.

[58] On 2009 figures.

Construction Industry Estimated Revenue Lost

By using the figures set out in Part 2 of the paper as to the estimated number of sham contracting arrangements in the construction industry, it is possible to make some projections as to the likely impact of sham arrangements on the total tax revenue contribution of the industry. In determining revenue losses it is accepted that whilst the APSI rules were supposed to restrict illegitimate access to deductions and income splitting, it is clear from the discussion above and from what follows in relation to loopholes in the current APSI tests (and the conclusions of Board of Taxation report), that the rules have failed to stop the loss of tax revenue.

The following table[59] gives two examples of net earnings differences between PAYG employees and ABN contractors working in an employee-like manner and the different tax revenue consequences that arise from both arrangements. The table assumes a gross income of $100,000 as the market rate for commercial building construction work for all categories of workers. The first column attributes a conservative approach to claiming deductions by an ABN 'contractor' and the second is indicative of an aggressive approach to deductions. The second part of the table factors in an income-splitting arrangement on a 50/50 basis with a spouse with no other income.

Table 11

Estimated Tax Variance – Contractor v Employee

Additional deductions likely to be claimed by contractor

	Conservation Deductions	**Aggressive Deductions**
Electricity	200	300
Home phone	120	360
Home internet		948
Office furniture	100	300

[59] Prepared by a firm of accounting/taxation practitioners with extensive knowledge of and experience in taxation matters related to the construction industry.

Rent		2,600
Stationery	20	100
Depreciation on home computer or laptop	400	1,000
Mobile phone	588	948
Car expenses *		11,688
Less GST	130	1,659
Total	1,298	16,585

***Assuming the following car expenses**

Fuel	5,200
Registration & Insurance	2,000
Depreciation on average bal $20,000	3,750
Interest on Average bal $20,000	1,800
Repairs, servicing and tyres	1,000
	13,750
X 85% business use	11,688

Effect of splitting income with spouse (assuming no other income for spouse)

Assuming gross income of $100k less expenses above

Gross Income	100,000.00[60]	100,000.00
Less business expenses (above)	1,298.18	16,585.00
Net income	98,701.82	83,415.00
Tax payable	25,950.20	13,375.73

Assuming 100K income after deductions as employee

Taxable income	100,000.00	100,000.00
	26,450.00	26,450.00
Estimated income tax leakage	499.80	13,074.28
Estimated GST leakage	129.82	1,658.50
Total estimated revenue leakage	629.62	14,732.78

The Table demonstrates a range of possible revenue leakages of between $630 to $14,733 per person, in round figures. Based on estimated the numbers of sham contractors of between 92,000 and 168,000 persons described in the preceding sections of the paper, it is possible to project revenue losses of between $58m and $2.475b per annum as a result of sham contracting in the construction industry. Such projections do not take account of other revenue losses through non-payment of superannuation guarantee charge contributions and payroll tax. Further, these estimates assume that at least some tax is remitted by all ABN 'contractor' workers, whereas in reality and because of a lack of withholding or regular remittances in the first twelve months, and because of ABN abuse and lack of mandatory cross-referencing and reporting by ABN

[60] An entrepreneur tax offset applies to reduce tax by 25% for businesses with a turnover of less than $50,000. This phases out as turnover increases and ceases to apply when turnover reaches $75,000. This could be worth up to $2,137 for someone with a turnover of $50,000.

holders and payers, there are many instances where no tax at all would be paid. In this case these estimates are more likely to be on the conservative side of the true public revenue deficit resulting from sham contracting practices.

6.4 Ralph Review and Introduction of APSI Rules

> *What John Ralph recommended was that people who rendered services in an employee like manner should be paying marginal income tax rates. What this government will be delivering is legislation that provides for people who are employees or delivering employee services to pay personal income tax rates.*[61]

Prior to the Ralph Report, the Australian tax system had relied on common law rules and the general anti-avoidance measures in Part IVA of the legislation to regulate the tax treatment of income generated by any individuals who had provided services to another. However the 1999 Ralph Report made it abundantly clear that taxation reform measures were urgently needed to stem the loss of tax revenue that was occurring through the use of interposed entities by those supplying their services in an employee-like fashion.

The Report noted that it was a fundamental principle of most tax systems that income derived from the personal exertion of an individual cannot be alienated. It observed that there had been an exponential growth in the number of owner/managers of incorporated entities in the preceding period and that the growing use of interposed entities created 'significant issues of equity' and posed 'a growing threat to the income tax base.'

> *'It is clearly inequitable that some taxpayers should be reducing their tax liability by using interposed entities to alienate income while other taxpayers*

[61] Hansard 13/04/00 p15945 Costello

also deriving personal services income, including ordinary wage and salary earners, pay the correct amount of tax.'[62]

The Ralph Report ultimately recommended that where a company, trust or partnership is interposed between a person or entity requiring services and the person who performs the services, the services should be treated as the income of the service provider where 80 per cent or more of work is for one service acquirer or services are provided in an 'employee-like manner'.[63]

Unfortunately there was a wide discrepancy between the substance of what the Ralph Report recommended and what was ultimately introduced into law as the APSI rules. As the Board of Taxation review noted:

2.13 Rather than adopting the approach recommended by the Ralph Report of defining 'employee-like' characteristics, the approach adopted applies tests to taxpayers' activities to determine if they are operating as a 'personal services business' or not.

2.14 In another departure from the Ralph Report recommendations, the rules allow taxpayers to self assess as a personal services business, even when 80 per cent or more of their income comes from one client, when that income is from producing a result (the 'results test').[64]

The consequence of these fundamental departures has been the failure of the legislation to meet the policy objectives identified by Ralph. Experience has also borne out the fact that the legislation that was ultimately introduced by the previous Government has done very little to restore equity and integrity into the tax system.

---

[62] Final Report Ch 7 p287

[63] See Recommendation 7.2

[64] Board of Taxation Report p11.

6.5 Board of Taxation Review –

In a submission to the Cole Royal Commission the Queensland Government accurately summarised the deficiencies with the final version of the alienation of personal services income legislation and the impact this would have on remedying the problems the legislation was originally designed to address.

> *'..the ensuing Alienation of Personal Income Services Act 2000 (sic) has weakened the tests proposed in the Ralph Report and as such undermines the anti-avoidance goal of the legislation. Dilution of the Act in 2001 raises serious questions about the efficacy of its objectives and clearly a tightening of the Act is required if problems identified within the BCI in the Ralph Report are to be remedied.' [Vol 9 Final Report pg 76-77]*

Cole in fact concluded that at the time of his report (February 2003) it was too early to reach a concluded view about whether or not the APSI legislation would reduce tax evasion in the construction industry.[65] He recommended that the ATO review the impact of the APSI legislation for the year ended 30 June 2003 and critically examine the effectiveness of the legislation in reducing non-compliance.[66] Such a review did not occur until the Board of Taxation considered the matter in 2009.

Even the previous Government, who were the authors of the current APSI rules, have admitted that the scheme of the tax legislation is a failure.

During the Second Reading Speech for the bill that became the IC Act and the bill to insert the sham contracting provisions in the *Workplace Relations Act 1996* (Cth) the then Minister for Employment and Workplace Relations, Kevin Andrews, made this concession:

---

[65] Vol 9 p89

[66] Recommendation 126

> *...we have not included in the definition [of 'independent contractor'] components of the Personal Services Income test used by the Australian Tax Office to identify independent contractors, despite the Committee's recommendation that we do so. This test has been developed to address the specific requirements of taxation law.* ***It is a self-assessment test and is easily manipulated to achieve the desired outcome if a worker is seeking to be classified as an independent contractor rather than an employee****.*[67] *(emphasis added)*

The 2009 Board of Taxation Review was therefore the first serious assessment of the APSI rules since their introduction. The key findings of the Board may be conveniently summarised:

- There is evidence of a low level of compliance.[68]
- The difficulty in applying the rules that determine whether or not the taxpayer is a personal services business leads to a degree of uncertainty or 'greyness' around the rules, that provides opportunities for taxpayers to interpret them in their favour.[69]
- There is evidence that the rules have not reached far enough into the potential population of taxpayers who were intended to be affected by the rules, to properly achieve their aim of improving integrity and ensuring equity between taxpayers. The very high 'strike rate' of ATO compliance activity of 83 per cent, notwithstanding it is the result of targeting the compliance activity to high-risk taxpayers, points to poor compliance.[70]
- The Board does not consider that the alienation of personal services income rules in their current form provide an acceptable level of integrity and equity. The Board therefore recommends that alternatives to the current provisions be considered, to meet the policy intent of improved integrity and equity.[71]

---

[67] See ABCC Discussion Paper p23

[68] P1

[69] ibid

[70] P25

[71] P2

Mandatory Reporting

One of the key recommendations of the Board of Taxation Report of October 2009 was the introduction of a mandatory reporting obligation similar to existing PAYG reporting, where a business makes a payment for the provision of labour services. The Report regarded this as a necessary measure to improve compliance with the rules relating to personal services income. It said:

> *A reporting obligation would facilitate data matching, assist in identifying high risk taxpayers and assist compliance activity by the ATO to determine those taxpayers who should be declaring personal services income. It could also lead to a higher level of voluntary compliance with the rules by providing information on the number and value of contracts that a taxpayer earning personal services income enters into in a year.*[72]

The Report recommended that identifying information such as an ABN of both the payer and payee be provided and that payers be required to provide an annual summary to the ATO of payments made. To facilitate data matching and compliance a corresponding obligation would be imposed on payees to include details of the payer's ABN and the payments made by them in their annual return. It concluded that these reports would assist to identify whether a taxpayer had received most of their income from a single source. Given the source of the income would become a central feature of the amended APSI rules discussed below, such a measure would be essential to maintaining the integrity of the APSI system and would act as a positive deterrent to those who did not take the self-assessment aspect of that system seriously.

A mandatory reporting system be introduced in respect of payments for labour services consistent with the recommendations of the Board of Taxation Report of October 2009.

[72] At 5.17

Withholding

At present there is only a withholding obligation for payers in respect of those contractors who do not supply an ABN. There is also the capacity for contractors to enter into voluntary withholding obligations with payers, but, unsurprisingly, the take-up rate of such arrangements has been very low.[73] The consequence of this is that there are very few contractors who have withholding arrangements, at source, in place. There is little doubt that the absence of withholding is a major incentive for people to enter into contracting arrangements.

The Board of Taxation Report recommended that consideration be given to the introduction of a withholding component for personal services income. It suggested that the withholding obligation would act as a reinforcement of the reporting obligation in industries with low compliance such as construction.[74]

The PPS experience in the construction industry in the 1980s and 90s suggests that withholding alone will not solve the revenue leakage that occurs through abuse of the contracting system. However, jettisoning withholding under the APSI system coupled with low compliance levels generally, has not provided any solution either. Urgent consideration should be given to the introduction of withholding to complement a system of mandatory reporting.

The rate of withholding is an important factor. Setting the rate at a level that is too low will lead to the view that was taken of the PPS during the 80s and 90s recurring, namely, that the withholding rate (which was always less than marginal tax rates), was the minimum ***and*** maximum rate at which contractors paid their tax. Any withholding rate should therefore be set having regard to the current company tax rate and the marginal rates applying to comparable PAYG taxpayers.

---

[73] There were only 23,300 voluntary agreements for withholding in 2008. BoT report p23

[74] Para 5.26 p33

The Board of Taxation Report of October 2009 recommended that consideration be given to the introduction of a withholding rate to complement a mandatory reporting system. The Government should consider the introduction of a withholding tax in respect of all personal services income.

Henry Tax Review

The Henry Tax Review 2010 accepted the Board of Taxation's analysis of the APSI rules and recommended accordingly:

> ***Recommendation 10:*** *Consideration should be given to a revised regime to prevent the alienation of personal services income that would extend to all entities earning a significant proportion of their business income from the personal services of their owner-managers, whether in employee-like or non-employee-like cases. This regime may also apply an arm's length rule to deductions arising from payments to associates to ensure deductions reflect the value of services provided.*[75]

The Government therefore has a substantial body of material and a range of authoritative opinion urging that there be changes to the APSI rules.

[75] P82 Henry Review Report

6.6 Changes to the APSI Rules

6.6.1 'Results Test'

The most necessary change to the APSI rules is the removal of the 'results test' as the initial test which determines whether the personal services income is subject to Part 2-42 of the *Income Tax Assessment Act* 1997. This test, which was inserted into its present position as an amendment to the original Bill introducing the alienation of personal services income provisions, has proved to be the great escape route for those who want to avoid the reach of the provisions.

Data contained in the recent paper by the Board of Taxation makes it clear that overwhelmingly those in receipt of personal services income are relying on the results test and self-assessing their way out the reach of these provisions through this test. The report showed that in 2008 of those declaring personal services income, 73 per cent (268,000) were assessed as personal services businesses, and consequently the alienation of personal services income rules did not apply to them. Of these, over 88% had relied on the 'results test' to self-assess themselves as being personal services businesses.[76]

Moreover, taxpayers are allowed to self assess whether the 'results test' is satisfied, regardless of whether 80 per cent or more of the individual's personal services is from one client.[77]

The fundamental problem with the results test is that it is not sufficiently rigorous to ensure that only those who are intended to be excluded are in fact excluded from the provisions. In *IRG Technical Services Pty Ltd v Deputy Commissioner of Taxation* [WAD174 OF 2004] the Court said:

---

[76] Para 2.35 B o T Report

[77] BOT 2.23

I agree with the following submission of the respondent:

> *While the "results test" is based on the common law criteria for characterising an independent contractor from an employee/employer relationship, the "results test" is satisfied by meeting 3 specified criteria (all being traditional indicia of a contract for service). Thus for the purposes of section 87-18(3) it is not necessary that all the recognised indicia of an independent contract are present.*

In other words, under the current formulation it is possible that those who meet only a very limited number of the independent contractor indicia but who in all other respects perform work in an employee-like fashion can be excluded from the reach of the provisions, and also that bona fide contract workers not satisfy this test because they fail to meet one or more of the specified criteria.

To address this shortcoming, the results test must be taken out as the first step in the assessment process once it has been determined that an individual or entity does in fact receive personal services income. Support for such an approach can be found in the Ralph Review and the more recent Board of Taxation report. It is also consistent with the original legislation [see *New Business Tax System (Alienation of Personal Services Income) Act* 2000]. An additional benefit would be that it would avoid the confusion which has arisen over the application of the test at this early stage.

6.6.2 The Primary Test – the 80% Rule

Once the 'results test' is removed from this point of the process the initial determining factor becomes the 80% rule i.e. does 80% or more of the taxpayer's personal services income in an income year derive from one client? If the answer to that is 'yes' then the taxpayer should be required to obtain a personal services business determination from

the Commissioner and in the absence of such a determination, the personal services income legislation would apply.

If on the other hand less than 80% of the income is derived from any one client, the taxpayer should then be required to satisfy the employment test *and* the business premises test.

6.6.3 Amended 'Employment' Test

The 'employment' test is a misnomer for the current test which appears at s 87.25 of the *Income Tax Assessment Act* 1997 since the test applies not just where a percentage of the principal work is carried out by direct employees, but also where it is performed by sub-contractors and other entities.

The current section provides;

> *SECT 87.25 The employment test for a personal services business*
>
> *(1) An* individual *meets the employment test in an* income year *if:*
>
> *(a) the* individual *engages one or more entities (other than ** associates *of the* individual *that are not* individuals*) to perform work; and*
>
> *(b) that* entity *performs, or those entities together perform, at least 20% (by ** market value*) of the* individual*'s principal work for that* year.
>
> *(2) A **personal services entity *meets the employment test in an* income year *if:*
>
> *(a) the* entity *engages one or more other entities to perform work, other than:*
>
> *(i)* individuals *whose ** personal services income *is included in the* entity*'s ** ordinary income *or ** statutory income*; or*
>
> *(ii) ** associates *of the* entity *that are not* individuals*; and*
>
> *(b) that other* entity *performs, or those other entities together perform, at least 20% (by ** market value*) of the* entity*'s principal work for that* year.

*(2A) If the ** personal services entity *is a* partnership*, work that a* partner *performs is taken, for the purposes of subsection (2), to be work that the* personal services entity *engages another* entity *to perform.*

(3) An individual *or a ** personal services entity *also meets the employment test in an* income year *if, for at least half the* income year*, the* individual *or* entity *has one or more apprentices.*

A provision such as this is open to manipulation in an industry like construction where there is extensive sub-letting of work and is therefore not a good measure of the extent to which a person is operating a genuine business.

One option would be to substantially re-write the employment test to introduce the types of factors recommended by the Ralph Review. Under this approach one would consider the circumstances in which the services are provided against a specified set of criteria not dealt with elsewhere in the process to determine whether the services are in fact provided in an 'employee-like manner'. This would include whether or not other persons or entities are employed or used to provide the services and the real extent to which the services are provided by a single person. These criteria might therefore include:

- the level of control exercised by the service acquirer;
- the use of substantial income producing assets;
- the extent of infrastructure provided by the interposed entity;
- whether incidental services are provided in conjunction with the sale of trading stock;
- whether more than one person actually provides the required services; and
- the degree of entrepreneurial risk in the way services are provided.

Alternatively, the existing employment test could be amended. At least two amendments are required to strengthen this provision. Firstly, the percentage of principal work which is to be performed by employees or other entities should be raised from 20% to 30%. Secondly, there should be included in the section a definition

of 'principal work' for the purposes of that section which makes it clear that this does not include support work such as secretarial, administrative or bookkeeping duties. This latter addition is consistent with ATO advice as to the intended operation of the section.

Under this approach the new employment test would be:

SECT 87.25 The employment test for a personal services business

(1) An individual *meets the employment test in an* income year *if:*

(a) the individual *engages one or more entities (other than ** associates *of the* individual *that are not* individuals*) to perform work; and*

(b) that entity *performs, or those entities together perform, at least 30% (by ** market value*) of the* individual*'s principal work for that* year.

*(2) A ** personal services entity *meets the employment test in an* income year *if:*

(a) the entity *engages one or more other entities to perform work, other than:*

(i) individuals *whose ** personal services income *is included in the* entity*'s ** ordinary income *or ** statutory income*; or*

*(ii) **associates *of the* entity *that are not* individuals*; and*

(b) that other entity *performs, or those other entities together perform, at least 30% (by ** market value*) of the* entity*'s principal work for that* year.

*(2A) If the ** personal services entity *is a* partnership*, work that a* partner *performs is taken, for the purposes of subsection (2), to be work that the* personal services entity *engages another* entity *to perform.*

(3) An individual *or a ** personal services entity *also meets the employment test in an* income year *if, for at least half the* income year*, the* individual *or* entity *has one or more apprentices.*

(4) For the purposes of this section 'principal work' means the work that is central to meeting the obligations of the individual or personal services entity to any acquirer of services from such individual or entity but does not include work that is ancillary to such work such as bookkeeping, accounting or secretarial work.

6.6.4 Remove 'Unrelated Clients' Test

The 'unrelated clients' test should be deleted as it does not provide a proper basis on which personal services income should be exempt from the application of the PSI rules. It is very common for example for construction workers to work for more than one employer in an income year and in that case, a mere offer to provide work to the public at large through an advertisement is a simple device to entirely avoid the operation of the PSI provisions.

6.6.5 Results Test and PSBs

Under the proposed amendments those with 80% or more of their personal services income deriving from one client in any one tax year would, for the very reason that they are more likely to be working in an employee-like fashion because the preponderance of their work comes from a single source, be required to undertake a more rigorous test than those that fell on the other side of the 80% line. For this reason, in reaching a view about whether to grant a personal services business determination, the Commissioner should be required to have regard not only to those tests relevant to persons/entities falling on the other side of the 80% line, namely the employment test and the business premises test, but also an amended version of the results test.

This amended test would tighten the existing requirement relating to the supply of plant and equipment by excluding the usual tools of trade and would include a new requirement that the individual/entity be responsible for the supply of materials necessary to complete the work. These changes are consistent with the HM Treasury report referred to above.

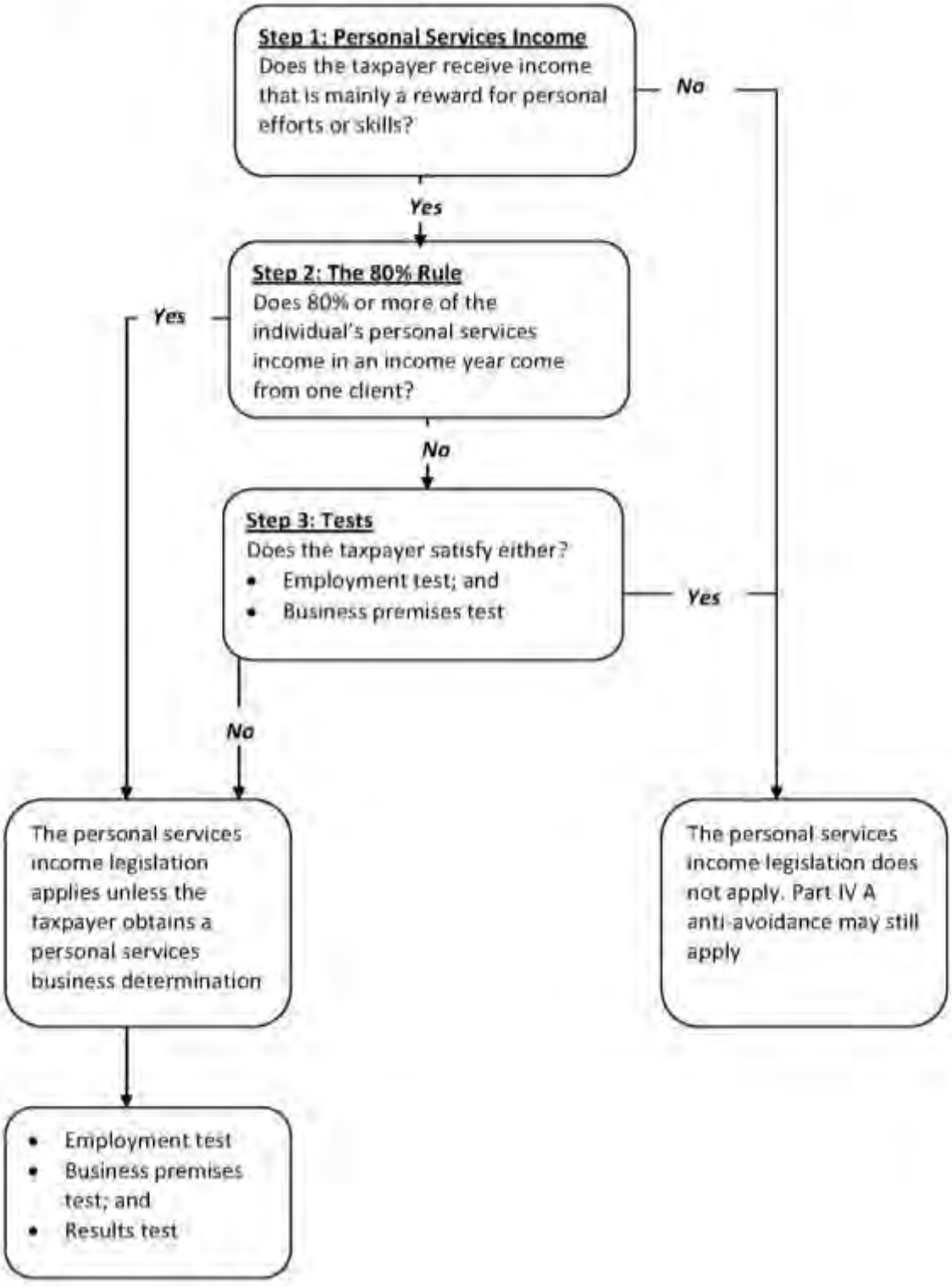
The amended results test would, relevantly, appear as follows:-

> ***The results test for a personal services business***
>
> (1) *An individual meets the results test in an income year if, in relation to at least 75% of the individual's personal services income during the income year:*
>
> *(a) the income is for producing a result; and*
>
> *(c) the individual is required to supply the plant and equipment,* ***not including the tools of trade which it is normal and traditional in the industry for individuals to provide for themselves to do their job and produce the result****; and*
>
> *(d)* ***the individual provides all the materials necessary to complete the work and produce the result;*** *and*
>
> *(e) the individual is, or would be, liable for the cost of rectifying any defect in the work performed.*

A corresponding test would apply to personal services entities.

A diagrammatic representation of the amended process is as follows:

ALIENATION OF PERSONAL SERVICES INCOME



6.7 Tightening the ABN System

The ease with which ABNs can be obtained is an important issue because it determines the size of the population potentially able to use – and abuse - the APSI rules. The provision of ABNs is governed by the *New Tax System (Australian Business Tax Number) Act 1999 (ABN Act*).

6.7.1 Test for ABN

Under the ABN Act, any person can apply for an ABN and the Commissioner of Taxation must issue an ABN if satisfied as to the identity of the applicant and that the applicant is carrying on an enterprise.[s 8] "Enterprise" is defined in the Act as an activity, or series of activities, done in the form of a business or in the nature of trade.[s38] A "business" is any profession, trade, employment, vocation or calling, but does not include occupation as an employee.[s41]. Whether one is carrying on a business is a matter of self-assessment.

During the Cole Royal Commission the ATO submitted that the construction industry accounted for 482 295 or 13% of the total number of ABNs issued. At the same time one estimate of the total blue collar workforce in the industry was around 450 000. Cole concluded that 'there appears to be a very high proportion of the workforce that possesses an ABN [Vol 9 pg 80]. He described the number of ABNs in the industry as 'a major area of concern' and concluded that the evidence suggested that there was an 'erroneous understanding that the possession of an ABN enables the holder to be treated as a contractor.' [Vol 9 pg 89]

The CFMEU has made many submissions arguing that ABNs were too easy to obtain under the ABN Act and ATO policy; and that this ease of access contributes to failure of the APSI to achieve its policy intent. In its October 2008 submission to the Henry Review the CFMEU's key points were:

- The ATO is required to issue an ABN based on defective tests to establish that ABN applicants are in fact operating a business.
- Certain categories of workers were eligible for ABNs when they should clearly not be, notably apprentices, workers doing general labouring work and 457 visa workers.
- The penalties for making false declarations in order to obtain an ABN were inadequate, for both individuals and their advisers.

6.7.2 Background

The Cole Report

The Cole Royal Commission final report concluded that that there appeared to be 'justified concerns' about the use of ABNs in the construction industry and suggestions that 'ABNs were misused to justify the treatment of persons, who hold ABNs but who are employees, as contractors. Cole recommended that the ATO conduct an audit of ABNs issued in the industry [Recommendation 127] and that there be an amnesty for ABN holders to return them without penalty [Recommendation 128].

ANAO Report 2002-03

The Australian National Audit Office (ANAO) examined ABNs and the Australian Business Register (ABR) in a 2002-03 report[78] and found serious shortcomings in the system. The report stated that:-

> *The ATO has identified an increasing propensity in job advertisements for employers to require applicants to have an ABN. The effects of this trend are being reflected by several indicators including:*

[78] Australian National Audit Office (ANAO), *Administration of Australian Business Number Registrations, Australian Taxation Office*, The Auditor-General Audit Report No.59 2002-03, Performance Audit.

- *A perceived leakage of employees out of the PAYG system, as employees become 'contractors' instead of staff;*
- *Analysis of ABR data that shows a significant increase in the proportion of new ABN registrations coming from individuals. In September 2000, individuals comprised 36 per cent of ABN registrants; by October 2002 they comprised 42 per cent.*
- *Data quality testing of ABR data by the ATO has identified registrants that appear to be employees rather than businesses.*[79]

The ANAO obtained a copy of the ABR data base as at 28 September 2002 and tested the data. This included attempting to identify potential employees in the data specifically excluded by the legislation from having an ABN. The ANAO reviewed the entire ABR data base "to determine the numbers of registrants that described themselves as either 'labourers' or 'apprentices'". The ANAO found 10,243 ABN holders had so described themselves:

- 8,889 persons described as some type of labourer or giving labouring as their main activity.
- a further 1,149 described themselves as contract labourers.
- 205 persons stated they were some type of apprentice.[80]

The ANAO provided examples of what it termed some of 'the more problematic descriptions provided by applicants' for these ABNs:

- 'Casual labourer currently unemployed registered with the CES.'
- 'I wish to seek employment as a labourer and have been told I need an ABN.'
- 'I am in Year 10 at school and work casually as a labourer on weekends.'
- 'Working for wages as an apprentice carpenter.'

---

[79] Ibid, p61-62.

[80] Ibid, p63.

As the ANAO report commented:

- Those persons "describing themselves as employees appear by their own admission to be ineligible for an ABN" and at the very least would require further investigation.
- Similarly the labourers appeared to be employees (not carrying on a business) and apprentices seemed incapable of undertaking a business until they finished their apprenticeships.

The ANAO recommended (Recommendation 3) that, to enhance current registration procedures for issuing ABNs, the ATO:

- *Extend up-front checking procedures to detect…the more obvious categories of apparently ineligible applicants.*
- *Review current registration procedures and ABR business rules to determine whether these are sufficient to meet the (ABR) legislative requirements; and*
- *If appropriate, provide advice to government on any necessary amendments to the legislation.*

The ATO's response, as recorded in the 2003 ANAO report, was:

> *Agreed in principle. A review of the ABN registration is planned, it will focus on actively seeking opportunities to enhance the registration process.*[81]

In a 2007 follow-up audit, the ANAO found that the ATO had partially implemented this recommendation, but that complete implementation would not occur until a number of

[81] Ibid, p65.

tools were integrated into the ABN application process to be delivered in Phase 2 of the Eligibility Tool project.[82]

Comment on ANAO Report

1. The ANAO's figure of 10,243 understates the total number of ABNs issued to persons working as labourers or apprentices in 2003. This is because the ANAO investigation was limited to ABN registrants who had self-described as labourers or apprentices. It therefore excluded persons working in these occupations but who had registered for ABNs using alternative descriptions of their so-called 'business' activities. ABS data suggests the total number of labourers with ABNs could have been up to 10 times the figures uncovered by the ANAO. An ABS survey in November 2004 recorded 119,200 labourers working as owner managers of incorporated and unincorporated 'enterprises' at the time, in all industries.[83]

2. The number of persons in 2009 still holding ABNs that have been wrongly issued to them is not known, but is likely to be substantial. This is despite ATO advice in 2009 that "400,000 inappropriate ABNs" had been cancelled following an examination of the ABN system (advice to the 22 March 2009 meeting of the Building and Construction Industry Forum). The detailed criteria for cancellation and the number from the construction industry are not known.

3. The propensity for employers to state in job advertisements that applicants were required to have an ABN – noted by the ANAO and ATO in 2003 – remains very widespread in 2011. A CFMEU examination of job vacancy advertisements specifying that the worker "must have an ABN" or containing similar requirements clearly indicates that this practice is commonplace. Attachment 2 provides recent examples of these types of job advertisements.

---

[82] Australian National Audit Office (ANOA), *Administration of Australian Business Number Registrations, Follow-up Audit*, Australian Taxation Office The Auditor-General Audit Report No.15 2007-08, Performance Audit , p42.

[83] ABS, *Forms of Employment Survey*, November 2004. Cat. 6359.0. The survey was not conducted in 2003.

The profusion of such advertisements is simply not consistent with ATO claims that compliance with the alienation measure is "satisfactory", as claimed by the Deputy Commissioner in his 2005 evidence to the Parliamentary inquiry, cited earlier.

Rather, these advertisements themselves raise serious questions about the effectiveness of ATO compliance activity in relation to bogus contracting. It is clear from the sheer number – and brazenness - of these job ads requiring workers to have ABNs that there is little concern about the ATO investigating the *bona fides* of the so-called contracting arrangements being advertised.

Case Study

In November 2010 the CFMEU uncovers a tiling company on a CBD site in Western Australia with a large number of people engaged as sham contractors using ABNs. The company agrees that workers are employees and to put them 'on the books' and pay correct entitlements. Evidence of this arrangement is provided to the union and the head contractor but it is later revealed that the company had continued to pay workers at a flat daily rate of $120 to $200 and had forced the workers to return the difference between their flat rate and what went into their accounts. Those who refused were either dismissed or went without wages at all until the difference had been returned to the company. Throughout this time the workers were constantly threatened with their visas being removed or being reported to immigration (some were on student visas, some on working holiday visas and some on 457 – all with different conditions attached to the visa).

6.7.3 ABN Eligibility

Exclusion of Certain Categories from ABN Eligibility

In March 2009, after repeated representations by the CFMEU[84], the ATO online application for an ABN excluded 'apprentice, trade assistant or labourer' from being eligible to register online for an ABN.

At the online screen listing 'description of your business activity', the ABN applicant is required to select the option that best relates to the business activity they are engaged in. If they nominate 'apprentice, trade assistant or labourer' the registration will be refused, with the following explanation provided:

> *ATO ABN Entitlement Tool Report — Apprentice, trade assistant or labourer*
> *"You are not entitled to an ABN"*
> *Apprentices, trades assistants and labourers are required to work under the direction, control and supervision of their employer to learn their trade. By their very nature, they are considered employees for Commonwealth taxation and superannuation purposes. As a result you are not entitled to an ABN.*

The CFMEU welcomed this move restricting ABNs for new ABN applicants, but there are several outstanding concerns.

- While the online ABN registration route excludes these three categories from registering for an ABN, those choosing to register via hard copy forms do not appear to encounter the same advice. In July 2009 the ATO was sending out ABN registration forms to Sole Traders wanting to register for an ABN that did not mention the three categories no longer eligible.

[84] See Appendix 2, extract from CFMEU submission to Cole Inquiry.

- The issue of removing/cancelling the ABNs of persons who were Apprentices, trade assistants or labourers, and who were issued ABNs *between July 2000 and* March 2009 needs to be addressed.
- Some categories of temporary residents (in terms of immigration status, not tax status) such as backpackers, working holiday makers and subclass 457 visa-holders (in construction and elsewhere) are known to register for ABNs and take part in bogus contracting. Some do so willingly (e.g. backpackers) while others are compelled by their employers. These groups are currently all eligible for ABNs[85], but there are grounds for restricting eligibility where the risk of involvement in bogus contracting is high.

According to recent advice from the ATO between June 2009 and 2010, the total number of ABNs in the building and construction industry grew by 7%, or 57,000 ABNs. Most of these (46,000) were ABNs issued to individuals, not companies – see Table 12 below. Overall there was a 9% growth in ABNs issued to individuals.

Table 12

No of ABNs in building and construction industry, June each year ('000)				
	2009	2010	Increase 2009 to 2010	
			No	%
Company	152	154.5	2.5	1.6
Individual	510	555.8	45.8	9.0
Other	171	179.7	8.7	5.1
Total	833	890.0	57.0	6.8
Source: ATO Building Industry Forum.				

At the same time, during 2009-10 in ALL industries (not construction), a total of 148,000 ABNs were cancelled either by the ATO or the ABN holder and 57,000 'ineligible' ABN registrations were refused.

[85] Immigration regulations require 457 visa holders to be the 'direct employees' of the sponsoring employer, except for 'exempt' occupations as declared by the Immigration Minister. To date these are mainly a few highly specialised medical occupations.

In an industry with a workforce of 940,000 of which some 336,000 are described by the ABS as independent contractors (2009 figures) the fact that there are some 890,000 ABNs in circulation, of which over 62% are held by individuals, demonstrates that there are many multiple ABN holders (an average of 2.7 ABNs per independent contractor) in the industry. Whilst a small proportion of contractors might legitimately hold a number of ABNs the figures confirm that the ease with which ABNs have been issued and obtained has contaminated the system and the ATO's more recent 'crackdown' has done little to stem the flow and even less to retrieve the problem that was created when the ABN system was first introduced.

The figures also suggest that ABN holders are not confined to independent contractors but that in fact many persons counted as employees in the industry also hold them.

The ATO should immediately initiate an audit of all multiple ABN holders in the construction industry and should review the ABN status of those whose tax returns do not appear on their face to be consistent with business activities of a bona fide contractor.

6.7.4 Prosecutions

Penalties for making false declarations

Section 8K of the *Taxation (Administration) Act* 1953 (Cth) provides a range of penalties for multiple offences under s 8C which includes giving incorrect information in respect to an ABN application. The maximum penalty for a first offence is $2,200; for second and subsequent offences the maximum penalty is a fine of $4,400.

The ATO website warns that:

Penalties for applying for an ABN if you are not entitled

> *If you apply for an ABN and are not entitled to be registered you may be committing an offence under section 8K of the Taxation Administration Act 1953 by making a false or misleading statement regarding the operation of an enterprise. Persons found guilty of making misleading statements may be prosecuted*

The total number of prosecutions under Section 8K since its inception as at 14 July 2009, was only 19 and none involved ABN offences.

> **The ATO should initiate and publicise a number of prosecutions involving alleged breaches of the legislation dealing with providing false information for the purpose of obtaining an ABN.**

6.7.5 Recovery of Superannuation Entitlements

Non-payment of superannuation is a major problem in the construction industry. The ATO, which is the agency with responsibility for enforcing the payment of superannuation guarantee charge contributions, has accepted this to be the case. In 2003 it estimated that around 29 per cent of employers either fail to make superannuation payments, or pay less than the full entitlement. The ATO attributed this, in part, to high levels of bogus contracting in the industry.[86]

[86] ABCC Paper para 8.2 pg 37.

The attempted avoidance of employment-related entitlements such as superannuation is a major factor motivating employers to insist on engaging workers on a 'contractor' basis. Unpaid superannuation contributions places further strain on the public revenue as more people are forced to rely on the age pension in their retirement. The proper enforcement of superannuation contributions is therefore a critical factor in reducing the scale of sham contracting and increasing the number of people who are able to fund their own retirement at decent levels.

Case Study

A concrete finisher in North Queensland supplies his labour and a few basic hand tools to a concrete company. He supplies an ABN and is paid an 'all-in' hourly rate of pay. He does not work for anyone else except people that the company directs him to (he was paid by the company for such work). He is seen by builders as part of the company's business, not his own business. He wears company supplied clothing with company logo. The company directs his work and insists he must perform it personally. It controls his start and finish times and location of work. He has no company or other business structure of his own. He does not advertise or have business cards of his own. The company pays for his meals and accommodation whilst he is on distant work. He is a member of BUSSQ but company refuses to pay him any superannuation contributions claiming he is at all times an independent contractor. Company claims union demand to pay to BUSSQ is illegal because once payments are overdue only the ATO can recover them as SGC which must be paid to the ATO not direct to a super fund.

In March 2010 the Inspector General of Taxation released a report into the ATO's administration of the superannuation guarantee charge.[87] Amongst the Report's key findings were the following:

[87] Review into the Australian Taxation Office's administration of the Superannuation Guarantee Charge A report to the Assistant Treasurer Inspector-General of Taxation March 2010

- Over an eleven year period, the difference between SGC raised and SGC collected has accumulated to $936.1 million, increasing substantially from 2000-01. Together with the current SGC debt relating to insolvent employers, approximately $600.8 million in SGC raised by the ATO has not been recovered, with most of this debt having been written-off and representing known lost employee retirement savings.
- The above amounts represent known SG non-compliance as they have been raised through the employer lodging a SGC Statement or the ATO issuing a default assessment. The actual SG non-compliance could actually be much greater than the figures suggest. If there is no Employee Notificiation (EN) complaint lodged by an employee then the non-payment may go undetected, again representing lost employee retirement savings and higher government outlays for social security payments.
- The ATO is heavily reliant on EN complaints as a source of risk identification in the SG system — of the total 24,195 SG audit activities, 20,199 related to EN complaints. In 2009-10 proactive risk based auditing will still only represent 27 per cent of the ATO's total SG audit activities, up from 16 per cent in 2008-09.
- Any risk identification system that overly relies on employee engagement is bound to have limited effect in driving systemic improvement in SG compliance.
- Until very recently, there has been comparatively little ATO proactive work to identify potential SG non-compliance due to a combination of resourcing, availability of relevant data and the Commissioner's commitment to investigate every EN complaint. Proactive compliance work was confined to the ATO conducting SG audits as part of their high risk PAYG(W) and employer obligation audits. However, from 1 July 2009 the ATO has sought to use data matching to identify high risk employers for proactive audit although there are significant limitations on the ATO being able to undertake real-time monitoring and rapid follow-up of high risk employers.
- Up until 2007-08 there were significant ATO delays in commencing and finalising its investigations following employee complaints. Employees also complained that they were not being kept informed of the progress of their complaint.
- The current penalty and prosecution regimes, and the ATO's administration of these regimes, do not have either a sufficient deterrence or behavioural effect on

those who do not lodge a SGC Statement or on employers that do not make SG payments at all.[88]

For present purposes however the most critical finding was:-

> ***2.5 The people most at risk with the current SG system are the employees who are the least empowered or incorrectly classified as 'independent contractors'*** *— and it is these very people who are most reliant upon compulsory superannuation contributions for a higher standard of living in retirement than only relying on the age pension.*

The ATO rejected the Report's Recommendation 4 which called for an expansion of its proactive compliance work arguing that its present allocation was adequate '*having regard to the overall level of risk in the SG system, and the range of other tax and superannuation risks that the ATO is required to address.'*[89]

In reality the ATO has failed in its responsibility to properly enforce the payment of superannuation guarantee charge contributions for Australian workers. These contributions are a subsidiary concern to the ATO which has shown little appetite to seriously tackle this growing problem over many years. The ATO's interest in superannuation entitlements is a very minor subsidiary concern even though in the longer term, unpaid superannuation contributions result in higher government outgoings through the age pension.

Whilst unions will continue to pay a major role in the recovery of unpaid superannuation contributions, the time has come for the ATO to be divested of its responsibilities in this area. Responsibility for the enforcement of superannuation guarantee charge is properly a matter for an industrial regulator with the single-mindedness, resources and expertise to deal with these matters. The Fair Work

---

[88] Ch 2 Summary of Findings and Recommendations.

[89] At pg 10

Ombudsman (FWO) should be given responsibility for enforcing superannuation guarantee charge contributions. This transfer of responsibility will assist to reduce the incidence of sham contracting.

The Fair Work Ombudsman should be given responsibility for the enforcement of superannuation guarantee charge contributions and conduct an audit in the construction industry, which has been identified as an high risk industry containing almost one-third of all 'independent contractors'. The FWO and the Government should adopt in full the measures recommended by the Inspector General of Taxation in the March 2010 Report and consider such other measures as may be available to improve overall compliance in this area.

7. LABOUR HIRE

7.1 What is Labour Hire?

The term 'labour hire' is generally used to describe a triangular work arrangement under which a labour hire firm provides people to work on a client company's premises under the general supervision and direction of the client. Under these arrangements the worker's contractual relationship is with the labour hire firm which also retains the ultimate over control those engaged through their agency. The labour hire agency receives a fee from its client in return for the services provided by the worker.

There are two broad categories of labour hire arrangements:

- those where the labour hire worker is an employee of the labour hire agency – and
- those where the labour hire worker is engaged by the labour hire agency under a contract for services and no employment relationship exist with either the agency or the host ('Odco' style arrangement).

Under both arrangements the general employment obligations are removed from the host who simply pays an agreed fee to the labour hire agency.

There is little doubt that there has been a sharp increase in the use of labour hire in the past two decades. In a 2005 Discussion Paper on independent contractors and labour hire, DEEWR observed that *'the data that is available consistently suggests that labour hire workers in Australia constitute between 1.7 and 3.1 per cent of employees. The Productivity Commission estimates that between 1990 and 2002, the average annual rate of growth in the number of labour hire workers stood at 15.7 per cent in workplaces with 20 or more employees.'*[90]

[90] Dept. of Employment and Workplace Relations Discussion Paper: *Proposals for Legislative Reform in Independent Contracting and Labour Hire Arrangements 2005* p26. Submission to House of Representatives Standing Committee on Employment, Workplace Relations and Workforce Participation Inquiry into Independent Contracting and Labour Hire.

Estimates as to the number of labour hire workers on the contractor or Odco-style arrangement, as opposed to those engaged as employees, have been in the order of 20 – 25%.[91]

The majority of labour hire workers are engaged as employees on short term, casual arrangements with sporadic periods of employment, little security of employment, minimal bargaining power, fewer opportunities for training and promotion, poorer occupational health and safety standards and difficulties in establishing various employment rights as between the host employer and the labour hire firm.

The use of labour hire also affects those who are directly employed by the host employer. Often labour hire employees are used not to supplement but to replace direct employees. Where their rates of pay and conditions of employment are less than those of the direct employees of the host they can also be used as a cost-cutting measure which undermines both the conditions enjoyed by direct employees and their security of employment.

The Final Report of the Cole Royal Commission noted:-

> *The use of workers provided through labour hire firms has become increasingly common in the building and construction industry. There have been significant issues raised about the use of labour hire businesses as a source of employees in the building and construction industry. These issues include who is the employer of labour hire workers and who is responsible for the safety of their workplace and for the payment of their entitlements. Calls have been made for greater certainty about these issues.*[92]

[91] Brennan, Valos and Hindle 2003.

[92] Volume 8 Final Report p88.

7.2 Labour Hire and Sham Contracting

Whilst the clear focus of this paper is on sham contracting, mention must also be made of labour hire in the current context. The two share some common features. As the Report from the House Standing Committee on Employment, Workplace Relations and Workforce Participation 2005 Inquiry into Independent contractors and labour hire arrangements observed:

> *This inquiry into independent contractors and labour hire arrangements has revealed some disturbing trends in the changing employment arrangements for Australian workers and employers. Although there was evidence to show the value in labour hire arrangements and genuine independent contracting there was comprehensive and compelling evidence exposing unfair practices, disguised forms of employment, and exploitation of employees.*[93]

The two must also be considered because labour hire like sham contracting, has grown to such a significant level as an alternative employment form and in many cases has also been used as a form of disguised employment. Moreover, simply dealing with sham contracting on its own may not be enough if labour hire remains the simple alternative for avoiding direct employment. If a discussion on sham contracting excludes labour hire the problem is merely shifted, that is companies currently exploiting the sham contracting/ABN system may shift their focus to using labour hire employees. The net result is the same in that those employees are denied the benefit of enterprise agreements and collective bargaining and face a steady erosion of established industry standards.

[93] Para 1.40 Dissenting Report

7.3 Recommendations

The substance of the following recommendations with respect to labour hire is taken from the final report of the House Standing Committee on Employment, Workplace Relations and Workforce Participation 2005 Inquiry into Independent Contractors and Labour Hire Arrangements, including the dissenting report by the ALP members of that Committee.

- **The Australian Government attend to the spiralling increase in casual employment by legislating to confer on labour hire workers the right to request permanent employment by the host firm after three months continuous service with the host. The host firm would have to give reasonable grounds why it could not employ such a worker. Fair Work Australia should be authorised to hear any dispute over a refusal to grant such a request.**[94]

The Australian Government enact laws that recognise that both the labour hire agency and host firm have a role in respect of employment responsibilities. The Australian Government, with the agreement of the State and Territory governments, should ensure that both agency and host share joint responsibility for matters concerning OH&S. The Australian Government should ensure joint responsibility in any unfair dismissal proceedings.[95]

[94] See Recommendation 17 dissenting report

[95] Rec 18

The Australian Government should legislate to protect the effectiveness of industrial agreements and awards by prohibiting labour hire agencies from undercutting wages and conditions prescribed within the awards or workplace agreements applying to the host firm.[96]

The Australian Government should recognise that so-called 'ODCO' arrangements are a form of disguised employment and should not be recognised as a legitimate contractual arrangement. The Australian Government should amend the Fair Work Act to 'deem' all persons working under such arrangements to be employees of the labour hire firm.[97]

Recommendation 100 of the Cole Report was as follows:

> *The Commonwealth initiate, through the Workplace Relations Minister's Council, the development of a Code of Conduct and Practice for Labour Hire in the building and construction industry.*

That recommendation was subsequently supported by the Master Builders Association who also argued that such a Code could be called up by the Commonwealth as a component of the National Code and Guidelines[18] published by the Australian Procurement and Construction Council and the Department of Employment and Workplace Relations and given effect on all Commonwealth projects.[98]

[96] Rec 19

[97] Rec 21

[98] Para 7.2 MBA submission

The House Standing Committee Report of 2005 unanimously adopted the following recommendation:

> *The Committee recommends that the Australian Government, through the relevant departments and peak industry bodies, establish a voluntary labour hire industry code of practice. The Committee recommends that the voluntary code is established by 2007, and endorsed by the Australian Competition and Consumer Commission.*[99]

Consistent with this approach the following recommendation is made:

> ***The Australian Government, through the relevant departments and peak industry bodies, establish a labour hire industry code of practice for the building and construction industry the terms of which are to be adopted as part of the National Code of Practice for the Construction Industry and Implementation Guidelines.***

[99] Recommend 11

8. NATIONAL CODE OF PRACTICE

8.1 Current Provisions

The Implementation Guidelines for the National Code of Practice for the Construction industry provide:

> *Sham contracting*
>
> *6.1.4 The FW Act and the Independent Contractors Act 2006 protect genuine employees from 'sham' contracting arrangements which are sometimes used by employers to avoid paying employee entitlements (e.g. annual leave). Sham contractor arrangements are inconsistent with the Code and Guidelines.*

These provisions need to be strengthened to demonstrate that the Government regards the practice as antithetical to the workplace relations regime established by the *Fair Work Act* and is one to which such importance is attached that serious sanctions are warranted.

Case Study

A major publicly-funded infrastructure project in the ACT is the site of a serious workplace accident. The formwork collapses during a large concrete pour resulting in road closures and injuries to fifteen employees, nine of whom are hospitalized for injuries ranging from broken limbs to suspected spinal fractures. No proper site register of workers is kept and emergency services have to use listening devices to ensure no one else was trapped under the rubble. Evidence emerges that the head contractor and formwork contractor sought to disguise employer-employee relationships as independent contracting arrangements

through the illegal misuse of ABNs. No superannuation contributions are made and the subcontracting company is underinsured for workers compensation purposes (for only four persons) being on a standard concrete pouring premium instead of a complex infrastructure premium when they were in control of in excess of ten workers. There is also evidence that workers were engaged on the site without proper induction and further breaches of health and safety law in the lead-up to the incident.

8.2 Recommendations

The Implementation Guidelines for the National Code of Practice for the Construction Industry be amended as follows:

The primary responsibility for monitoring and promoting compliance with the Code and Guidelines be vested in the Fair Work Ombudsman, not the ABCC.

All head contractors are to be accountable for any sham contracting arrangements found to exist on their projects. Head contractors must include a standard form clause in their contractual documents with sub-contractors prohibiting the practice of sham contracting and requiring confirmation

(a) that work is to be undertaken by employees of the sub- contractor; and

(b) that any work which is to be sub-let by the sub-contractor is to be notified to the head contractor to enable them to assess the bona fides of any further sub-contracting arrangements.

All head contractors must seek and obtain written confirmation from each subcontractor that all superannuation, long service leave, redundancy and other employment entitlements have been paid, together with current and adequate workers compensation coverage, prior to the payment of any progress payment or retention monies.

Any contractor found to have engaged in utilised or benefited from sham contracting arrangements shall receive an automatic disqualification from all Commonwealth funded projects for a period of twelve months.

9. CONCLUSION

The problem of sham contracting in the construction industry has reached critical proportions. Sham contracting has flourished in a legislative environment that offers no disincentive to employers who set out to avoid the operation of industrial and other laws and a Government regulator, the ABCC, that has systematically ignored what is the single largest compliance problem in the industry.

The public revenue consequences of the practice are so significant that they warrant a major programme of legislative reform on their own account.

These conclusions are all available from government inquiries ranging from Royal Commissions, parliament committees and expert reviews of the taxation system. They are supported by official statistical material and privately commissioned research.

A comprehensive legislative and administrative response is now necessary to ensure that the unlawful practice of sham contracting is eradicated. The starting point for this course of action is set out in the recommendations attached to this paper as Appendix 1.

APPENDIX 1

SUMMARY OF RECOMMENDATIONS:

1	**Amend Division 6 of Part 3-1 Fair Work Act**	***DIVISION 6 – SHAM ARRANGEMENTS*** ***[Clause] 357 Engaging an employee as an independent contractor*** *(1) A person (the **employer**) must not engage, or propose to engage, another person (the **employee**), whether through an interposed entity or otherwise, as an independent contractor where the true character of the engagement, or proposed engagement, is that of **employment**.* ***Note:** This subsection is a civil remedy provision (see Part 4-1).* *(2) For the purposes of sub-section (1) 'interposed entity' means corporation, partnership or trust.*
2	**Delete the exception in s.357(2) of the FWA**	***Misrepresenting employment as independent contracting arrangement*** *(1) A person (the **employer**) that employs, or proposes to employ, another person (the **employee**) must not represent to the employee that the contract of employment under which the employee is, or would be, employed by the employer is a contract for services under which the employee performs, or would*

		perform, work as an independent contractor. ***Note:*** *This subsection is a civil remedy provision (see Part 4-1).*
3	**Delete exception in s.357(2) of the FWA**	***357A Misleading conduct relating to employment*** *(1) A person must not, in relation to employment that is to be, or may be, offered by the person or by another person, engage in conduct that is liable to mislead persons seeking the employment as to:* *(a) the availability, nature, terms or conditions of the employment, terms or conditions upon which the employment may lawfully be offered ; or* *(b) any other matter relating to the employment.* ***Note:*** *A pecuniary penalty may be imposed for a contravention of this section.*
4	**Amend clause 357 of FWA relating to dismissal and re-engagement**	***358 Dismissing to engage as independent contractor*** *An employer must not dismiss, or threaten to dismiss, a person who:* *(a) is an employee of the employer;* *(b) performs particular work for the employer;* *in order to engage the person as an independent contractor, or through a labour hire arrangement, to perform the same, or substantially the same, work under a contract for services, whether with the employer, a related employer or labour hire firm.* ***Note:*** *This subsection is a civil remedy provision (see Part 4-1).*

5	**Amend s.359 relating to misrepresentation and inducements**	***359 Misrepresentation to engage as independent contractor*** *A person (the **employer**) that employs, or has at any time employed, a person (the **employee**) to perform particular work must not make a false statement in order to persuade or influence the employee to enter into a contract for services under which the employee will perform, as an independent contractor, the same, or substantially the same, work for the employer.* ***Note:** This section is a civil remedy provision (see Part 4-1).*
6	**Mandatory Reporting System**	A mandatory reporting system be introduced in respect of payments for labour services consistent with the recommendations of the Board of Taxation Report of October 2009.
7	**Withholding Tax**	The Board of Taxation Report of October 2009 recommended that consideration be given to the introduction of a withholding rate to complement a mandatory reporting system. The Government should consider the introduction of a withholding tax in respect of all personal services income.
8	**New Employment Test**	**SECT 87.25 The employment test for a personal services business** (1) An *individual* meets the employment test in an *income year* if: (a) the *individual* engages one or more entities (other than * *associates* of the *individual* that are not *individuals*) to perform work; and

		(b) that *entity* performs, or those entities together perform, at least 30% (by * *market value*) of the *individual*'s principal work for that *year*. (2) A **personal services entity* meets the employment test in an *income year* if: (a) the *entity* engages one or more other entities to perform work, other than: (i) *individuals* whose * *personal services income* is included in the *entity*'s * *ordinary income* or * *statutory income*; or (ii) **associates* of the *entity* that are not *individuals*; and (b) that other *entity* performs, or those other entities together perform, at least 30% (by * *market value*) of the *entity*'s principal work for that *year*. (2A) If the * *personal services entity* is a *partnership*, work that a *partner* performs is taken, for the purposes of subsection (2), to be work that the *personal services entity* engages another *entity* to perform. (3) An *individual* or a * *personal services entity* also meets the employment test in an *income year* if, for at least half the *income year*, the *individual* or *entity* has one or more apprentices. (4) For the purposes of this section 'principal work' means the work that is central to meeting the obligations of the individual or personal services entity to any acquirer of services from such individual or entity but does not include work that is ancillary to such work such as bookkeeping, accounting or secretarial work.

9	**An amended 'Results' Test**	***The results test for a personal services business*** (1) *An individual meets the results test in an income year if, in relation to at least 75% of the individual's personal services income during the income year:* (a) *the income is for producing a result; and* *(b) the individual is required to supply the plant and equipment, not including the tools of trade which it is normal and traditional in the industry for individuals to provide for themselves to do their job and produce the result; and* (c) *the individual provides all the materials necessary to complete the work and produce the result; and* *(d) the individual is, or would be, liable for the cost of rectifying any defect in the work performed.*
10	**Audit of ABN Holders**	The ATO should immediately initiate an audit of all multiple ABN holders in the construction industry and should review the ABN status of those whose tax returns do not appear on their face to be consistent with business activities of a bona fide contractor.
11	**Publicise Prosecutions**	The ATO should initiate and publicise a number of prosecutions involving alleged breaches of the legislation dealing with providing false information for the purpose of obtaining an ABN.
12	**FWO Responsibility for**	The Fair Work Ombudsman should be given responsibility for the enforcement

	superannuation	of superannuation guarantee charge contributions and conduct an audit in the construction industry which has been identified as an high risk industry containing almost one-third of all 'independent contractors'. The FWO and the Government should adopt in full the measures recommended by the Inspector General of Taxation in the March 2010 Report and consider such other measures as may be available to improve overall compliance in this area.
13	**Right to Permanent Employment**	The Australian Government attend to the spiralling increase in casual employment by legislating to confer on labour hire workers the right to request permanent employment by the host firm after three months continuous service with the host. The host firm would have to give reasonable grounds why it could not employ such a worker. Fair Work Australia should be authorised to hear any dispute over a refusal to grant such a request.[100]
14	**Employment Responsibilites**	The Australian Government enact laws that recognise that both the labour hire agency and host firm have a role in respect of employment responsibilities. The Australian Government, with the agreement of the State and Territory governments, should ensure that both agency and host share joint responsibility

[100] See recommendation 17 dissenting report

		for matters concerning OH&S. The Australian Government should ensure joint responsibility in any unfair dismissal proceedings.[101]

[101] Rec 18

15	**Prohibition of Undercutting of Wages and Conditions of Awards**	The Australian Government should legislate to protect the effectiveness of industrial agreements and awards by prohibiting labour hire agencies from undercutting wages and conditions prescribed within the awards or workplace agreements applying to the host firm.[102]
16	**'ODCO' Arrangements**	The Australian Government should recognise that so-called 'ODCO' arrangements are a form of disguised employment and should not be recognised as a legitimate contractual arrangement. The Australian Government should amend the Fair Work Act to 'deem' all persons working under such arrangements to be employees of the labour hire firm.[103]
17	**Labour Hire Code of Practice**	The Australian Government, through the relevant departments and peak industry bodies, establish a labour hire industry code of practice for the building and construction industry the terms of which are to be adopted as part of the National Code of Practice for the Construction Industry and Implementation Guidelines.
18	**Compliance of Code and Guidelines**	The primary responsibility for monitoring and promoting compliance with the Code and Guidelines be vested in the Fair Work Ombudsman, not the ABCC.

[102] Rec 19

[103] Rec 21

19	**Accountability**	All head contractors are to be accountable for any sham contracting arrangements found to exist on their projects. Head contractors must include a standard form clause in their contractual documents with sub-contractors prohibiting the practice of sham contracting and requiring confirmation a) that work is to be undertaken by employees of the sub- contractor; and b) that any work which is to be sub-let by the sub-contractor is to be notified to the head contractor to enable them to assess the bona fides of any further sub-contracting arrangements.
20	**Automatic Disqualification**	Any contractor found to have engaged in utilised or benefited from sham contracting arrangements shall receive an automatic disqualification from all Commonwealth funded projects for a period of twelve months.
21	**Transfer of Responsibility**	The Fair Work Ombudsman should be given responsibility for the enforcement of superannuation guarantee charge contributions and conduct an audit on the construction industry which has been identified as an high risk industry with almost one-third of all 'independent contractors'. The FWO and the Government should adopt in full the measures recommended by the Inspector General of Taxation in the March 2010 Report and consider such other measures as may be available to improve overall compliance in this area.

APPENDIX 2

LIST OF ABN JOB ADVERTS:

Formworker: http://jobview.careerone.com.au/Formworker-Job-Geelong-VIC-AU-96203799.aspx

Geelong Advertiser

Job Summary

Division Name
The Geelong Advertiser

Job Code
2385723

Date Posted
29/01/2011

Category
Construction, Architecture & Interior Design

City
Geelong

State
VIC

Job Type
Full Time
Permanent

Contact Information
Paul
Geelong, VIC 3220

Phone: 0417-342997

As Advertised in Advertiser

Formworker

About the Job
FORMWORKER Qualified. Must have ABN. Surfcoast area. Phone Aztec Concrete, Paul 0417-342997.

This ad appeared in The Geelong Advertiser on 29 Jan 11

Formwork Carpenter: http://www.seek.com.au/Job/formwork-carpenter/in/darwin/19089497

formwork carpenter - Territory Construction Services Pty Ltd

formwork carpenter

11 Feb 2011

Location
Darwin

Salary
$35 - $49.99 per hour

Classification
Construction
- Other

APPLY

Small Darwin based civil construction company specialising in bridge, culvert and floodway construction requires quality construction workers (2 positions) for projects this year and beyond for the right person. Bush jobs a long way from town.

Bridge and culvert experience very useful. You should be a decent formworker, but as part of a small crew of 5 or 6 men you need to be multi skilled and be steel, pour concrete, operate plant if you can, etc. If you can read drawings and run a small team in a leading hand type role all the better.

White cards, tickets, training certificates and similar nonsense are a disadvantage. You only need to know what you're doing.

Start March 2011, top rates.

Please email resume to gregcousens@bigpond.com. Phone 0427393052 for further information.

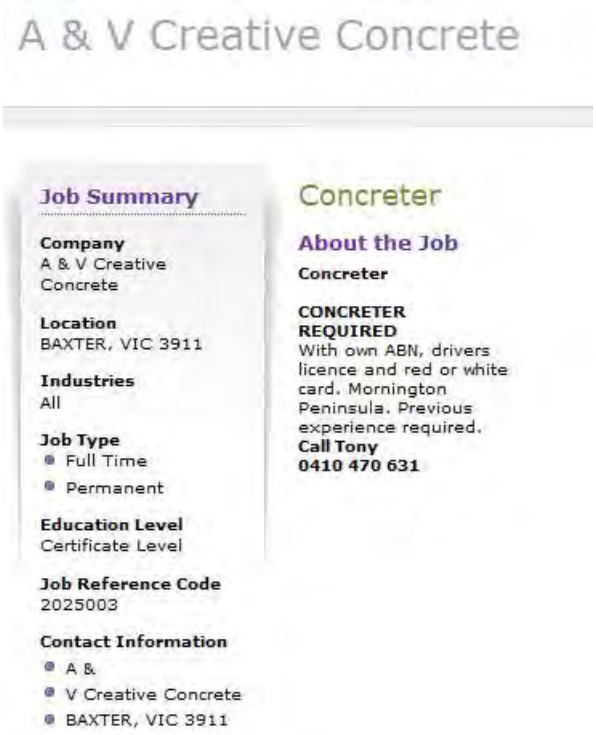
greg cousens Director
Territory Construction Services Pty Ltd
0427393052

Related Courses

- Certificate IV in Bui... Construction (Build...
- Diploma of Building... Construction (Build...

Concreter 13/2/11:

http://jobview.careerone.com.au/Concreter-Job-BAXTER-VIC-AU-96962313.aspx



A & V Creative Concrete

Job Summary

Company
A & V Creative Concrete

Location
BAXTER, VIC 3911

Industries
All

Job Type
- Full Time
- Permanent

Education Level
Certificate Level

Job Reference Code
2025003

Contact Information
- A &
- V Creative Concrete
- BAXTER, VIC 3911

Concreter

About the Job

Concreter

CONCRETER REQUIRED
With own ABN, drivers licence and red or white card. Mornington Peninsula. Previous experience required.
Call Tony
0410 470 631

Concreter/Concrete Labourer 13/2/11:

http://jobview.careerone.com.au/Concreter-Concrete-Labourer-Job-PATTERSON-LAKES-VIC-AU-96962408.aspx

Harbour Concret Services

Job Summary

Company
Harbour Concret Services

Location
PATTERSON LAKES, VIC 3197

Industries
All

Job Type
- Full Time
- Permanent

Job Reference Code
2063812

Contact Information
- Harbour Concret Services
- PATTERSON LAKES, VIC 3197

Concreter/Concrete Labourer

About the Job

Concreter/Concrete Labourer
Harbour Concreting Services

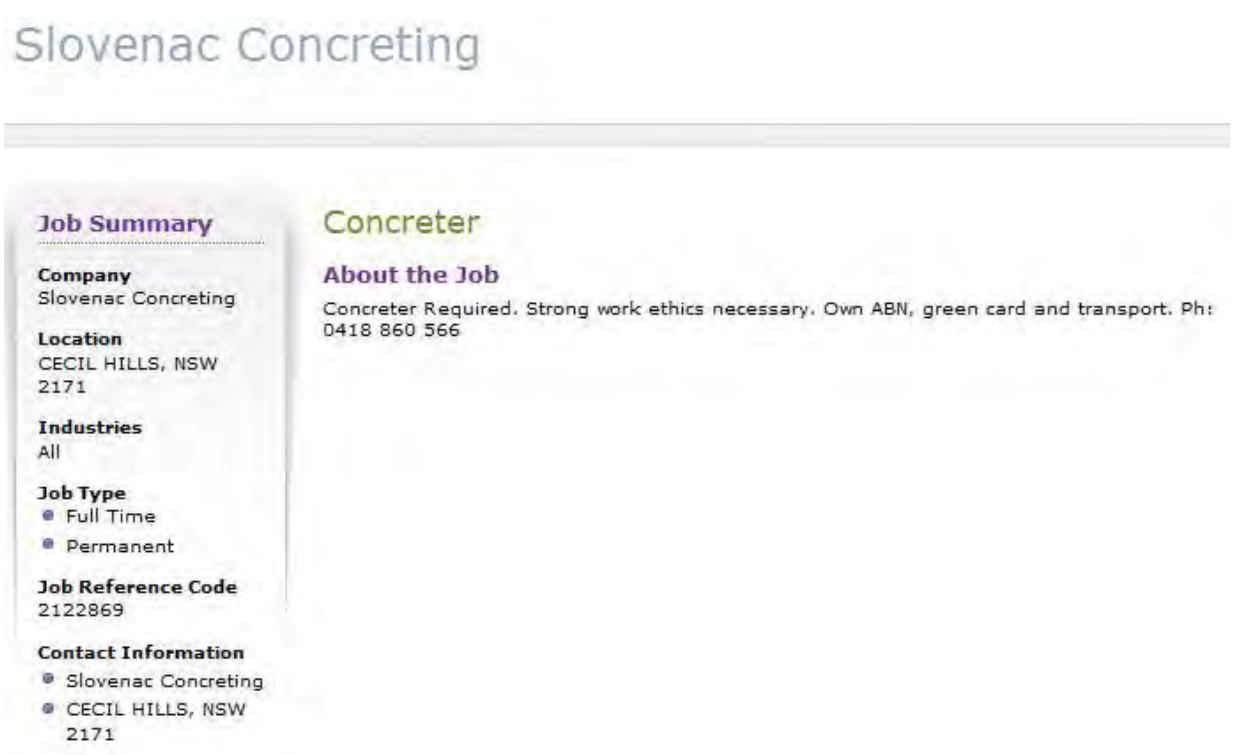
CONCRETER AND/OR CONCRETE LABOURER
Must be experienced in house slabs. Must have own transport and ABN.
Harbour Concreting Services
0418 138 820

Concreter/Labourers 10/2/11:

http://jobview.careerone.com.au/CONCRETER-LABOURERS-Job-SUNBURY-VIC-AU-96725522.aspx

Concreter 10/2/11:

http://jobview.careerone.com.au/Concreter-Job-CECIL-HILLS-NSW-AU-96758871.aspx



Concreter 9/02/11:

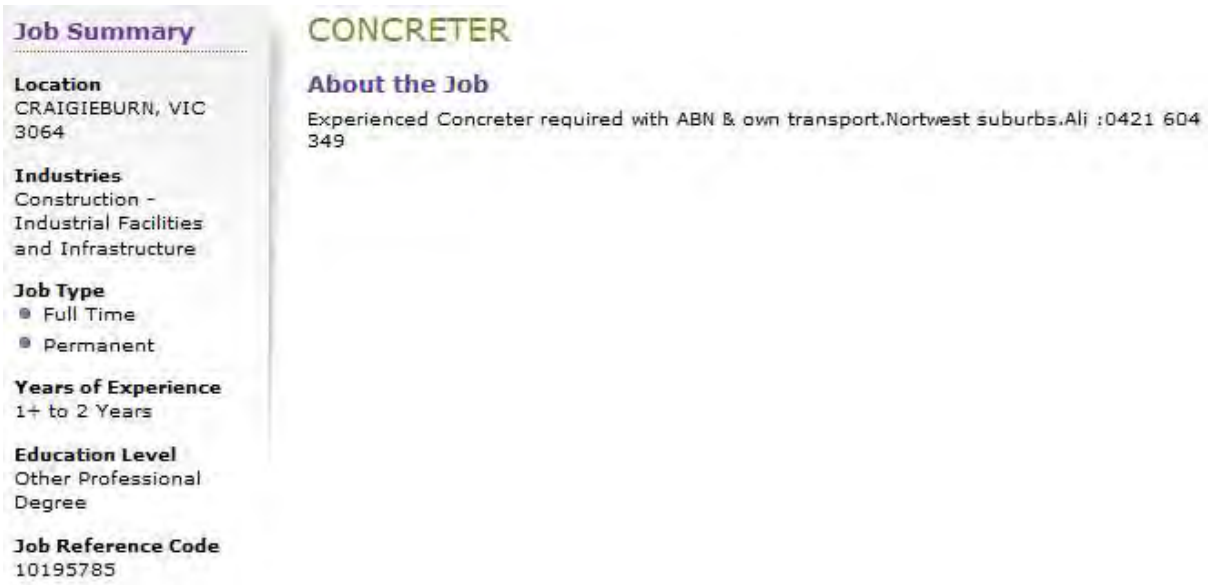
http://jobview.careerone.com.au/CONCRETER-Job-Brisbane-QLD-AU-96692058.aspx

Concreter 8/2/11

http://jobview.careerone.com.au/CONCRETER-Job-NORAVILLE-NSW-AU-96692534.aspx

Concreter 4/2/11

http://jobview.careerone.com.au/CONCRETER-Job-CRAIGIEBURN-VIC-AU-96298953.aspx



Job Summary

Location
CRAIGIEBURN, VIC 3064

Industries
Construction - Industrial Facilities and Infrastructure

Job Type
- Full Time
- Permanent

Years of Experience
1+ to 2 Years

Education Level
Other Professional Degree

Job Reference Code
10195785

CONCRETER

About the Job

Experienced Concreter required with ABN & own transport.Nortwest suburbs.Ali :0421 604 349

Concreter 2/2/11

http://jobview.careerone.com.au/CONCRETER-Job-HILLSIDE-VIC-AU-96280014.aspx

Concrete Inc

Job Summary

Company
Concrete Inc

Location
HILLSIDE, VIC 3037

Industries
All

Job Type
- Full Time
- Permanent

Job Reference Code
2102947

Contact Information
- Concrete Inc
- HILLSIDE, VIC 3037

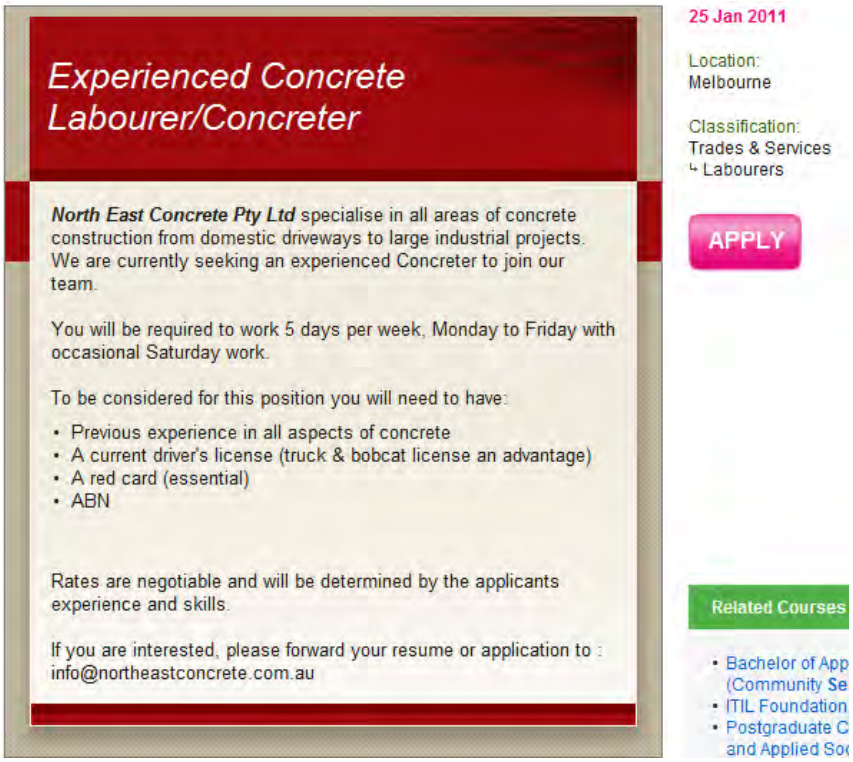
CONCRETER

About the Job

CONCRETER - EXPERIENCED Labourers, North/West subs, for Waffle POD slabs, immed. start, full time position, references req. Must have ABN and red card, own car and licence, great conditions and rates for the right people. 0432 829 021

Concreter:

http://www.seek.com.au/Job/experienced-concrete-labourer-concreter/in/melbourne/18955613



Experienced Concrete Labourer/Concreter

North East Concrete Pty Ltd specialise in all areas of concrete construction from domestic driveways to large industrial projects. We are currently seeking an experienced Concreter to join our team.

You will be required to work 5 days per week, Monday to Friday with occasional Saturday work.

To be considered for this position you will need to have:

- Previous experience in all aspects of concrete
- A current driver's license (truck & bobcat license an advantage)
- A red card (essential)
- ABN

Rates are negotiable and will be determined by the applicants experience and skills.

If you are interested, please forward your resume or application to : info@northeastconcrete.com.au

25 Jan 2011

Location:
Melbourne

Classification:
Trades & Services
↳ Labourers

APPLY

Related Courses

- Bachelor of App (Community Se
- ITIL Foundation
- Postgraduate C and Applied Soc

Bricklayer and Labourer:

http://jobview.careerone.com.au/BRICKLAYER-LABOURER-Job-Melbourne-VIC-AU-96693041.aspx

Herald Sun

Job Summary

Division Name
The Herald Sun

Job Code
2378469

Date Posted
9/02/2011

Category
Trades & Services

City
Melbourne

State
VIC

Job Type
Full Time
Permanent

Career Level
Experienced (Non-Manager)

As Advertised in **Herald Sun**

BRICKLAYER AND LABOURER

About the Job
BRICKLAYER AND LABOURER Inner subs. Experience req. Red card and abn. 0425 552 580

This ad appeared in Herald Sun on 09 Feb 11

Qualified Bricklayer:

http://www.seek.com.au/Job/qualified-bricklayer/in/melbourne-bayside-south-eastern-suburbs/18988876

Qualified Bricklayer - Barclay Bricklaying

Back to search

Qualified Bricklayer

31 Jan 2011

Location:
Melbourne
↳ Bayside & South Eastern Suburbs

Classification:
Trades & Services
↳ Building Trades

APPLY

Barclay Bricklaying is a small family bricklaying business seeking a Qualified Bricklayer for work in South Eastern Suburbs of Melbourne. All jobs are domestic. We have a large work load and are needing someone to start ASAP
We are looking for a good qualified that we can rely on long term to be a major part of building our business.

skills required:
- Completed apprenticeship
- Be competent and able to lay bricks neat and fast
- Ability to read plans
- Ability to assist with some general duties within a building company
- Ability to recognise any on job problems
- Excellent communication skills
- Responsibility of supervising apprentices if needed
- Trust worthy

Paid as subcontractor
Red Card, ABN and own transport required!
Loyalty will be rewarded
30 - 40 hours a week (including possible weekend work)
pay negotiable depending on skill level and speed

Jacqui Barclay
Barclay Bricklaying
0404843794

Related Courses

- Bachelor of Applied Social Scienc (Community Services)
- ITIL Foundation Exam
- Postgraduate Certificate in Policy and Applied Social Research

Scaffolder/Labourers:

http://jobview.careerone.com.au/Scaffolder-Labourers-Job-MORNINGTON-VIC-AU-96220368.aspx

Alltrade Scaffolding P/L

Job Summary

Company
Alltrade Scaffolding P/L

Location
MORNINGTON, VIC 3931

Industries
All

Job Type
- Full Time
- Permanent

Job Reference Code
2076449

Contact Information
- Alltrade Scaffolding P/L
- MORNINGTON, VIC 3931

Scaffolder/Labourers

About the Job

SCAFFOLDER/LABOURERS Mornington Peninsula based scaffold hire company requires staff. Red card. Own transport. ABN. Send resume to alltradesscaffolding@bigpond.com or (03)5978-8110 Phone: (03)5978-8118

Bricklayer and Labourer:

http://mycareer.com.au/jobs/sydney/trades/bricklaying/7833489+bricklayer+labourer+experience+in.aspx?s=155

Bricklayer & Labourer Experience In

BRICKLAYER & Labourer
Experience in veneers need only
apply. ABN, OH&S, own vehicle. Long run. Eastwood.

Ph: 0419 975 506

This ad appeared in

The Sydney Morning Herald
The Sun-Herald

Sector & Subsector	Trades and Services: *Bricklaying*
Ref No.	Not Specified
Salary	Salary not specified
Work Type	Full Time
Location	Sydney Metro, NSW
Date Posted	Mon 07/02/11
Posted Till	Wed 09/03/11
Ad Placed By	Published in The Sydney Morning Herald View other jobs from this employer

Important security notice:
Never provide your identity, bank or credit card details as part of the job application process. How to make your job search secure..

Labourer: http://jobsearch.gov.au/findajob/job.aspx?CurrId=173916205

labourer

Description

Scaffolding labourer required to assist Scaffold hire teams for erection of Kwik Stage Steel scaffold. Own transport to yard & or site. Red Card. ABN. You will be responsible for tax, Super etc. Basic ticket an advantage. Email resume: alltradescaffolding@bigpond.com Fax: 5978 8110

Details

Location: VIC - MORNINGTON
Salary: $20 per hour neg
Work type: Full time position, 35 hours or more per week
Tenancy: Permanent, 6+ months
Hours: 40hrs
Number of positions: 3

Source: Public Employer
Job ID: 173916205
Last modified: 01 February 2011
Options: Apply directly to employer

How to apply

To apply, please fax your application and resume to Josh Dentry at Alltrade Scaffolding P/L* on 03 59788110.

Enquiries from all suitable job seekers welcome.

Rigger: http://www.jobseeker.com.au/Rigger-jobs-in-Sydney-NSW

RIGGERS
Kpr Engineering - Arncliffe NSW
RIGGERS tickets, green card, EWP, own transport, abn holders advantage, casual ongoing work. alex@kprengineering.com.au...
From CareerOne - 2 days ago - save job ▸ more...

Bricklayer:

http://melbourne.gumtree.com.au/c-Jobs-construction-trade-engineer-tradesmen-labour-Looking-for-a-bricklayer-to-work-full-time-in-Epping-W0QQAdIdZ259729290

Date Listed	10/02/2011
Address	Epping VIC 3076, Australia
Job Type	Fulltime
Advertised by	Private

must hold a red card, have ppe, have own tools and transport, a MUST! be a clean, neat and fast bricklayer. If you think thats you, contact me on 0402 537 786.

Visits: 46

Bricklayer:

http://melbourne.gumtree.com.au/c-Jobs-construction-trade-engineer-tradesmen-labour-Bricklayer-W0QQAdIdZ257786268

Bricklayer

Date Listed	01/02/2011
Address	Melbourne VIC, Australia
Job Type	Fulltime

Reliable and Experienced Bricklayer required. Must have ABN.
Must have own Transport. Very Constant supply of work and Good payment conditions. Friendly small-medium gang. Immediate Start.
Work mainly centralised Epping / Craigieburn area.
Experienced Brick layers may only apply. Phone Chris 0411 187 810

Visits: 184

Bricklaying Labourer:

http://melbourne.gumtree.com.au/c-Jobs-Wanted-construction-trade-engineer-tradesmen-labour-BRICKLAYING-LABOURER-NEEDED-ASAP-W0QQAdIdZ257750561

BRICKLAYING LABOURER NEEDED ASAP

Date Listed	01/02/2011
Last Edited	07/02/2011
Address	Point Cook Rd, Point Cook VIC 3030, Australia
Job Type	Fulltime

-FULL TIME OR PART TIME POSITION FOR BRICKLAYER LABOURER
-START ASAP
-MUST HAVE OWN TRANSPORT
-WORKING IN THE WESTERN SUBURBS
-WE PAY $150 A DAY ON THE BOOKS (ABN)
-MUST HAVE RED CARD
-WORKING HOURS 7:30am till 4:30pm
IF YOUR INTRESTED CALL ME Bojan ON 0420 987 119

Bricklaying: http://www.alljobs.com.au/bricklayer-house-builder-list.html

4. 8th Feb - QUALIFIED **BRICKLAYER** - Doreen, VIC, 3754

QUALIFIED **BRICKLAYER**QUALIFIED **BRICKLAYER**WANTEDMust have ABN forwork in th.. « less

QUALIFIED **BRICKLAYER**QUALIFIED **BRICKLAYER**WANTEDMust have ABN forwork in the Doreenarea. Contact Peter 0417 472 758

Company Confiden...

Permanent link to this job

5. 5th Feb - **BRICKLAYER** - Hobart, TAS, 7000

BRICKLAYER Must have ABN. 0412 424 703This ad appeared in The Hobart Mercury on 05. « less

BRICKLAYER Must have ABN. 0412 424 703This ad appeared in The Hobart Mercury on 05 Feb 11

The Mercury

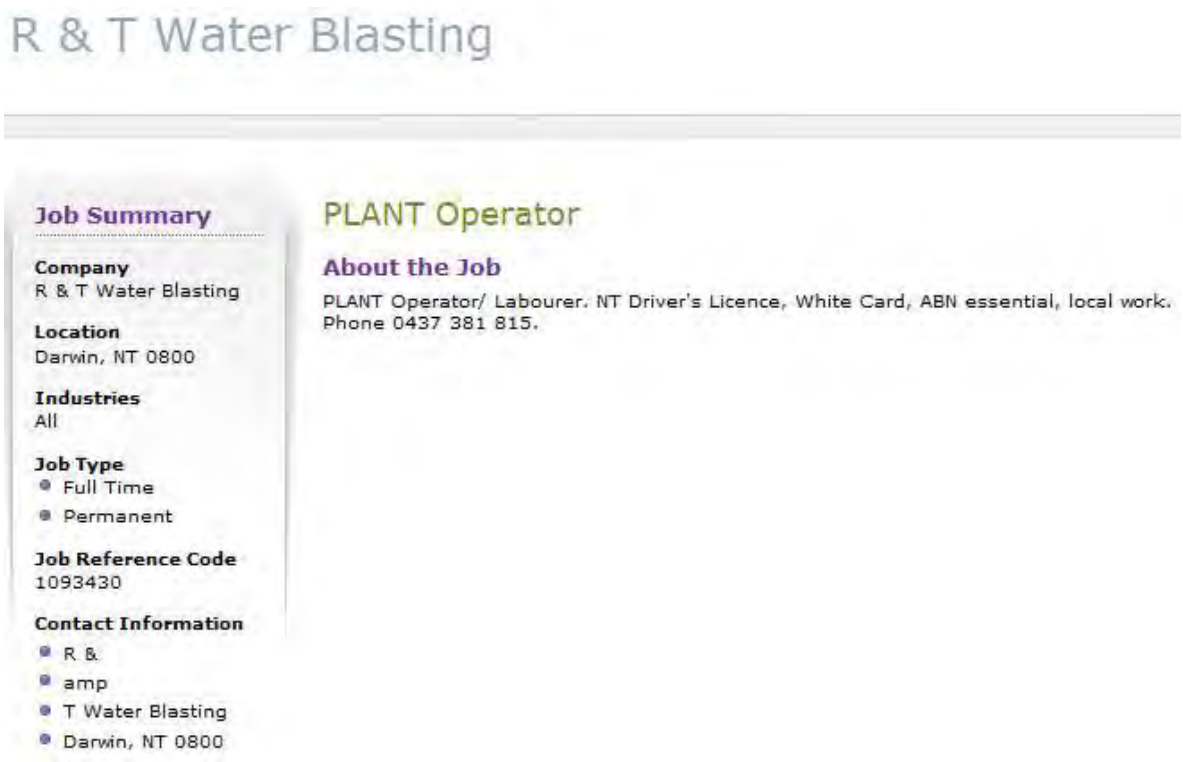
Permanent link to this job

Building Worker:

http://jobview.careerone.com.au/BUILDING-Worker-Job-Darwin-NT-AU-96996722.aspx

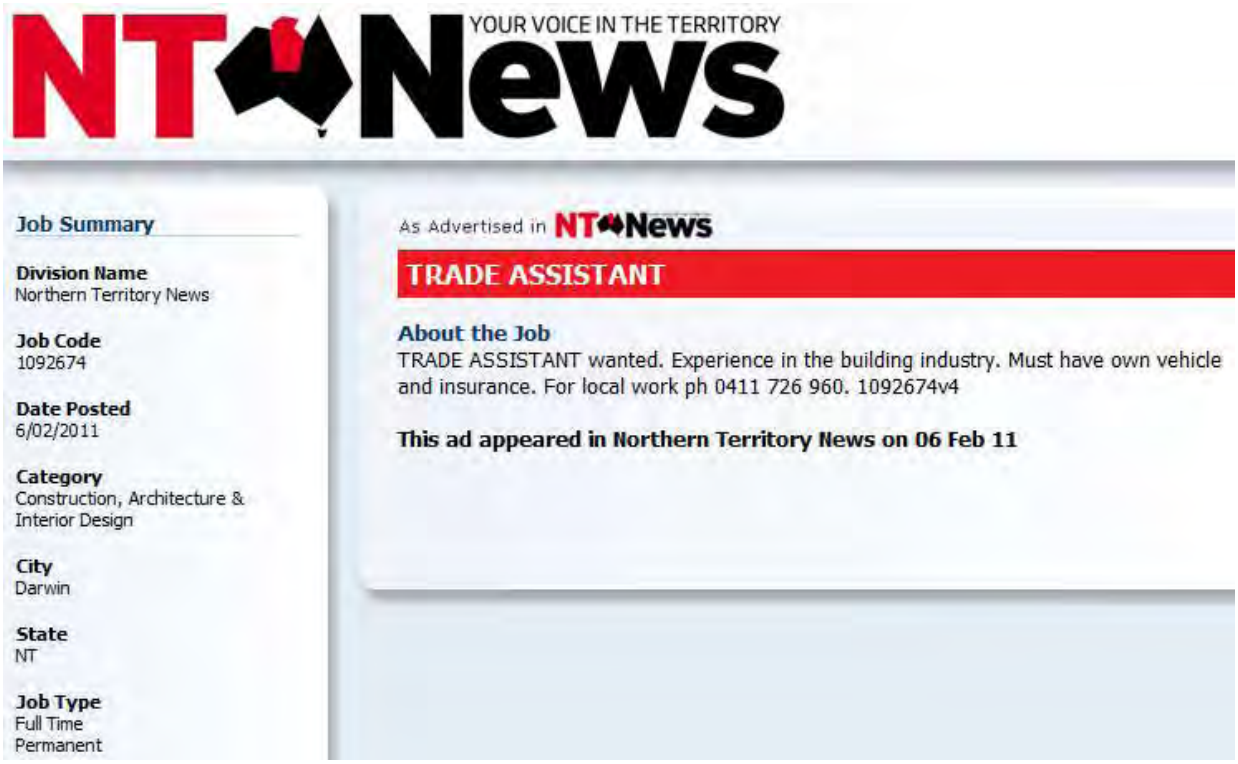
Plant Operator:

http://jobview.careerone.com.au/PLANT-Operator-Job-Darwin-NT-AU-96745015.aspx



Trade Assistant:

http://jobview.careerone.com.au/TRADE-ASSISTANT-Job-Darwin-NT-AU-96618158.aspx



NT News YOUR VOICE IN THE TERRITORY

Job Summary

Division Name
Northern Territory News

Job Code
1092674

Date Posted
6/02/2011

Category
Construction, Architecture & Interior Design

City
Darwin

State
NT

Job Type
Full Time
Permanent

As Advertised in NT News

TRADE ASSISTANT

About the Job
TRADE ASSISTANT wanted. Experience in the building industry. Must have own vehicle and insurance. For local work ph 0411 726 960. 1092674v4

This ad appeared in Northern Territory News on 06 Feb 11

Blocklayer: http://jobview.careerone.com.au/BLOCKLAYER-Job-Darwin-NT-AU-96250757.aspx

NT News YOUR VOICE IN THE TERRITORY

Job Summary

Division Name
Northern Territory News

Job Code
1000492

Date Posted
1/02/2011

Category
Construction, Architecture & Interior Design

City
Darwin

State
NT

Job Type
Full Time
Permanent

Career Level
Experienced (Non-Manager)

As Advertised in NT News

BLOCKLAYER

About the Job
BLOCKLAYER tradesman, must have own transport, ABN & Insurance, long run of work. Phone Peter 0417 608 295. 1000492v4

This ad appeared in Northern Territory News on 01 Feb 11

APPENDIX 3

POST IMPLEMENTATION REVIEW INTO THE ALIENATION OF PERSONAL SERVICES INCOME RULES

Australian Government

The Board of Taxation

POST IMPLEMENTATION REVIEW INTO THE ALIENATION OF PERSONAL SERVICES INCOME RULES

A report to the Assistant Treasurer

the board of taxation

www.taxboard.gov.au

The Board of Taxation

October 2009

ISBN 978-0-642-74572-9

CONTENTS

FOREWORD

The Board of Taxation is pleased to submit this report to the Assistant Treasurer following its post-implementation review into the alienation of personal services income rules. The Board has considered whether the rules have been effective in achieving the goals of greater equity and neutrality in taxing income from personal services.

The Board established a Working Group chaired by Mr Keith James to conduct the review. The Board conducted consultation with stakeholders and received assistance from officials from the Treasury and the Australian Taxation Office. The Board would like to thank all those who so readily contributed to assist the Board in conducting the review.

The Board would like to express its appreciation for the assistance provided to the Working Group by officials from the Treasury and the Australian Taxation Office.

The *ex officio* members of the Board — the Secretary to the Treasury, Dr Ken Henry AC, the Commissioner of Taxation, Mr Michael D'Ascenzo, and the First Parliamentary Counsel, Mr Peter Quiggin PSM— reserved their final views on the issues canvassed in this report for advice to Government.

On behalf of the Board, it is with great pleasure that we submit this report to the Assistant Treasurer.

SIGNED

Richard F E Warburton AO
Chairman, Board of Taxation

SIGNED

Keith James
Chairman of the Board's Working Group

EXECUTIVE SUMMARY

The Board of Taxation has undertaken a post-implementation review into the alienation of personal services income rules.

The alienation of personal services income rules are aimed at ensuring that the taxation of personal services income applies equally, regardless of the arrangements under which the income is earned, and that neither 'business-like' deductions, income splitting nor tax deferral are available to entities that are not genuinely conducting a business enterprise.

The key issues before the Board were to establish if the legislation is having its intended effect and whether its implementation can be improved.

The Board's key findings are as follows:

- The alienation of personal services income rules have gone some way to achieving their intention of improving integrity and equity in the tax system.
- However, the extent of improvement in the integrity and equity in the tax system provided by the rules is in the Board's view inadequate.
- The difficulty in applying the rules and associated uncertainty, together with a limited level of compliance activity by the ATO, has diminished their efficacy in achieving their policy intent.
  - There is evidence of a low level of compliance. An unintended consequence of the ATO not being seen to be widely monitoring and auditing compliance with the alienation of personal services income rules is that it may have contributed to complacency among some taxpayers and advisors. The ATO considers that personal services income is a low risk to revenue, however, if low compliance is allowed to continue, it may undermine integrity and equity of the tax system. The Board accepts that monitoring of compliance activity on personal services income is made difficult by the absence of information from other sources on the taxpayers who should be reporting that they have personal services income.
  - The difficulty in applying the rules that determine whether or not the taxpayer is a personal services business leads to a degree of uncertainty or 'greyness' around the rules, that provides opportunities for taxpayers to interpret them in their favour. Complex attribution rules and associated

pay-as-you-go withholding obligations have also contributed to the costs of compliance.

– A key focus of the rules, in addition to addressing alienation of personal services income, is to ensure that taxpayers claim the appropriate deductions. While there was some initial reduction in incorrect claiming of deductions it continues to be an area of concern, in particular payments to associates for non-principal work.

– The rules were intended to reduce the Commissioner's reliance on Part IVA of the ITAA 1936 to deal with tax avoidance through the alienation of personal services income. The large number of taxpayers who assess themselves as personal services businesses means that the Commissioner continues to need to rely on Part IVA to a considerable extent. Taxpayers are also uncertain about the circumstances that would trigger the application of Part IVA once they have passed one of the personal services business tests.

The Board does not consider that the alienation of personal services income rules in their current form provide an acceptable level of integrity and equity. The Board therefore recommends that alternatives to the current provisions be considered, to meet the policy intent of improved integrity and equity.

The Board has suggested a number of options which, either alone or in a combination, could assist in providing greater equity and neutrality in the taxation of personal services income. These are:

- providing some third party information to assist in monitoring compliance with the rules by the ATO by *introducing a reporting obligation*, which could be supplemented by *introducing a withholding obligation*;

- addressing the alienation of income by entities deriving personal services income *by extending the attribution rules to personal service businesses*;

- *clarifying and simplifying the deduction provisions*;

- clarifying the rules around who is affected by the rules, possibly by *implementing the tests of 'employee-like manner' as originally recommended by the Ralph Report*; or

- *introducing a deemed labour income approach* which would focus on distinguishing that part of an entity's income that is derived from an individual's labour from the part that is a return to their business assets or capital.

A key issue to be considered when assessing the options is whether to focus on those providers of personal services income who have 'employee-like' characteristics rather than those who operate in a 'business-like' way, or whether to focus more broadly on the providers of personal services income.

Consistent with the terms of reference, the Board recommends that these options be considered further in the context of the Review of Australia's Future Tax System headed by Dr Ken Henry.

CHAPTER 1: INTRODUCTION

1.1 On 3 June 2009, the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, the Hon Chris Bowen MP, asked the Board of Taxation to undertake a post-implementation review into the alienation of personal services income rules and to report its findings and recommendations to the Government by the end of October 2009. As part of that request, the below terms of reference were provided to the Board.

TERMS OF REFERENCE

Background

1.2 The alienation of personal services income rules were introduced to improve the integrity of the tax system. The rules resulted from calls for greater equity and neutrality in the taxation of personal services income.

1.3 The changes came out of recommendations of the *Review of Business Taxation*. The rules are designed to improve integrity by addressing both:

- the capacity of individuals and interposed entities (providing personal services of an individual) to claim higher deductions than employees providing the same or similar services; and

- the alienation of personal services income through an interposed entity.

1.4 Even if a taxpayer's income is not affected by these rules, the general anti-avoidance provisions may still apply to schemes to reduce income tax by income splitting.

1.5 The Government has become aware of significant stakeholder concerns that the personal services income rules may not entirely achieve the goals of greater equity and neutrality in taxing income from personal services.

Scope of the review

1.6 The Board of Taxation is requested to undertake a post-implementation review[1] into the alienation of personal services income rules. In undertaking the review, the Board is also to:

- examine the operation of the rules to determine whether the rules are achieving their desired policy outcome;
- identify any problems with the operation of the rules; and
- if appropriate, consider options for improving the rules.

1.7 In conducting the review, the Board is to:

- have regard to the Review of Australia's Future Tax System headed by Dr Ken Henry;
- seek public submissions and consult widely; and
- produce a final report by 31 October 2009 so that any findings and recommendations can inform the Panel undertaking the Review of Australia's Future Tax System, which is due to report by the end of 2009.

THE REVIEW TEAM

1.8 The Board appointed a Working Group of its members comprising Mr Keith James (Chairman), Mr Peter Quiggin and Mr Curt Rendall to oversee this post-implementation review.

REVIEW PROCESS

1.9 As requested by the terms of reference, the Board sought public submissions addressing the terms of reference and consulted widely with interested stakeholders.

1.10 In its invitation for submissions, the Board clarified that the intention in undertaking post-implementation reviews is not to reopen debates about the merits of

[1] The standing terms of reference for a post-implementation review requires the Board to consider whether the legislation: gives effect to the Government's policy intent, with compliance and administration costs commensurate with those foreshadowed in the Regulation Impact Statement for the measure; is expressed in a clear, simple, comprehensible and workable manner; avoids unintended consequences of a substantive nature; takes account of actual taxpayer circumstances and commercial practices; is consistent with other tax legislation; and provides certainty.

a particular policy or measure, but rather to establish if the legislation is having its intended effect and to find out whether its implementation can be improved.

1.11 The Board invited submissions by 27 July 2009. It received 13 submissions, eight of which were made by associations, four by accounting professional bodies and one by an individual. The names of those who made public submissions are listed in Appendix A.

1.12 To supplement the feedback obtained from submissions, the Board organised three workshops with tax practitioners with expertise in this area of the law. Workshops were organised with the assistance of the professional accounting bodies in Melbourne on 11 August, in Sydney on 24 August and in Canberra on 2 September. In total, around 30 tax practitioners attended these workshops.

BOARD'S REPORT

1.13 The Board has considered the issues raised by stakeholders in their submissions and at the consultation meetings. However, the Board's recommendations reflect its independent judgment.

CHAPTER 2: BACKGROUND ON THE ALIENATION OF PERSONAL SERVICES INCOME RULES

POLICY DRIVERS

2.1 At the time the Ralph Report was conducted in 1999, the use of interposed entities to alienate payments in respect of personal services was increasing, as was the use of contractors rather than employees in some industries.

2.2 Personal services income is 'alienated' when an entity (a company, trust or partnership) is interposed between the individual and the person paying for their services, so that the interposed entity derives the income rather than the individual. The entity can then be used to distribute income to owners or beneficiaries of the entity who provide none or very little of the personal services. Some of the income may also be left in the entity. If the entity is a company, it will incur tax at the company tax rate and so deferring tax at potentially higher personal tax rates.

2.3 The Ralph Report referred to some taxpayers who were operating in an 'employee-like manner' who were using an entity or holding themselves out to be a contractor in order to claim deductions not generally available to an employee, such as home-to-work travel expenses or payments to an associate.

2.4 These practices were seen to raise significant issues of equity and a threat to the income tax base. The use of such arrangements to reduce tax liabilities of individuals meant that people in substantially the same financial and work situation would be paying significantly different amounts of tax.

2.5 Prior to the enactment of the alienation of personal service income rules, the general anti-avoidance provisions in Part IVA had to be relied upon to prevent income splitting and access to additional deductions. Part IVA could only be applied on a case-by-case basis and required an assessment by the Commissioner that the dominant purpose of entering into the arrangement was to gain a tax benefit.

2.6 In broad terms, Part IVA could be said to allow income splitting which was not undertaken with a dominant purpose of obtaining a tax benefit, and to prohibit income splitting which was undertaken with such a dominant purpose. While some principles emerge from the cases, they were heavily dependent on the individual facts,

such as in the cases of Mr Mochkin[2] who was able to prove that the dominant purpose of his scheme in 1992 was not that of obtaining a tax benefit, or of Mr Ryan[3], who was able to prove that he did not receive tax benefits from a superannuation scheme in 1995-1997. Being so fact-dependent, ensuring compliance by ruling and audit action was very resource-intensive.

2.7 It was against this background that the Ralph Report recommended a more systematic approach that would be set out in legislation, rather than solely relying on Part IVA.

RALPH REPORT RECOMMENDATIONS

2.8 The Ralph Report recommended that where a company, trust or partnership is interposed between a person or entity requiring services and the person who performs the services, the services should be treated as income of the service provider where 80 per cent or more of work is for one service acquirer or services are provided in an 'employee-like manner'. The recommendations also sought to limit the deductions of such an entity.

2.9 As recommended by the Ralph Report, payments received by an interposed entity should be treated as income of the service provider where:

- the interposed entity receives 80 per cent or more of its receipts in respect of personal services from one service acquirer during the income year;
- the services are provided in an 'employee-like manner' as determined by a range of specified criteria; or
- the interposed entity is unable to obtain from the Commissioner of Taxation a decision that the 80 per cent / one service acquirer test should not apply.

2.10 The Ralph Report noted that a range of criteria would need to be taken into account in determining if the services are provided in an 'employee-like manner'. These criteria would include:

- the level of control exercised by the service acquirer;
- whether the services are also contracted to the public at large;
- the use of substantial income producing assets;
- the extent of infrastructure provided by the interposed entity;

---

[2] See *FC of T v Mochkin* [2003] FCAFC 15, 2003 ATC 4272.
[3] See *Ryan v FCT* 2004 ATC 2181.

- whether incidental services are provided in conjunction with the sale of trading stock;
- whether more than one person actually provides the required services; and
- the degree of entrepreneurial risk in the way services are provided.

2.11 Payments in respect of personal services were to include amounts that are wholly or predominantly for the labour or skill of an individual who performs that labour or exercises that skill, including those rendered to provide a specific result or outcome.

POLICY INTENT OF THE APPROACH ADOPTED

2.12 The alienation of personal services income rules are designed to improve the integrity and equity of the tax system by addressing (a) the capacity of individuals and interposed entities providing personal services of an individual to claim higher deductions than employees providing the same or similar services, and (b) the alienation of personal services income through an interposed entity, which enables income to be split with other members of the entity, including associates, or retained within the entity, allowing less tax to be paid or tax to be deferred.

2.13 The objective of the rules is not to deter the use of contracting arrangements but to ensure such arrangements do not produce a tax benefit. Rather than adopting the approach recommended by the Ralph Report of defining 'employee-like' characteristics, the approach adopted applies tests to taxpayers' activities to determine if they are operating as a 'personal services business' or not.

2.14 In another departure from the Ralph Report recommendations, the rules allow taxpayers to self assess as a personal services business, even when 80 per cent or more of their income comes from one client, when that income is from producing a result (the 'results test').

LEGISLATION

2.15 The alienation of personal services income rules are located in Part 2-42 of the *Income Tax Assessment Act 1997* and in Division 13 in Schedule 1 to the *Taxation Administration Act 1953*, and took effect from 1 July 2000.

- Part 2-42 of the *ITAA 1997* contains Divisions 84 to 87.
  - Division 84 defines the term personal services income.

  - Division 85 limits the entitlements of individuals to deductions that can be claimed against personal services income.
  - Division 86 introduces rules governing the income tax treatment of personal services income paid to interposed entities, including deductions available against that income.
  - Division 87 determines when an individual or entity is conducting a personal services business. If they are a personal services business, Divisions 85 and 86 do not apply.
- Division 13 in Schedule 1 to the TAA 1953 introduces pay-as-you-go (PAYG) withholding obligations for attributed personal services income.

2.16 The rules set out a number of tests that are designed to allow contractors and entities that earn personal services income to self assess or seek a determination from the Commissioner that they are carrying on a personal services business, and therefore are not affected by the measures.

2.17 Even if a taxpayer's income is not affected by these rules, the general anti-avoidance provision may still apply to schemes that are aimed at reducing income tax by income splitting or deferring tax by allowing income to be retained within the entity.

Assessment of personal services income

2.18 Personal services income is defined in the Act as income that is mainly a reward for an individual's personal efforts or skills (or would be mainly such a reward if it was the income of the individual who did the work).

2.19 As explained in a taxation ruling by the ATO[4], the definition requires a determination as to whether the income, if it was derived by an individual, would be mainly a reward for that individual's personal efforts or skills rather than being generated by the use of assets, the sale of goods, or by a business structure.

Assessment of a personal services business

2.20 The legislation sets out tests under which the individual or entity can self assess whether they are a personal services business for the purpose of the provisions. If they are a personal services business, the limits on deductions, the attribution rules and PAYG withholding obligations do not apply. A determination can also be sought from the Commissioner to confirm whether or not an individual or entity is affected by the measures.

---

[4] TR 2001/7 Income tax: the meaning of personal services income

The results test

2.21 All taxpayers earning personal services income are able to self assess whether or not they are a personal services business against the 'results test'.

2.22 To satisfy the 'results test' the taxpayer must:

- work to produce a result;
- provide plant and equipment or tools of the trade (if required); and
- be liable for rectification of any defects in work performed.

2.23 The 'results test' was enacted in 2001 and replaced the 'further grounds test'. Taxpayers are allowed to self assess whether the 'results test' is satisfied, regardless of whether 80 per cent or more of the individual's personal services is from one client. This is in contrast with the 'further grounds test', which although based on the same criteria as the 'results test', could only be applied by the Commissioner in making a determination.

2.24 As noted by the then Treasurer in his press release[5], the 'results test' is based on traditional criteria for distinguishing independent contractors from those contractors who work essentially in the same way as employees. The introduction of the 'results test' substantially reduced the number of taxpayers who would have been required to apply for a personal services business determination from the Commissioner. This amendment was aimed at reducing the compliance costs for independent contractors who would have been able to meet the 'further grounds test' had they applied for a determination. It was estimated to have no cost to revenue.

The 80 per cent rule and personal services business tests

2.25 If an individual or entity does not satisfy the 'results test', and they earn less than 80 per cent of their income from a single source during the income year, then they may self assess against the other personal services business tests.

- Broadly, the other three personal services business tests require that the individual or entity:
  - had two or more unrelated clients who were obtained as a result of making offers or invitations to the public at large or to a section of the public (unrelated clients test);
  - had separate business premises (business premises test); or

[5] Treasurer's press release No. 051 of 9 July 2001

– had an employee who performed at least 20 per cent of the principal work by value of the business (employment test).

2.26 If the taxpayer earns less than 80 per cent of their income from a single income source during an income year and can satisfy one of the personal services business tests, they will not be affected by the alienation of personal services income measures. Conversely, if 80 per cent or more personal services income is earned from a single source and the results test is not met, the alienation of personal services income measures apply.

Personal services business determination

2.27 Where an individual or entity earns more than 80 per cent of the personal services income from a single client and they can not meet the results test, they may seek a determination from the Commissioner that they are operating a personal services business. If a determination is granted, the individual or entity is outside the measure.

2.28 In making the determination, the Commissioner may consider any unusual circumstances that exist in the income year in question.

Additional withholding obligation

2.29 If the alienation of personal services income rules apply, an entity has additional PAYG obligations for the amount attributed to each individual who performed the services.

2.30 Where personal services income received by the personal services entity is not paid out as salary or wages it will be attributed to the individual providing the services (less deductions available to the entity), and gives rise to a withholding obligation. A personal services entity is required to work out the amount to withhold from the attributed personal income and pay and report to the ATO on a quarterly or monthly basis, depending on the size of the withholder.

2.31 Where it is paid out as salary and wages the entity will have the normal PAYG withholding obligations. The measures did not impose PAYG withholding obligations on service acquirers.

Financial impact

2.32 The estimated revenue to be raised by the measures, as described in the Explanatory Memorandum, was $190 million in 2000-01, $290 million in 2001-02, $435 million in 2002-03 and $515 million in 2003-04. Small upfront compliance costs were anticipated to arise primarily from taxpayers and their advisors having to familiarise themselves with the new provisions. Compliance costs were also noted for taxpayers who choose to apply for a Commissioner's determination and for the

interposed entities required to pay amounts during the income year under the PAYG withholding system (for personal services income attributed to an individual under the rules).

ADMINISTRATION OF THE PROVISIONS

2.33 Individuals in receipt of personal services income (not including income received as an employee) are required to indicate this on their income tax return. They are asked whether or not they are a personal services business and if so, which test was passed. They must also complete the Business and Professional Items Schedule, as for the purposes of the income tax law they are considered to be in business regardless of whether they have passed a personal services business test or not. As the schedule is designed for individuals who are in business, such as sole traders, it contains labels for business deductions that would not be available to an individual who is not a personal services business.

2.34 Data provided by the ATO indicates that in 2008 around 368,000 individuals and entities declared personal services income in their income tax returns, with an 80 per cent increase in the number of taxpayers declaring personal services income in 2004 (associated to an extensive education campaign run by the ATO), and subsequently levelling off around 370,000 per annum since 2006.

2.35 Of those declaring personal services income in 2008, 73 per cent (268,000) were assessed as personal services businesses, and consequently the alienation of personal services income rules did not apply to them. Most personal services businesses self assessed on the basis of the different tests (mainly through the results test) and only a limited number were assessed by a determination from the Commissioner:

PSB determination by Commissioner	0.6%
Results test	88.2%
Unrelated clients test	9.6%
Employment test	0.6%
Business premises test	1.0%
Total PSBs	**100.0%**

2.36 For those taxpayers returning personal services income, deductions claimed for rent and motor vehicles expenses and the amount of retained earnings held in companies decreased significantly in 2001, following the introduction of the alienation of personal services income rules, and have since levelled off.

2.37 Entities need to work out the amount of additional PAYG withholding for each business activity statement they are required to submit. The ATO has introduced simplified ways to work out the attributed income amount for additional PAYG withholding, including using a percentage based on the previous year's reporting.

CHAPTER 3: THE OPERATION OF THE ALIENATION OF PERSONAL SERVICES INCOME RULES

3.1 This Chapter reports feedback received from stakeholders on the operation of the rules and compliance data made available by the ATO.

ARE THE OBJECTIVES OF THE RULES CLEAR?

3.2 Some stakeholders noted a lack of clarity in the objective of the rules. There was broad understanding that the rules were intended to impose a PAYG withholding obligation on attributions of personal services income and limit the availability of deductions for those who earned personal services income but could not meet any of the personal services business tests.

3.3 The structure of the current provisions whereby the income is initially determined to be personal services income, rather than income from a business structure, and then taxpayers can self assess whether they are a personal services business, created confusion for some stakeholders. Some stakeholders queried why the rules were concerned at all with personal services income and did not instead focus solely on 'employee-like' situations.

3.4 There was some confusion even among tax advisers about the implications for taxpayers who meet a personal services business test. In particular, a number of stakeholders noted the uncertainty regarding the interaction between the alienation of personal services income rules and the general anti-avoidance provisions (Part IVA). As noted in the submission by the Institute of Chartered Accountants in Australia:

> In the Institute's view, the potential application of Part IVA is not a consideration or risk factor that is well understood by all tax advisors involved in advising their clients about the impact of the APSI rules. There is anecdotal evidence that some tax advisors consider that Part IVA does not have a role to play once a taxpayer has satisfied one or more of the PSB tests in Division 87. In contrast, there are other tax advisors who are unsure about the potential application of Part IVA and therefore adopt an overly cautious approach to advising their clients in this area.

3.5 Some of the uncertainty about the intent and application of the rules arises from the level of knowledge and understanding among tax advisers. The Board observed that most tax advisers at the consultations had only a few clients affected by the rules and so they were not as familiar with them as with other parts of the tax law.

Consultations undertaken in Canberra with some tax practices that had numerous clients affected by the rules elicited a much better understanding of the rules and raised a number of issues in implementing them that had not been raised in other forums.

ARE THE RULES EXPRESSED IN A CLEAR, SIMPLE, COMPREHENSIBLE AND WORKABLE MANNER?

3.6 A number of stakeholders find the rules difficult to apply. CPA Australia noted that the main problem with the personal services business tests appear to be that they are difficult to apply, particularly in respect of the 'results test'. It notes that the results test is arguably the least understood test and yet this is the only test where taxpayers can self assess in cases where they receive more than 80 per cent of their income from one source. It notes that some contractors simply tick the 'results' box on the ATO form even though they may not in fact meet the criteria specified in the alienation of personal services income rules.

3.7 Feedback obtained at the workshops confirmed the view about the rules being difficult to apply. Stakeholders noted that too many rules and tests add to the confusion. The fact that the rules are poorly understood provides scope for abuse. In some instances taxpayers are reluctant to accept that they are not as independent or self-employed as they thought they were. Because the rules have room for interpretation, this creates an incentive for 'opinion shopping'.

3.8 Some stakeholders, such as the Taxation Institute of Australia (TIA), noted the difficulty in applying the definition of 'personal services income', in particular in determining when income is derived mainly from the efforts and skills of an individual, as opposed to generated from a business structure.

3.9 Stakeholders have also noted that the provisions on PAYG withholding are complex and hard to comply with, requiring quarterly and in some instances monthly calculations of attributed income and withholding tax payable. Compliance costs are significantly increased when taxpayers do not report their PAYG obligations on time, either because they are not aware of them or because they shift in and out of scope of the rules during a year. The issuance by the ATO of a Practice Statement containing simplified methods for calculating withholding on attributions of personal services income has not fully addressed these concerns.

3.10 Even stakeholders who support the continuation of the rules in their current form, such as Master Builders Australia, acknowledge that there is complexity evident in the application of the rules.

DO THE RULES TAKE ACCOUNT OF ACTUAL TAXPAYER CIRCUMSTANCES AND COMMERCIAL PRACTICES?

3.11 The Association of Professional Engineers, Scientists & Managers Australia (APESMA) and the TIA, amongst other stakeholders, have argued that the results test fails to take into account the particular circumstances of taxpayers. They submit that knowledge workers (that is workers, such as consulting professionals, who produce intangible property or provide advice or services using their intellect) are disadvantaged under the alienation of personal services income rules compared to workers who produce tangible property.

3.12 Similarly, these stakeholders submitted that the results test fails to take into account commercial practices, in particular the fact that in some industries, like information technology (IT), it is customary for the service acquirer to provide the equipment (typically a computer) and for the contractors to be paid by hours worked. With respect to the latter, stakeholders have argued that in IT, parties to a contract can agree on the required outcome or result, but cannot predict how long it will take to get it done, hence the practice is for pay to be on the basis of hours worked.

DOES THE LEGISLATION GIVE EFFECT TO THE GOVERNMENT'S POLICY INTENT?

3.13 There are mixed views on the efficacy of the rules. A number of stakeholders, such as the Housing Industry Association (HIA), Independent Contractors Australia and the Civil Contractors Federation consider that the alienation of personal services income rules are working appropriately and are meeting their policy intent. As noted in the submission by the HIA:

> HIA considers that there is currently no difficulty or dissatisfaction with the Alienation of Personal Services Income provisions of the Income Tax Assessment Act. HIA believes that the rules have worked well and have fully addressed the issues (originally raised in the Ralph Report in 1999) about which the Government was concerned. So far as HIA is aware, there is no evidence to suggest that the provisions are not effective, have led to unforseen outcomes, or require improvement.

3.14 On the other hand, some stakeholders such as the Australian Council of Trade Unions (ACTU) consider that the alienation of personal services income rules do not adequately or effectively distinguish those workers who genuinely carry out their own businesses from those who are working in a dependent or controlled way and should be treated for taxation purposes as employees.

3.15 The Construction, Forestry, Mining and Energy Union (CFMEU) argued that the legislation has failed to achieve the policy intent of reducing the extent of bogus contracting.[6] It notes that the extent of bogus contracting, where individuals providing services in an 'employee-like manner' are treated as contractors rather than employees for tax purposes, has not been reduced since 2000, but has at best been stable and may have increased. Quoting statistics sourced from the 2008 ABS *Forms of Employment* survey, it notes that out of the 967,100 independent contractors working in all industries in November 2008, 79 per cent (761,500) had no employees; 54 per cent (517,900) had only one contract; 35 per cent (338,300) were not able to sub-contract their own work; and 27 per cent (260,500) were not usually able to work on more than one active contract. The last estimate is contrasted by the CFMEU with the Productivity Commission lower bound estimate of 230,000 dependent contractors in 2001.[7]

3.16 CPA Australia, amongst other stakeholders, noted that the growth of 'contractors' in recent times does not appear to be tax driven, but instead appears to be more related to changes in the economy more generally, such as down-sizing and cost reductions by larger companies as employment costs have increased.

3.17 Some stakeholders also raised the issue of taxpayers acting on the basis of poor advice from colleagues or head contractors. Contractors are being induced into non-employee arrangements as a means to increase their take home pay (not affected by employee-related deductions such as withholding), and also by the expectation of being able to access additional income tax deductions compared to employees.

3.18 Other stakeholders consider that the alienation of personal services income rules have been successful to some extent, but, as noted above, suggest there is scope for the rules to be improved to minimise their undue complexity and associated compliance costs while still being effective in addressing the concerns over excessive deduction claims and income splitting by some groups of taxpayers.

WHAT IS THE EXTENT OF COMPLIANCE WITH THE RULES?

3.19 As noted in the previous chapter, about 368,000 individuals and entities declared personal services income in their income tax returns in 2008. It is difficult to

---

[6] The Board notes that reducing the extent of bogus contracting was not the policy intent of the measure; rather, the intent was to limit the avoidance of income tax that occurs through the alienation of personal services income.

[7] Productivity Commission, *The Role of Non-Traditional Work in the Australian Labour Market*, Commission Research Paper, 2006. Dependent contractors are defined in the lower bound estimate of the Productivity Commission paper to include self-employed contractors: who do not have control over their own working procedures *and* the terms of whose contract prevent them from subcontracting their work; *or* who do not have control over their own working procedures *and* whose contract prevents them from working for multiple clients. The Productivity Commission notes that the lower bound estimate is the more realistic one, given that it accords with ATO estimates of employee-like contractors, and that it is based on tests that would be applied by Australian courts and tribunals.

determine whether this is an accurate reflection of the size of the 'personal services income population' that is potentially affected by the rules. However, data from the ABS records over 1 million independent contractors as at November 2008.[8] While acknowledging the differences in definitions and methodology between the ABS and the ATO data, the data does nevertheless suggest that there is significant underreporting of personal services income in income tax returns.

3.20 The ATO undertook a review of 11,000 contractor entity records from labour hire firms in 2008. Data matching allowed the ATO to find that of the 11,000 entities, over 8,000 did not declare that their income was personal services income. It is difficult to extrapolate this finding to the larger personal services income population because contractors offering their services through labour hire firms were targeted because they were considered likely to be affected by the alienation of personal services income rules. However, it again suggests that there is significant underreporting of personal services income.

3.21 In 2008-09 the ATO undertook compliance activities on 231 cases identified as high risk and predominately selected from the data provided by labour hire firms with potential tax adjustments of over $5,000 each. Of the 164 cases reviewed, 138 voluntarily disclosed that they were not compliant with the alienation of personal services income rules during a review of their activities. Of the 67 cases that were audited, 55 cases were found to be non-compliant. That is, of the sample subject to compliance action, 83.5 per cent were found to be non-compliant. In total, 193 cases were found to be non-compliant and $4.8 million was raised. The average net amount of primary tax per case was $18,800 and average penalties and interest of $6,000 were raised in each case. An average of $4.4 million per year was raised in the preceding four years as a result of the ATO's compliance activities.

3.22 The ATO has noted that deductions for wages and superannuation contributions for an associate (usually a spouse) are the most prevalent deductions that are disallowed in whole or in part, because they relate either to non-principal work or only partially to principal work. Other deductions that are frequently incorrectly claimed are motor vehicle expenses, travel expenses and living away from home allowances.

3.23 Currently, a limited compliance program is being undertaken by the ATO which may assist in identifying suitable cases to assist in clarifying when Part IVA will apply following the introduction of Part 2-42. Providing further guidance in relation to Part IVA and income splitting is also under consideration. The ATO has issued a

[8]This includes 967,000 independent contractors in their main job and 134,000 people who were independent contractors in their second job. Independent contractors are defined as those who operate their own business and who contract to perform services for others without having the legal status of an employee. They are engaged under a contract for services (a commercial contract), whereas employees are engaged under a contract of service (an employment contract). Source: ABS *Forms of Employment* 6359.0 - November 2008.

discussion paper to the National Tax Liaison Group in relation to Part IVA and income splitting as part of this work.

DEVELOPMENTS SINCE THE RULES WERE INTRODUCED: GROWING USE OF CONTRACTORS

3.24 There are indirect indications that since the alienation of personal services income rules were introduced the use of contractors has continued to grow. As noted before, the ABS estimated more than 1 million independent contractors in November 2008. As a reference, the Productivity Commission (ibid) estimated the number of self-employed contractors at 740,000 in 2001 and at 788,000 in 2004. As indicated at paragraph 3.15, the CFMEU also noted in its submission the apparent growth in the number of dependent contractors.

3.25 The Board heard that the drivers of the spread of contracting were not the perceived tax advantages to the contractor, but rather the advantages to those acquiring personal services income. A number of reasons were put forward. For some acquirers it was the desire to avoid employment 'on costs' such as payroll tax, workers' compensation payments and Superannuation Guarantee contributions. However, based on the anecdotal evidence collected through consultations, this varied, with some service acquirers paying workers' compensation and other 'on costs' for contractors. This may reflect different definitions used across the States and Territories and the Commonwealth.

3.26 Another key driver was broader workplace relations considerations. The ability to easily terminate or not renew the contract was cited as a key factor. For the construction industry some considered that the ability to not bear the costs of paying for employees for what could be protracted periods between construction projects or during wet weather was an important consideration in using contractors. The CFMEU noted in its submission that the culture of 'no ABN no start' was widespread in the construction industry, which was reinforced by not having stringent business tests as a requirement for the issuing of ABNs. The CFMEU also noted that a July 2009 examination of job vacancy advertisements' requirements clearly indicates that the 'no ABN no start' practice is commonplace.

3.27 The Board heard that the use of an entity was also driven in some instances by the service acquirer, in particular some large corporations (and parts of the public sector), preferring to make contracts with entities to save on administrative and compliance costs associated with having ongoing employees.

3.28 While the impetus for the continued growth of contracting may not be the perceived tax benefits available to the contractor, they do appear, in some industries at least, to act as an inducement to the taxpayer to agree to the arrangement.

Other related measures: prescribed payment system (PPS) and The New Tax System (PAYG)

3.29 Another factor that the Board considers relevant to the increase in contracting arrangements is the transition from the PPS to the PAYG system.

3.30 The *A New Tax System (Pay As You Go) Act 1999* replaced five payment and reporting systems (including pay as you earn, the PPS and the reportable payment system (RPS)) with one comprehensive PAYG system. The PPS and RPS were introduced in 1983 in an attempt to stem income tax evasion in a number of traditionally cash-based industries using:

- deduction at source; and
- third-party reporting of income to the ATO.

3.31 Under PAYG:

- businesses pay quarterly instalments (based on income actually received) after the end of the quarter or, in some cases, annually; and
- employees and similar workers have tax withheld from the payments they receive.

3.32 Businesses that register for GST (whether company, sole trader or other) pay their income tax in four quarterly instalments, at the time they remit their GST payments (or claim their GST refunds). Non-GST payers make quarterly PAYG payments. Non-GST payers, as a general rule, remit amounts based on income actually derived in the quarter, or annually for very small businesses that are not registered for GST.

3.33 Withholding arrangements apply to payments to employees and other office holders. In addition, withholding applies to a payment to a worker from a labour hire firm, for work performed for a client of the labour hire firm.

3.34 Withholding also applies to payments for contracted work or services where businesses and workers voluntarily agree that withholding will occur and when payments requested on an invoice do not include quotation of an ABN. The extent to which such voluntary withholding arrangements have been adopted is very limited. There were 23,300 voluntary agreements for withholding in 2008. As a result, for many contractors there are no withholding arrangements at source in place. This may also act as an encouragement to enter into a contracting arrangement.

3.35 The New Tax System also introduced ABNs as a whole-of-government initiative. The purpose of ABNs is to make it easier for businesses to conduct their dealings with the Australian Government. The Commissioner, as the Australian

Business Registrar, is developing measures to address integrity concerns that the register contains ABN holders who are not entitled to an ABN.

CHAPTER 4: BOARD'S ASSESSMENT

4.1 The Board's assessment of the effectiveness of the alienation of personal services income rules in addressing the integrity and equity issues is based on the information it has collected from stakeholders and the ATO. Clear themes emerged from the consultation process.

4.2 The Board considers that the alienation of personal services income rules have gone some way to achieving their intention of improving integrity and equity in the tax system. This is indicated by the ATO's advice to the Board that claims for rent and motor vehicle expenses and the amount of retained earnings held in companies decreased significantly in 2001 and have levelled off since. However, the extent of improvement in the integrity and equity in the tax system provided by the provisions is in the Board's view inadequate. There are four key issues that the Board considers are contributing to this:

- poor compliance with the rules;
- uncertainty about how the rules interact with Part IVA, with the Commissioner having to continue to rely on Part IVA to address the alienation of personal services income;
- the lack of clarity around deductions that can be claimed; and
- the rules are difficult to apply, in particular the application of the tests for a personal services business and the complexity of the PAYG withholding obligations on attribution.

POOR COMPLIANCE

4.3 There is evidence that the rules have not reached far enough into the potential population of taxpayers who were intended to be affected by the rules, to properly achieve their aim of improving integrity and ensuring equity between taxpayers. The very high 'strike rate'[9] of ATO compliance activity of 83 per cent, notwithstanding it is the result of targeting the compliance activity to high-risk taxpayers, points to poor compliance.

[9] Strike rate is defined as the number of tax returns adjusted by the ATO as a proportion of the number of tax returns subject to an ATO review.

4.4 ATO audit activity has concentrated on entity records from labour hire firms. While the Board understands that from a cost-benefit perspective, it is efficient for the ATO to focus its monitoring and auditing compliance activity on high-risk taxpayers and to use third party reporting to assist in this activity, an unintended consequence of the ATO not being seen to be widely monitoring and auditing is that it may have contributed to complacency among some taxpayers and advisors. That is, while the Board accepts the ATO view that the alienation of personal services income is a low risk to revenue, if low compliance is allowed to continue, it may undermine the integrity and equity of the tax system.

4.5 The Board accepts that the ATO's monitoring of compliance activity on the alienation of personal services income is made difficult by the absence of information from other sources on the taxpayers who should be reporting that they have personal services income.

4.6 On the other hand, the Board considers that the incentives to alienate personal services income, particularly for those with annual incomes below $80,000, have been diminished as a result of the reduction of income tax marginal rates since 2003. There are also costs involved in running an entity that act as a disincentive to alienate personal services income.

UNCERTAINTY IN RELATION TO PART IVA

4.7 A major area of uncertainty relates to the purpose of the rules as an anti-avoidance provision directed at alienation of personal services income and its interaction with Part IVA.

4.8 As noted in Chapter 2, one of the drivers behind adopting the rules was to reduce the Commissioner's reliance on the application of Part IVA to deal with the alienation of personal services income as this approach was regarded as labour intensive and inefficient.

4.9 However, data provided to the Board by the ATO indicated that 73 per cent of taxpayers who return personal services income in their income tax return self assess as meeting one of the personal service business tests. As a result, the Commissioner continues to have to rely heavily on Part IVA to address the alienation of personal services income. In this respect, the rules have not met one of their stated aims.

4.10 Taxpayers and their advisers are uncertain about the circumstances that would trigger the application of Part IVA once they have passed one of the personal services businesses tests. Others wrongly assume that Part IVA does not apply to them once they have passed one of the personal services business tests.

4.11 The Board also considers that the use of the term personal services 'business' has added to the confusion. The use of the term 'business' has led some taxpayers to

assume that they are a business for other purposes of the tax law. They may then assume that their income is not personal services income, which cannot be alienated, but instead assume that it is business income, where the same restrictions on alienation do not apply. However, while they may have met one of the tests to be regarded as a personal services business, the income remains income from personal exertion and therefore cannot be alienated.

4.12 As noted before, the ATO has advised the Board that a limited compliance program is being undertaken which may assist in identifying suitable cases to help in clarifying when Part IVA will apply following the introduction of Part 2-42. Providing further guidance in relation to Part IVA and income splitting is also under consideration. This may go some way to address this significant area of confusion.

UNCLEAR REGIME FOR DEDUCTIONS

4.13 The Board considers that the regime specifying the deductions available for individuals subject to the rules is unclear. As a result of the confusion around the deductions available, there is anecdotal evidence that some taxpayers wrongly consider that they would be able to access additional deductions if they were engaged as contractors rather than as employees and seek access to one of the personal services business tests, such as the 'results test', to be out of scope of the rules. The restrictions on payments to associates are another area of confusion for taxpayers.

4.14 In the Board's view the current administrative arrangements for the reporting of personal services income further add to the lack of clarity around deductions, in that they must complete the Business and Professional Items Schedule yet they are not entitled to 'business-like' deductions where they have not passed a personal services business test or obtained a determination from the Commissioner.

COMPLEXITY AND UNCERTAINTY

4.15 The rules appear in some circumstances to be confusing, which can lead to uncertainty in their application and inconsistent outcomes. The lack of clarity in the rules that determine whether or not the taxpayer is a personal services business leads to a degree of uncertainty or 'greyness' around the rules, that provides opportunities for taxpayers to interpret them in their favour.

4.16 It is the Board's view that the application by taxpayers of the four personal services business tests to their own circumstances means that the alienation of personal services income rules are not applying to some taxpayers as they should. This is particularly so for the 'results test'. The personal services business tests are not a recognised or reliable indicator of whether an entity is carrying on a business and the

Board considers that the 'results test' in particular is not an accepted indicator of whether a person is carrying on a business.

4.17 Complexity is added to this because the income tax laws in relation to a personal services business and to an independent contractor or employee are not mutually exclusive. A taxpayer may still be considered to be an employee for other purposes even if they meet one of the personal services business tests.[10]

4.18 Further to this, the 'results test' can lead to outcomes that are seemingly inconsistent with the intent of the rules. There is an apparent bias in the operation of the rules towards industries or activities which can produce 'tangible' results versus those that produce 'intangible' results. The former can more readily meet the 'results test' — the overwhelming rule relied upon to determine status as a personal services business — or can arrange the provision of their personal services so that they can meet the test.

4.19 The operation of the attribution rules and the associated PAYG withholding obligations is overly complex. The difficulty of complying strictly with these rules also undermines compliance.

OVERALL ASSESSMENT

4.20 The Board does not consider that the alienation of personal services income rules in their current form provide an acceptable level of integrity and equity nor are they relieving the Commissioner from reliance on the application of Part IVA.

4.21 The Board therefore recommends that alternatives to the current rules be considered to address the problems identified in this Chapter and meet the policy intent of improved integrity and equity. These alternatives are discussed in the next chapter.

[10] Taxation Ruling 2005/16 *Income Tax: Pay As You Go – withholding from payments to employees* sets out the circumstances when a person would be considered an employee, and clearly shows that a person could pass one of the personal services business tests yet still be considered an employee for the purposes of PAYG withholding from payments to employees.

CHAPTER 5: OPTIONS FOR IMPROVING THE RULES

5.1 There are a number of options that should be considered for improving the operation of the rules and enhancing their efficacy in addressing the key concerns raised in Chapter 4, that is poor compliance with the rules, confusion over the interaction with Part IVA and the Commissioner having to continue to rely on the application of Part IVA, the lack of clarity around available deductions and the complexity of the rules.

5.2 The Board offers a number of options that it considers would address the shortcomings of the current rules and their administration, and these are set out below. Some options may increase compliance costs for certain groups of taxpayers and the Board has concerns about further adding to the cost of complying with the tax law. However in this case the Board sees this as a necessary trade-off to address the current poor compliance with the rules and to achieve an acceptable level of integrity and equity in the operation of the rules.

5.3 Before assessing individual options, the Board considers that a key consideration is whether the desired approach should seek to target those taxpayers who do not meet the personal services business tests as in the current approach, or those taxpayers who meet the Ralph Report 'employee-like' criteria, or whether the focus should be on the appropriate taxation treatment of personal services income.

5.4 A focus on personal services income could help to clarify that this type of income is treated differently to income derived from capital in that it cannot be alienated; that is, personal services income is always to be attributed to the taxpayer who provided the services and it should be taxed at the taxpayer's marginal tax rate. It could therefore clarify that interposing an entity, acquiring an ABN or providing the services under a contract other than a contract of employment does not change the taxation treatment. This approach could also prove more robust; if the forces that are driving the trend towards greater contracting continue, then a focus on an employee or someone who shares characteristics with an employee may be increasingly irrelevant.

5.5 On the other hand, a focus on personal services income intensifies the need to distinguish such income from income derived from a business. Personal services income is income that is mainly a reward for an individual's personal efforts or skills. This is distinguished from income which is generated by a 'business structure'. However, drawing the line where income ceases to be personal services income and becomes income generated from a business structure is difficult, and taxpayers'

circumstances may change from year to year, pulling them in or out of personal services income. The '80/20' rule was an attempt to make a clearer distinction.

5.6 An approach that would make this distinction unnecessary is to not differentiate between personal services income and income from a business structure, or to treat some personal services income as generated in an 'employee-like manner', but instead to differentiate between income from capital and income from labour.

5.7 Under this approach, the objective is to distinguish which part of an individual's income is derived from their labour and which part is a return to their business assets or capital. That part of the income derived from labour would be attributed to the person who supplied the labour. The return to capital could be returned to the owner(s) of the capital, which may differ from the person who provided the labour.

5.8 In principle, there are two potential approaches for implementing this option: either starting by imputing a rate of return to business assets and treating the residual business profit as labour income (as it is done by the Nordic countries — see Appendix B), or starting by applying a domestic transfer pricing rule to any labour services provided by the self-employed worker to the entity and treating the residual business profit as a return to capital.

5.9 There is precedence in the application of domestic transfer pricing rules in the context of service trusts used by professional practices. A service trust is used to employ administrative (and sometimes professional) staff and to provide office premises, equipment and a range of services to the professional practices for a fee. The ATO has provided guidance on the circumstance under which these service trusts (and the fees they charge to the professional practices) are acceptable arrangements.

5.10 Service trust profits are typically not distributed to partners or practitioners personally, but to associated entities of the practitioner. The application of the ATO guidelines on acceptable fees limits the potential for alienation of labour income from partners via the transfer of profits to the service trusts.

5.11 Domestic pricing rules such as those applicable in professional practices could be made applicable more extensively under this option. Rules based on an imputed return on capital, with labour income as residual, may be easier to implement across the different sectors of the economy and with reduced administrative costs (see Appendix B on the Nordic experience).

5.12 Attributed returns on labour income as a result of the application of the domestic pricing rules would be reported as salary payments under this option, subject to instalments or PAYG withholding obligations as applicable. To the extent that labour income is appropriately reported, the scope for accessing undue deductions and splitting income via the use of entities would be severely restricted.

5.13 While this option is well suited to self assessment and may result in greater equity in the taxation of labour income, it would be a significant shift from the existing taxation system to affect only a small number of taxpayers. Attempting to 'graft' it on to the rest of the taxation system may give rise to unintended consequences and further uncertainty and complexity.

5.14 However, the Board considers that there a number of options that could improve the operation of the alienation of personal services income rules and that fit more readily into the current taxation structure. These are set out below.

ADDRESSING POOR COMPLIANCE

Introducing a reporting obligation

5.15 The Board has identified poor compliance as a key reason for its view that the rules are not as effective as they could be. The Board therefore considers that a direct way to address this is to provide the Commissioner with better means of identifying those taxpayers who should be reporting personal services income in their income tax return.

5.16 One option is to introduce a reporting obligation on the payer and / or a corresponding obligation on the payee.

5.17 This option is aimed at making the ATO's compliance activity more cost-effective and improving overall compliance with the rules. A reporting obligation would facilitate data matching, assist in identifying high risk taxpayers and assist compliance activity by the ATO to determine those taxpayers who should be declaring personal services income. It could also lead to a higher level of voluntary compliance with the rules by providing information on the number and value of contracts that a taxpayer earning personal services income enters into in a year.

5.18 The reporting obligation could arise when a business makes a payment for the provision of labour services. The report could include identifying information, such as the ABN of the payer and the payee. Under this option, payers could be required to provide an annual summary to the ATO and to the payee of payments made (including the payer's and the payee's ABN). This could also assist in identifying those taxpayers who have received most of their labour income from one source; or alternatively a combination of reports from different payers could be used to identify whether a taxpayer has received payments from a number of taxpayers.

5.19 This could assist in identifying those who are unlikely to have passed one of the personal services business tests, as it could allow the ATO to identify, amongst other things, the number of payers for an individual.

5.20 However, this reporting obligation may apply more broadly than to those taxpayers who provide personal services income. It may be difficult for a payer to know whether the labour service that they acquired was provided as personal services income or whether it was provided through a business structure. If the reporting obligation is to apply too broadly, it could result in unnecessarily high compliance costs for payers compared to the compliance risk associated with personal services income.

5.21 An alternative approach would be to link it to other obligations; for example, it could apply where payments are made on the taxpayer's behalf for workers' compensation, payroll tax or Superannuation Guarantee. However, this could result in different outcomes for taxpayers in different States and Territories if the coverage of the schemes differs.

5.22 A threshold could be considered to determine which payers would have the reporting obligation. The threshold could be based on the number of contractors or the length of time each contractor is engaged by the payer. For example, the payer may be required to report payments made to contractors where a contract is for more than one month in any 12-month period. This would contain compliance costs and ensure that one-off payers do not have to report, but may also generate behaviours to seek to be or remain below the threshold. It could also affect the competitiveness of those with the obligation compared with those without the obligation.

5.23 The reporting obligation could apply only to commercial payments and not to those that are private or domestic in nature. The reporting obligation could be similar to current PAYG withholding reporting obligations in respect of employees so as to minimise compliance costs for those payers who already comply with employer obligations.

5.24 An individual in receipt of personal services income could also be required to provide their ABN and their payers' ABNs and payments received on their income tax return. This could facilitate data matching and compliance activity.

5.25 The Board considers that a reporting obligation is an option to support the integrity of the alienation of personal services income rules. It is not specifically targeted at the cash economy. However, the Board accepts that the reporting obligation could also lead to improvements in compliance in this area. An examination of the cash economy is outside the terms of reference of this review and the Board has not examined the issues. Nevertheless, information collected in the course of the review suggests that there could be an overlap between taxpayers who do not report personal services income and those who do not report all or some of their income. However, the Board makes no particular comment on the effectiveness of a reporting obligation to address the cash economy, including compared with other options to address it.

Introducing a withholding obligation on payers

5.26 Consideration could also be given to introducing a withholding obligation on payers, if there was a concern that high levels of alienation of personal services income were combined with other forms of tax evasion such as the cash economy. The withholding obligation would act as a reinforcement of the reporting obligation in industries with low compliance such as construction. A similar approach is currently being considered by HM Treasury (summarised in Appendix B).

5.27 The Board has not sought to design a withholding system. It only recommends that the option of withholding be considered as part of the broader options to generate third party information to assist compliance.

5.28 As payers are currently required to withhold tax in relation to payments made to contractors if the contractor fails to quote an ABN, introducing a reporting or withholding obligation for all payments for personal services may reduce the incentive to be a contractor and acquire an ABN.

5.29 The purpose of a withholding system is to provide for the progressive payment of a person's expected tax liability by withholding an amount from payments at source.

5.30 Withholding obligations would need to be implemented appropriately, in line with existing systems, in order to avoid undue compliance costs. Imposing a withholding obligation on the payer would require them to understand aspects of the contractor's business which they may not be privy to, although the application of related legislation, such as workers' compensation or payroll tax, may already require them to do these assessments.

5.31 There would need to be an objective test to assist payers to determine to whom the withholding would apply. In line with the discussion of a reporting obligation, this could be made by reference to the application of other related legislation such as workers' compensation or payroll tax.

5.32 In addition, the withholding rate would need to be set at a rate that is not too high. A high rate may adversely affect the cash flow of taxpayers, resulting in requests to vary the withholding rate, and in turn increasing administrative costs. However, pre-filling of the withheld or reported amounts into the payee's tax return would reduce their compliance costs.

5.33 This proposal would largely address the problem of taxpayers failing to disclose personal services income on their income tax returns. While there will be an additional compliance burden placed on service acquirers in doing the additional paperwork, the burden will be minimised because many, if not most, service acquirers would have employees for whom they would be already familiar with the reporting and withholding obligations, and could readily extend their existing systems to

accommodate the obligations. Some smaller payers may find the additional reporting and withholding obligations onerous.

GST registration requirement

5.34 Another option to assist compliance is to impose a mandatory GST registration requirement if there is a concern in a particular industry that the alienation of personal services income was combined with other forms of non-compliance such as the cash economy.

5.35 The current GST registration threshold is $75,000 per annum. Instead of applying this threshold, taxpayers in particular industries where non-compliance with alienation of personal services income rules was accompanied by cash economy concerns, could be required to register for GST if they were not being taxed as an employee. Registration for GST would require that service providers issue a tax invoice, that GST was included in the consideration for taxable supplies that they make and entitle them to claim input tax credits for creditable acquisitions. The ATO would be able to follow up those GST registrations where no GST return was made through a business activity statement. Imposing a GST obligation may also act as a disincentive to enter into a contracting arrangement.

Implementing Ralph Report-like recommendations

5.36 This option could assist in addressing poor compliance through clarifying the rules, particularly the personal services business tests. The 'results test' and the personal services business tests moved away from the recommendations in Ralph. This option would revert back to the original principles and so make it clear that they are directed only at those in an 'employee-like' position.

5.37 A key practical effect of adopting a Ralph Report-like approach would be that the 80 per cent test would apply to all taxpayers in receipt of personal services income. That is, it would remove the 'results test' that is currently used by 88 per cent of personal services income taxpayers who self assess as a personal services business. Compliance would be easier for the ATO to enforce if there was an objective test such as the '80 per cent' test that was the basis for determining tax status, rather than attempting to ensure compliance around a test that is surrounded by a large 'grey area'.

5.38 Removing the results test may also bring more taxpayers into the ambit of the rules, or require them to meet one of the other personal services business tests.

5.39 In addition, for cases where the 80 per cent test might not be met (that is, only one service acquirer), it requires establishing a range of criteria that would be taken into account in determining if the services are provided in an 'employee-like' manner.

5.40 A safeguard arrangement would allow the Commissioner to issue a determination on the facts of a particular case that the 80 per cent test should not apply (subject to the interposed entity demonstrating that it is conducting an independent trade or business).

5.41 Existing definitions could provide guidance to develop this option, such as those being considered by current Council of Australian Governments (COAG) work on payroll tax harmonisation (see Appendix C).

5.42 An advantage of this approach is that it would focus clearly on individuals that are 'employee-like'; for example, instances where a worker changes employers at least once a year (thus in practice meeting the current unrelated clients test), but for all practical purposes continues to work in an 'employee-like' manner and should ideally be subject to the alienation of personal services income rules. As a result, it could address the confusion about whether passing one of the tests as a personal services business means that the taxpayer could be considered to be a business for any other purpose.

5.43 However, this approach would not restore equity between those taxpayers who are clearly 'employee-like' and those whose arrangements are less clear, but are still providing personal services income. It is a 'bright line test' but it is necessarily arbitrary. For example it could lead to very different tax outcomes for taxpayers who earn 81 per cent of their income from one source and those who earn 79 per cent. As noted above, if recent growth in more flexible workplace arrangements continues, focusing solely on 'employee-like' may capture an increasingly smaller part of the intended population.

Amending the 'results test'

5.44 As noted earlier, the Board has heard that the degree of 'greyness' around the test has led to some taxpayers incorrectly assessing themselves as meeting the test. Compliance may therefore be improved if the test is reconfigured to make it less easy to misunderstand or incorrectly apply.

5.45 One option is to add a fourth 'leg' to the test to require the taxpayer to have at least two employees. Another option is to make the results test applicable only to those who earn less than 80 per cent of their income from one source.

ADDRESSING CONFUSION OVER INTERACTION WITH PART IVA

5.46 One of the instigators of the alienation of personal services income rules was to reduce the reliance on Part IVA to deal with the alienation of personal services income and overclaiming deductions. As discussed in Chapter 4, Part IVA still needs to apply to a large number of taxpayers who earn personal services income as a result of the way the alienation of personal services income rules operate. Under the current

rules, when an entity is in receipt of personal services income and is not a personal services business, the personal services income must be attributed to the individual providing the services. Personal service businesses are subject to the application of Part IVA provisions.

5.47 The option below seeks to reduce the number of taxpayers earning personal services income to whom the Part IVA provisions need apply.

Extending attribution rules to personal service businesses

5.48 As noted above, the ATO is undertaking a limited compliance program which may assist in identifying suitable cases to assist in clarifying when Part IVA will apply to personal service businesses. Providing further guidance in relation to Part IVA and income splitting is also under consideration.

5.49 The ATO issued a discussion paper to the National Tax Liaison Group in relation to Part IVA and income splitting. This may go some way to addressing the confusion that the Board has observed around this issue. However, any interpretive advice will not address the difficulties and costs for the ATO and taxpayers of progressing the issue of alienation under Part IVA.

5.50 A next step would be to amend the existing alienation of personal services income rules so that personal services income earned through an entity is attributed to the individual or individuals who provided the services. That is, this approach would apply the current attribution regime in the alienation of personal services income rules to all taxpayers in receipt of personal services income, not only those who do not meet any of the tests to be a personal services business.

5.51 This would make it clear that meeting the tests to be a personal services business means that some deductions that are not available to an employee may be available, but that personal services income cannot be alienated.

5.52 This option would address one of the key areas of current uncertainty, the interaction with Part IVA. Its focus is clearly on personal service income, not whether the taxpayer is 'employee-like'. As discussed above, this is a fundamental difference. However, moving to a focus on personal services income rather than 'employee-like' for the purposes of addressing alienation is not a departure from the current policy. Since the alienation of personal services income rules were introduced it was made clear that while the attribution provisions applied to those that could not meet the personal services business tests, arrangements put in place to alienate income could be subject to the provisions of Part IVA.

5.53 This approach may place more pressure on the distinction between income derived from personal services and income derived from a business structure. Only those taxpayers that meet the definition of personal services income would be affected, that is those whose income is mainly a reward for their individual's personal efforts or

skills. The option could be implemented in a way that any return from business assets or capital would not be affected by the attribution regime. As discussed at paragraph 5.8, this could be achieved by applying a domestic transfer pricing rule to the labour supplied, or alternatively by applying an imputed rate of return to any capital and treating the residual as personal services income.

5.54 The approach described here would address alienation more directly than the current provisions, and could simplify the law considerably and make it much easier for the ATO to administer the law as they would no longer need to commit resources to considering where Part IVA will apply.

CLARIFYING THE DEDUCTION RULES

5.55 The current alienation of personal services income rules generally limit deductions of an entity in receipt of personal services income to those that would be available if the personal services income was derived by an employee. In practice there are four deductions of concern in relation to personal services income: payments to associates, superannuation contributions, home-to-work travel and home office expenses. The approach in the current provisions is to deny certain deductions to taxpayers that do not meet one of the personal services business tests.

5.56 However, the Board is concerned that, for some taxpayers, this approach seeks to highlight a difference that may be marginal. For example, the issue of claiming a deduction for home-to-work travel in the construction industry is not so much whether a taxpayer is providing the services in an 'employee-like manner', but as set out in case law, whether the transport expenses can be attributed to the transportation of bulky equipment that could not be left at the workplace rather than to private travel between home and work.

5.57 A deduction or a tax offset for superannuation contributions on behalf of a spouse (not Superannuation Guarantee or employer contributions) is only available in limited circumstances (such as where the spouse has a low income). The rules setting out the circumstances where a deduction or tax offset is available are set out in Division 290 of the ITAA 97, not in the alienation of personal services income rules.

5.58 Amounts paid to an associate for non-principal work, for example support such as secretarial work, are not available to those in receipt of personal services income that are not a personal services business. In addition, excessive or unreasonable payments to a relative or a partnership in which the relative is a partner may not be deductible even where it is for principal work. This is also the area that the ATO continues to have most difficulty in administering and has been the subject of a number of court cases.

5.59 An option to address the different issues around deductions is to set out clearly when each of the deductions is available. Home-to-work travel and deductions for home office expenses would be available under the guidance provided already by case law. Payments to associates for non-principal work would be allowed only where a case was made out that the work was required in order for the principal to earn assessable income. That may involve the application of tests similar to the personal services business tests currently set out in the law — such as whether there were multiple customers that required invoices to be prepared or debts to be followed up.

5.60 As part of this option, the rules would allow a deduction for a payment to an associate incurred for the purpose of deriving assessable income that is made on an arm's length basis and can be regarded as being commercially in line with the level and skill of the actual work being undertaken.

5.61 An alternative to a specific arm's length rule for personal services income that the Government may wish to consider is a general arm's length rule as recommended in the Ralph Report.

5.62 The existing rules for superannuation contributions could be modified so that a deduction is available regardless of whether the work done is principal work or administrative work, but the deduction could be limited to the amount that needs to be contributed in order to avoid a Superannuation Guarantee shortfall for the associate.

5.63 In addition to legislative change, improvements could be made to the administrative arrangements for individuals in receipt of personal services income, either directly or attributed, that are not a personal services business. Instead of completing the Business and Professional Items Schedule which contains labels for deductions only available to those in business, they could instead complete much fewer labels, similar to those for work-related expenses.

5.64 While this approach would maintain some tests that stakeholders have told the Board they find difficult to apply, the tests would only apply to those taxpayers that sought to make payments to associates for non-principal work. They would therefore apply to a much-reduced potential population than the current tests that are applied to all taxpayers earning personal services income.

5.65 This approach would also highlight the similarities in the availability of deductions for some taxpayers, rather than highlighting the differences. This may assist in dismissing the perception that there are significant taxation benefits from being a contractor or operating through an entity.

5.66 A disadvantage of this approach is that it would require very specific provisions to be included in the law. If other deductions became an issue of concern, the law would need to be amended, rather than relying on the principle that is set out in the current rules. It could also lead to tax planning opportunities around the words

used in the law to describe and define the availability of deductions, which the current principle in the law about work-related deductions avoids.

5.67 Another drawback for the proposal is that some of the currently available deductions are sector-specific. For example, specifying in the law that home-to-work travel is an allowable deduction if heavy equipment is required to be carried to the workplace may provide some certainty to the construction industry, but not to other industries.

ADDRESSING COMPLEXITY

Simplifying the PAYG withholding obligations on attributed income

5.68 Suggested options such as replacing the personal service business tests with more objective 'employee-like' tests as suggested in the Ralph Report, extending the attribution rules to all entities in receipt of personal services income, or simplifying the deduction rules, would assist in addressing complexity. Another option would be to simplify the PAYG withholding obligations on attributed income.

5.69 An ATO practice statement, PS LA 2003/6, was developed as a result of taxpayers expressing concern following the introduction of the alienation of personal services income rules about the high compliance costs associated with complying with the PAYG withholding requirements in Division 13. The administrative arrangements permit a personal services entity that has an obligation to withhold not to comply with Division 13, if the entity withholds on the basis outlined in the Practice Statement. The administrative arrangements have assisted taxpayers by providing an easy method for calculating the amount to withhold and not penalising taxpayers who try to go some way to meet their PAYG obligations but nevertheless do not pay the correct amount.

5.70 In addition to the facilities currently provided by the ATO through its Practice Statement, current PAYG obligations on personal services entities in respect of attributed income could be made more flexible through the allowance of annual reconciliation in reporting and payment. Annual reconciliation of PAYG withholding obligations would facilitate compliance in cases where the status of taxpayers (whether covered or not by the personal service business tests exclusions) varies during an income year. The facility would not exempt taxpayers from the withholding obligation on attributed income. It would provide greater flexibility for personal service entities to reconcile errors due to changing circumstances.

5.71 These facilities would be even more important if attribution were to apply to all entities in receipt of personal services income. These facilities would assist compliance with PAYG withholding obligations.

APPENDIX A: LIST OF SUBMISSIONS

The Board received 13 submissions on the post-implementation review into the alienation of personal services income rules from the following parties:

Association of Professional Engineers, Scientists and Managers, Australia

Australian Council of Trade Unions

Civil Contractors Federation

Construction, Forestry, Mining and Energy Union

Courier and Taxi Truck Association

CPA Australia

Housing Industry Association

Iemi, Luigi

Independent Contractors of Australia

Institute of Chartered Accountants in Australia

Master Builders Australia

National Tax & Accountants Association

Taxation Institute of Australia

APPENDIX B: TAXATION OF PERSONAL SERVICES INCOME IN OTHER JURISDICTIONS

UNITED KINGDOM

The Intermediaries Legislation (IR35) was introduced in the UK on 6 April 2000 to eliminate the avoidance of tax and National Insurance Contributions (NICs) through the use of intermediaries, such as Personal Service Companies or partnerships, in circumstances where an individual worker would otherwise, for tax purposes, be regarded as an employee of the client.

The legislation is not targeted at any particular occupation or business sector. It can apply in any business sector. Examples of occupations where people work through service companies run right across the board, including medical staff, chief executives of large public companies, the teaching profession, legal and accountancy staff, construction industry workers, IT contractors, engineering contractors, clerical workers and many others.

The IR35 rules require consideration as to whether the individual would have been an employee, subject to tests or indicators which are similar to those proposed in the Ralph Report. The Pay as You Earn (PAYE) and NIC legislation imposes an obligation on the person engaging the worker (the 'engager') to determine the status of a worker (employed or self-employed contractor) by applying these tests.

Notwithstanding the IR35 legislation, HM Treasury has recently released a consultation paper [11] that has noted that there are a substantial number of workers in the construction industry working under employment terms who are presented as self-employed. It has concluded that the best way to address this problem is to introduce legislation. Under the proposed legislation, workers within the construction industry are deemed to be in receipt of employment income unless one of three criteria is met. Any payment made to a worker which is deemed to be employment income will be subject to PAYE and NICs.

The consultation paper proposes the following three criteria as reliable indicators, within the construction industry, of a worker being in receipt of self-employment income:

---

[11] HM Treasury 'False self-employment in construction: taxation of workers', July 2009.

- provision of plant and equipment – that a person provides the plant and equipment required for the job they have been engaged to carry out. This will exclude the tools of the trade that are traditionally provided by the individuals;
- provision of all materials – that a person provides all materials required to complete a job; or
- provision of other workers – that a person provides other workers to carry out operations under the contract and is responsible for paying them.

The consultation paper also notes that HM Treasury recognises the effect that the economic downturn has had on the construction industry and intends that the measures developed as a result of consultation will take effect when the industry is in a stronger position.

NEW ZEALAND

As a result of the introduction of the Avoidance Legislation in 2000, personal services income received by a company is attributed to the individual who derived it, after allowable deductions are taken into account. The attributed amount is deducted from the entity's income for tax purposes.

For attribution to apply all the following criteria must be met:

- 80 per cent or more of the entity's personal services income is from one source;
- 80 per cent or more of the entity's personal services income is derived from the individual or their relative;
- the entity's net income is greater than NZ$60,000; and
- the business structure does not have substantial business assets (depreciable property costing more than NZ$75,000 or at least 25 per cent of the company's gross personal services income for the year).

NORDIC COUNTRIES[12]

For the self-employed, taxation of income is split between income from labour (subject to progressive taxation) and income from capital, which is subject to a flat tax rate. As capital can more easily be defined and valued, the rate of return on business assets is calculated and then the residual is treated as income from labour. If the self-employed

[12] Sorensen, P 'The Nordic Dual Income Tax: Principles, Practices and Relevance to Canada' Canadian Tax Journal (2007) Vol 55, No. 3, 555-607

person does not split their income from labour and income from capital, all income is taxed as labour income.

The imputed rate of return on business assets can be calculated using gross assets or net assets.

Under the gross assets method the net financial liabilities of the entity are not deducted from the asset base. The income from labour is calculated by deducting the imputed return to gross business assets (as recorded on the balance sheet) from the gross profits.

Under the net assets method the net financial liabilities are deducted from the asset base. The income from labour is calculated by deducting the imputed return to net business assets (business assets minus business debt) from the net profits (profits after the deduction of interest).

The imputed rate of return is set by the tax authority and may differentiate between business activities to prevent distortion in investments.

CANADA[13]

The Canadian Income Tax Act limits deductions available to companies which derive income from a 'personal service business'. All deductions are denied except for:

- salary, wages, or other remuneration paid to an 'incorporated employee';
- selling and similar expenses that would have been deductible in computing employment income if the taxpayer had been employed and had been required by a contract of employment to pay them; and
- legal expenses incurred in collecting amounts owing for services rendered.

A Canadian personal service business is defined as one where the services of an 'incorporated employee' are provided to an entity in which it could reasonably be concluded that the 'incorporated employee' would be regarded as an officer or employee (that is, an employee as opposed to an independent contractor).

The incorporated employee or a related person must own 10 per cent of the issued shares of any class in the company at any time during the year. Exceptions are where throughout the year the company employs more than five full-time employees or where a company receives the proceeds from an associated company.

[13] Pennicott, S 'Resolving the personal services income dilemma in Australia: An evaluation of alternative anti-avoidance measures' Journal of Australian Taxation (2007) Vol 10(1), 85

APPENDIX C: PAYROLL TAX HARMONISATION

The States are currently undertaking payroll tax harmonisation.

Stage 1 has been completed and includes the adoption of common payroll tax administration provisions and definitions for: timing of lodgement; vehicle allowances; accommodation allowance; fringe benefits; work performed outside a jurisdiction; employee share acquisition schemes; superannuation for non-working directors; and grouping of businesses.

Stage 2 reforms are currently under way and include the harmonisation of definitions and terms in payroll tax legislation (employer is included as a term defined in legislations, however employee is not expressly defined in all legislations).

NSW, Victoria, Queensland and Tasmania have already agreed to reforms as part of Stage 2. WA, SA and the NT are still considering second-stage reforms.

APPENDIX 4

A UCATT REPORT – THE EVASION ECONOMY: FALSE SELF-EMPLOYMENT IN THE UK CONSTRUCTION INDUSTRY

A UCATT Report

The Evasion Economy

False Self-employment in the UK Construction Industry

Mark Harvey
and Felix Behling

THE EVASION ECONOMY

FALSE SELF-EMPLOYMENT IN THE UK CONSTRUCTION INDUSTRY

Mark Harvey

and

Felix Behling

The authors

Professor Mark Harvey is Director of the Centre for Research in Economic Sociology and Innovation in the Department of Sociology, University of Essex. He has published widely on labour markets and welfare systems, including an earlier report *Undermining Construction: the corrosive effects of false self-employment*, Institute of Employment Rights, 2001

Felix Behling is a doctoral student in the Department of Sociology, University of Essex. He is undertaking comparative research on corporate social responsibility in the United Kingdom and Germany.

Cover photograph: reprinted with thanks to Paul Box/reportdigital.co.uk

Contents

Tables and figures

Figures

Tables

Executive summary

- Self-employment is defined as false when the engaged worker would be deemed directly employed by normal legal tests. False self-employment is adopted as a device to reduce the tax liabilities and employer responsibilities' of the engager and/or engaged. The false self-employed are not in business on their own account, come under the control and supervision of their engagers, are paid wages rather than work for a client under contract, and in most cases, continue to work for the same engager of their labour on successive construction projects, and for long periods of time. It contrasts with genuine self-employment, where work is undertaken for clients by individuals in business on their own account, assuming risk and being rewarded by the price of the contracts and the profits gained thereby. The UK construction industry has been characterised by high levels of false self-employment over several decades, and recently that level has been rising again.

- The level of registered self-employed is uniquely high in the UK construction industry, and can only be attributed to the presence of false self-employment on a massive scale. Self-employment is between two and three times higher than any other advanced building industry, including the famously flexible US labour market. Even within the UK, the construction industry is a freak case in terms of the level of registered self-employment. After a short period of decline, the evidence now is that **false self-employment is once more on the increase**. On the basis of statistical and empirical evidence, the report concludes that between 375,000 and 433,000 workers are currently falsely self-employed. As a round figure, we estimate **mass false self-employment currently standing at 400,000**. This leaves a figure of genuinely self-employed at between 270,000 and 325,000, a high level by any international standards. These assessments are based on official statistics, and given the hidden nature of informal economies, are undoubtedly conservative. (Chapter 2)

- With false self-employment, employers pay no National Insurance, and their workers pay a lower rate of National Insurance and less tax, making workers cheaper to employ. In conditions of competition, employers are often faced with little choice but to engage workers illegally on the basis of false self-employment. All construction trades unions, and a significant proportion of construction employers associations, including the Construction Confederation, have long campaigned for a level playing field in order to eradicate the scourge of false self-employment from the industry. (Chapter 3)

- The fiscal losses arising from false self-employment are on a massive scale. Although by nature precise figures for this evasion economy are impossible to calculate, the loss can reliably and conservatively be estimated as being between £1.4 billion and £1.9 billion per year**, or a best-estimate round figure of £1.7 billion per year**. By far the largest

proportion of this loss is accounted for by the non-payment of National Insurance by employers. If this loss could be eradicated in the way proposed by this report, the recovered revenue would be enough to build, maintain and run many new hospitals or schools. (Chapter 3)

- Government figures of between 100,000 and 200,000 false self-employed, and a fiscal loss of £340 million are gross underestimates, and reveal little understanding of the construction industry. As surprising is the fact that the Treasury Minister, Stephen Timms, dismissed even these figures as being of little concern to the government, stating that it was a 'matter for the industry' and not 'for Government to regulate how companies are organised.' This is an unusual government attitude with respect to tax evasion, to seriously underestimate its extent and then to ignore it anyway. (Chapter 3)

- Much of the recent rise in false self-employment can be attributed to the influx of migrant labour from the new member and accession states in Europe. Employers have taken advantage of the vulnerability of migrant workers, and exacerbated their insecurity by engaging them as false self-employed. Government regulations for migration make it easier to migrate as self-employed, and this has played into the evasion economy characteristic of much of the industry. Building workers from Bulgaria and Rumania have little choice but to come as self-employed if they enter the UK to work in the construction industry. (Chapter 2)

- The report analyses the reasons for this gross irregularity in the UK construction industry. Confusion in the law, and obstacles to prosecuting the principal responsible agents for engaging the false self-employed are noted. But the distinctiveness of the construction industry lies in a unique and distorting taxation regime, where workers have their tax deducted at source by their employers, whilst still being registered as self-employed. The taxation system thereby provides substantial incentives for tax evasion by engaging workers on a basis that does not require their employers to pay National Insurance. (Chapter 4)

- Treasury Ministers John Healey and Jane Kennedy have accepted that there have been no effective tests or limits applied by Her Majesty's Revenue and Customs in issuing self-employed tax status to 2.4 million individuals between 1999 and 2006, and that 1.9 million self-employment identity cards were in circulation in 2007, when the total official self-employed workforce was less than 700,000. In effect, they are admitting that self-employment in the construction industry is out of control. (Chapter 4)

- False self-employment in the UK construction industry is the most visible and tangible symptom of a much deeper malaise. False self-employment reflects a failure to invest in the employment relation, and especially a

failure to build the necessary skills from within the UK, to support and maintain a technologically innovative and modernising industry. The skills gap has been widely evident ever since the decline in employment-based apprenticeships, and underlies much of the demand for migrant labour. Mass false self-employment is shown to directly contribute the low levels of training, leading to the UK having less than half the level of construction skills to be found in Germany, France, The Netherlands or Denmark. There is now **an annual deficit of over 20,000 apprenticeships and trainees**, with cumulative effects from previous decades. In order to close the historic skills gap, the need has been identified for between three and four times the annual deficit to be trained over the next decade. (Chapter 5)

- For employees, false-self employment deprives them from employment rights to which they are entitled by law, often with difficulty obtaining holiday pay, and excluded from sick or unemployment benefits. Already reliant on their own provision for pensions, many construction workers end their working lives dependent on means-tested state benefits as a consequence of insecure and irregular employment. This is the hidden cost of false self-employment, and will increase markedly with the implementation of the second state pension, from which they will be excluded, and to which their employers will not contribute. Last, but not least, the construction industry remains one of the most hazardous industries This cannot be only attributed to the physical nature and environment of their work, but more significantly to the failure of their employers to assume their normal responsibilities by investing in a trained workforce. (Chapter 5)

- The diagnosis of the causes of the tax evasion economy leads to a quite straightforward set of proposals for the remedy. The report recommends that a robust business test for self-employed tax status becomes the primary one that is valid for the industry. This brings the construction industry into line with all other sectors in the UK. We recommend that the form of self-employment where tax is deducted by the engager of labour is abolished. We propose a single category of self-employed in the industry. This not only simplifies the taxation system, but also makes it more transparent, and consistent with the accepted legal criteria regarding employment status. This proposal brings the construction industry back into line with all other sectors of the economy.(Chapter 6).

Chapter 1

The Evasion Economy

For nearly three decades now, the UK construction industry has been under the sway of a shadow evasion economy,[1] to such an extent that it has almost become accepted as 'normal'. In simple terms, this aberrant 'normality' is characterised by the presence of false self-employment on a mass scale, on the one hand, and extensive tax evasion whereby employers pay no National Insurance, and the falsely self-employed, pay lower rates of National Insurance and tax in conditions of heightened insecurity and exploitation. In this report, the nature of false self-employment and its consequences will be analysed in some depth. The extent of the evasion and the fiscal black hole will be examined, and evidence is presented that it amounts to a staggering £1.4 billion to £1.9 billion per year lost to the taxpayer. And that is just the tip of the iceberg in relation to the shift of costs from employers to the state.

We will explain the more technical legal and taxation definitions of false self-employment later in the report. But there is a fairly straightforward and common sense way of understanding it. In substantiating the case for 'the evasion economy', we need to distinguish between genuine and false, even illegal, self-employment. The construction industry is characterised by relatively high levels of genuine self-employment compared with other industries. The genuinely self-employed are, as the term suggests, their own bosses: they decide when, how and for whom they work. They set a price for their work, and they work for a client that purchases their labour

[1] The term 'evasion economy' is used here to mean an illegal and hidden economy, as opposed to a criminal economy, such as occurs with drug or people trafficking, or the mafia economy in Italy. There is no suggestion that illegal false self-employment is a result of criminal activity by any of those implicated in the practice. Tax evasion is distinguished from tax avoidance, where the latter involves all legitimate means for reducing the tax liability of the person or organisation.

services. The self-employed set the price they expect to be paid for the job, and depending on the competition, the client either agrees, or seeks an alternative. These genuinely self-employed may gain respect and trust from their clients, and work on successive contracts over several years. But they also can easily switch from client to client, depending on their work load, and their opportunities for increasing their rate of return. They are described as 'making a profit' rather than earning a wage. If a job is undertaken at a price, including possibly both labour and materials, the gain made by the self-employed exceeds the costs incurred in undertaking the contract. The price is set at the self-employed's own risk.

This characterisation of genuine self-employment describes well the situation for many thousands of jobbing carpenters, plumbers and electricians with which the general houseowner is familiar. It also clearly embraces those situations where small-scale building work is undertaken for private clients. In the construction industry today, even on large construction sites, there are also many occasions when genuinely self-employed workers are contracted to undertake all kinds of specialist jobs. This contributes to the renowned 'flexibility' of the labour market – large contractors are not obliged to keep such specialist trades permanently on their books, but can hire them in, when and where they are needed.

This then describes, in common sense terms, what it means to be genuinely self-employed: people literally employ themselves, they are in business on their own account. They are their own boss. Clearly, their clients have none of the responsibilities of a normal employer when purchasing the services from a self-employed person. You would not expect them to pay holiday pay, for example. Nor would you expect the client to deal with any of the tax affairs of the self-employed person. And it is quite right that they do not have to pay any National Insurance on

top of the price they pay for the job. Because the genuine self-employed do not work for wages in the normal sense, but by contract price, they also pay tax in different ways and, taking the rough with the smooth, are taxed on their annual profits. They are entitled to allowances with respect to running their own businesses – secretarial help, costs of running an office, and so on.

What then is 'false' self-employment? Again, in common sense terms, if you walk on to a large construction site, with hundreds of workers, working often in teams, you would not expect them all to be their own boss – the result would not be flexibility but chaos. Yet, as we will show, it is an extraordinary fact that many large construction sites have 100% self-employment, and many others well over 50%. This is strange. Then, the next thing you would find is that most of these 'self-employed' are paid wages, say £60, £80, £100 or more a shift of 10 hours a day. These workers do not set their own wages or 'price' for their labour – indeed, they may easily be recruited by employers' advertisements stating their rates of pay. In this sense, to use the term 'profit' makes no sense, because there is no difference between the price they are paid and the costs they incur, any more than there is for a normal employee. They take no financial risks, because they do not set their own price. Moreover, they are entirely under the control of their engager, who tells them what to do, when to do it, and indeed they are often in large teams or gangs working under the identical terms and conditions, gangs of bricklayers, plasterers, labourers, scaffolders, carpenters, dryliners, concrete workers, and so on. To think of each of these as independent self-employed persons, every single one their own boss, is a blatant absurdity.

The engagers of the false self-employed are not clients in any normal sense, but employers. Over the last few decades, the large construction companies became 'hollowed out', no longer directly employing labour themselves, but managing

subcontractors under contract. The new and dominant type of firm employing labour became the labour-only subcontractor. They do not pay any National Insurance, often pay no separate holiday pay, and are not responsible for sick pay or any other similar expenses. They are simply getting labour on the cheap, treating their workforce as employees, but paying them as self-employed. Moreover, astonishingly, instead of the self-employed paying their own taxes in the way that the genuinely self-employed do, their engager deducts their tax and National Insurance out of their wages. In any normal world of work, you could find no surer sign that the worker is not their own boss, if their engager handles their tax matters for them.

The phrase ‘bad money drives out the good’ is a commonplace in economics. This is what has happened in the UK construction industry. Faced with the choice of whether to employ workers on a proper basis, as an employee with normal employment rights, or to hire a cut-price phoney employee, the false self-employed, employers have little choice in a competitive world. So false self-employment has driven out proper direct employment in the construction industry. We will later show how and when this has happened, but it can be conservatively shown that there are between 375,000 and 433, 000 false self-employed in the construction industry in the UK today.

The startling fact is that the UK construction industry currently has more self-employed than directly employed manual workers, over 50% of the total workforce of 1,345,000. No other country has more than 25%, not even the USA. In the rest of Europe, including many of the less highly regulated labour markets, the figure never exceeds 20%. Although these statistics are indeed powerful evidence that something is seriously awry, the common sense test is by far the strongest. On an organised building site where there are several hundred workers, working in a hierarchical,

coordinated, and controlled way, it is absurd to think that they could all be independent businessmen and women. It is pretty strange to think that even half could be. It begins to make sense only when you get closer to the numbers found in other countries. It is clear that the UK construction industry is in the grips of an evasion economy. We are used to thinking that illegal economies only happen in other countries – Italy, for example. It could not happen here, not on this scale, it might be assumed. The alarming fact is that this situation has now come to be treated as accepted normality, by successive governments, and by the Inland Revenue who seem to have vested interested in preserving this evasion economy. In the report, we will seek to explain how this 'normalisation' of the evasion economy has come about.

The level of self-employment has gone in ups and downs over the years (for reasons looked at in greater detail in Chapter 2). Recently, it has again been increasing quite rapidly. And for two identifiable reasons. First, it has become easier for a worker to self-declare as self-employed. Indeed you can do it on-line. Second, most of the steep increase can be attributed to an influx of migrant labour from the new accession states of Europe, including Poland, Bulgaria and Rumania. Of course, migration can be of genuine as well as false self-employed, and given the nature of the evasion economy, it is not possible to give any precise figures on the respective proportions. There are also many genuine directly employed migrant labours.

But two things have conspired to funnel migrant construction workers into self-employment. Firstly, the immigration rules make it much easier to enter as self-employed than as a registered worker, especially from Bulgaria and Rumania. Secondly, the lack of policing of the evasion economy presents no obstacles to entering into false self-employment. Vulnerable and exploitable workers are only too easily taken advantage of by engaging them on the cheap within the category of the

false self-employed, already endemic in the industry. As self-employed, they do not have the protection they are entitled to as employees, and coupled with their migrant status, that makes them yet more vulnerable. They cannot be held responsible for entering the industry as false self-employed, when in effect there is very little opportunity to do otherwise. They are made into false self-employed by the system that categorises them as such, only after they have entered the UK. It is important to emphasise that migrant construction workers are not responsible themselves from falsely declaring themselves to be self-employed. That is how they are engaged by their employers.

Although the evasion economy is at the heart of bad false self-employment driving out good employment practices, the consequences and impact of the phenomenon are much wider. The UK construction industry is renowned for its lower levels of productivity compared with many countries of continental Europe, where false self-employment is almost non-existent. The artificial competition triggered by tax evasion has led to a race to the bottom, where there is a minimum investment in the employment relation. There is minimum commitment between employer and employed.

For the false self-employed this means deprivation of normal employment rights. Although, as a consequence of European legislation, even the false self-employed have acquired the right to holiday pay in principle, in practice they are in a weak position to ensure their rights. Many thousands do not have normal paid holidays. More seriously still, there is effectively no security of employment. The myth of being your own boss masks a reality of hire and fire by the employers of the false self-employed. Over the course of a working lifetime, this leads to irregular periods of employment, characterised by many interruptions. When the current

construction boom ends as a consequence of the credit crunch, the false self-employed will be the first to go. They are the most easily dispensable, with no costs of redundancy.

Falling outside any working time directives, the false self-employed also work long hours, the ten hour shift is common, a five and a half or six day week also. Again, these false self-employers are no masters of their own hours or time: they work to the conditions required of their real employers. Time off for bad weather, for sickness, for care of sick children, for visits to doctors, are at their own expense. They take all the down sides of self-employment, and none of the upsides of employment. Together with the overall lack of employment rights, it is amongst the false self-employed that you find the most vulnerable and exploited.

The corruption of the construction economy by false self-employment has a profound impact on training and skills. The fact that over half the work force are now self-employed has drastically restricted the opportunities for workplace apprenticeships. Only with employment do employers invest in skills and training. Breaking the employment tie means breaking the commitment to skills training, and continuous skills upgrading. The responsibility and investment for training is shifted onto the self-employed, through college-based learning, and for off-site training. The consequences are plain for all to see in the vicious circle of a skills gap within the UK workforce, leading to demand for migrant labour which expands false self-employment, which then reduces further the scope and opportunity of home-based training, thus exacerbating the original skills gap we started with. In a sense, both the employers and the false self-employed are trapped in this circle: so long as the evasion economy is in place, employers cannot afford to escape it, any more than the false self-employed have an opportunity to do so. That is why, along with the

construction trades unions, the Construction Confederation has supported attempts to get this systemic failure corrected.

The presence of a widespread ‘evasion economy’ at the heart of one of the UK’s major industrial sectors does present something of a mystery. If the Treasury has around £2 billion per year to gain, if the employers want to invest in skills and productivity and regain efficient management of construction sites, if trades unions have long campaigned over the injustices of the exploited and vulnerable in the netherworld of false self-employment, why has the ‘evasion economy’ not only lasted so long, but become more entrenched? The report, after diagnosing the root of the problem, will propose some fairly straightforward, indeed, simplifying reforms that would bring the construction industry back in line with the rest of the economy. If the solutions are simple in principle, further explanations are needed to account for the resistance to reasonable reform to eliminate the aberration. There are certainly some entrenched interests: the housebuilding construction companies were instrumental in initiating the growth of false self-employment, and have in large remained its most bunkered-in defenders. Inland Revenue, as the engineer of the instruments that enable the evasion, have consistently buried their heads in their own bureaucratic routines, and defended what they see as a tool effective in recovering at least some revenue. The Labour Government, since 1997, has run scared of grasping the nettle, frightened of short-term risks of labour-price escalation, unprepared to take on entrenched interests, and unwilling to take a principled long-term stand on the need for systemic reform to remove an injustice and increase productivity and innovation in the industry. The government has allowed its objective to reduce over-regulation to be confused with attempts to eliminate irregularities.

But now is the time to put the construction industry on a legal and proper footing. Once more the evasion economy is on the rise, and the cost to the taxpayer is escalating. The need to address the causes of the skills gap and overdependence on importing skilled labour has become more and more pressing. The insecurity and lack of employment rights for the false self-employed, has been compounded with the vulnerability and exploitation of migrant workers sucked into the shadows of this evasion economy.

Following this scene-setting chapter, the report will provide the detailed evidence.

Chapter Two will first demonstrate the scale of false self-employment in the construction industry in the United Kingdom. It will show how unique the United Kingdom is in comparison with other countries, and it will show also how the construction industry is such an aberration even within the United Kingdom. The chapter will demonstrate the ups and downs of false self-employment, and the recent rise, fuelled by migrant labour.

Chapter Three will draw out the consequences for the losses to the tax payer, and provide estimates of the extent of the fiscal black hole. It will explain how the losses are made, and show that the employers are source of the major losses.

Chapter Four will provide explanation and analysis of how the evasion economy has taken such a hold in the industry, firstly by looking at the law on employment status, and secondly, by analysing the systemic origins of the problem in a taxation regime unique to the construction industry. The analysis will be brought up to date with a discussion of recent fine-tunings of the regime that has facilitated the upsurge of false self-employment.

Chapter Five will draw out the consequence of false self-employment for the ‘victims’: exploitation, vulnerability and the lack of employment rights; the effect on pension provision and exclusion from the second state pension; and the devastating impact on training and the development of skills.

Chapter Six will conclude the report by proposing a set of reforms to simplify the existing tax regime, and bring the construction industry back into line with the rest of the economy. It will spell out the rationale for reform and the benefits to be derived from it, and attempt to counter the most obvious obstacles thrown up by those with entrenched interests in the evasion economy.

Chapter Two

The epidemic of false self-employment

In this chapter, we identify the scale and peculiarity of mass illegal and false self-employment in the UK construction industry.[2] In subsequent chapters, the legal and taxation classification of workers is analysed in order to show how, in formal terms, an individual can be deemed to be falsely or genuinely self-employed. Part of the problem that legal and taxation authorities have is that they ask the question of genuine or false employment status to be proven case by individual case. They fail to approach the systemic nature of the evasion economy, and to recognise that there is an argument to be made from the scale of the phenomenon of self-employment in this country's construction industry. Put simply, if there are so many self-employed, not all of them can be genuine. Moreover, above a certain level, you can be fairly sure of a range numbers that are falsely and illegally self-employed. When the number goes above one quarter of the workforce, there begins to be suspicion of deviance from genuine self-employment, and the more it goes above that level, the more suspicion turns to certainty. As explained in the previous chapter, the starting point is the reality

[2] In this chapter there are two sources for the statistics, the Labour Force Survey and the Housing and Construction Statistics produced by the Department for Business Enterprise and Regulatory Reform (previously the Department of Trade and Industry). There is a discrepancy between the two sets of statistics, and, following previous publications (Harvey, 1995, 2001) the BERR statistics have been used when dealing with the construction industry alone, as they have greater accuracy for dealing with manual occupations. The LFS provides the only source for making comparisons either with other UK data, or with European data, and this database has been used when this is the case.

on the ground. On any given construction site, it is quite absurd to think of the engagement and use of labour as being anything other than employment above a certain percentage. Not everyone can be their own boss.

The uniqueness of the UK construction industry

How do we know that there is false self-employment on a mass scale in the UK construction industry? Let us first look at just how exceptional the UK construction industry is within the United Kingdom context.

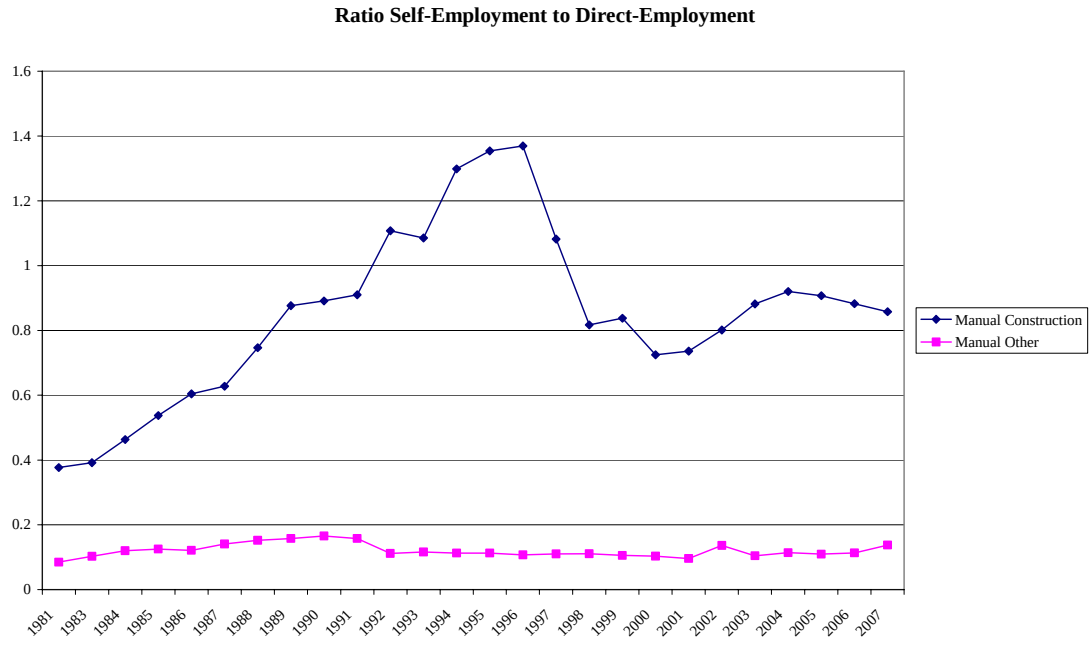


Figure 2.1. Ratio of self-employed to employed in construction manual workers versus other manual trades, 1981-2007. *Source Labour Force Survey, 2007. HMSO.*

Historically, there had always been a high level of illegal self-employment in the UK construction industry, even before Thatcher came into power in 1979 (Austrin, 1980; Birch, 1993; Harvey, 1995). Known as 'the lump', the system involved cash-in-hand payments, the phenomenon was largely untracked, and reliable statistics hard to obtain. Nonetheless, according to official figures by 1981, the construction industry already had more than double the proportion of self-employed

to employed, at roughly three employed manual workers to every two self-employed (Figure 2.1). This compared to roughly 10 directly employed to 1 self-employed in other manual occupations. Deregulation by the Thatcher government changed the whole scale of the phenomenon, to levels that have made the construction industry a massive aberration. Peaking in 1996 when nearly two thirds of the manual construction force were self-employed (1.4 self-employed to 1 employee), the proportion has fallen but remained at extraordinarily high levels compared with any other industry in the country. It should be remembered that comparisons include transport where significant numbers of self-employed taxi, lorry and bus drivers are included; or catering, distribution and hotels, where likewise there are substantial numbers of small service providers, in cleaning, small shops, food preparation and other such occupations. Even in comparison with these sectors, where there are at a maximum 15% of self-employed, the construction industry is a massive anomaly. So even with the general move towards outsourcing and flexible labour, the contrast between these sectors and the construction industry has grown rather than diminished. Current levels in construction have recently again exceeded 50% of the total manual workforce, more than one self-employed person to every one employed person.

Exceptional within the UK, the construction industry also contrasts with all other comparable and not-so-comparable construction industries in other countries (Philips and Bosch, 2002). For the UK there is just more than one self-employed construction worker for every one directly employed. For the EU overall, there are on average four directly employed workers to every one self-employed (European Labour Force Survey, 2007). If we compare the UK with France, Germany and Spain over the last decade, France has remained more or less stable at 20%; Spain has declined from just over 20% to 18%, and Germany alone has shown an increase from

just under 10% to 18%. So whether comparing with Southern or Northern Europe, and during a period where substantial labour market reforms have taken place, nothing comparable exists in the construction industries of these countries. An argument is often made that there is something special about the construction industry, by nature of the production process – there are distinctive discontinuities in contracts and labour process, in time and place. This, it has been argued, 'explains' why self-employment is so much more pronounced. These figures simply demonstrate that this argument has no legs to stand on. Even if there may be slightly higher levels of self-employment in other countries' construction industries compared with other sectors, there is nothing intrinsic to the construction industrial process that can explain the contrast between UK and other European countries' patterns of self-employment.

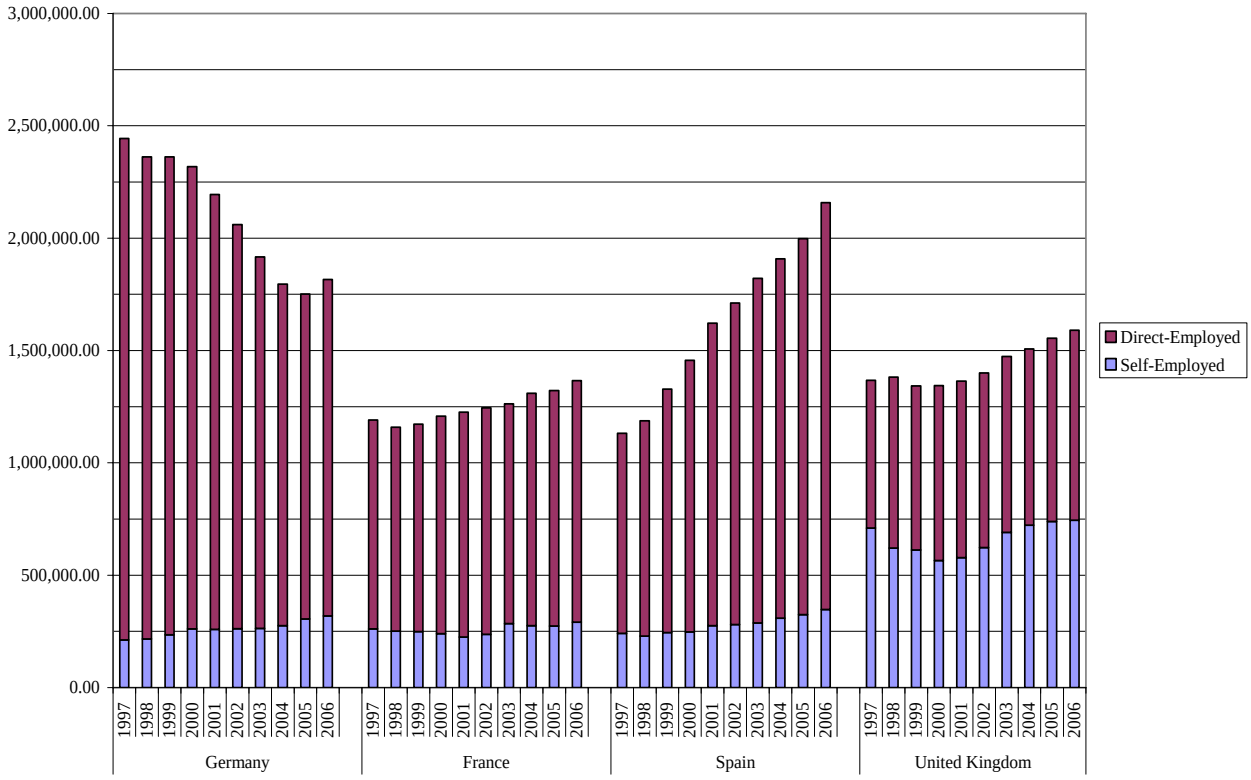


Figure 2. 2 European construction industries and employment status. *Source: European Labour Force Survey, 2007*.

Developing this argument further, the contrasting fates of European construction industries quite clearly demonstrate that demand for labour supply, the boom and bust nature of an industry sensitive to changes in economic climate, does not account for the expansion of self-employment. As figure Figure 2.2 shows, Spain and France, both enjoyed an expansion, Spain an explosive one. Yet, in contrast to the UK, expansion was accompanied almost entirely by the growth in direct employment in Spain, as was the case, at a lower level, for France. Germany, experiencing a recession in construction, shows the decline to be greatest in direct employment, whereas self-employment increased slightly. So it is not the case there that the 'more flexible' labour was more easily dispensable in times of recession.

Comparisons with the USA are not straightforward, as their industry is quite sharply divided between industry covered by collective bargaining and the non-union sector (Philips, 2002). Nonetheless, even in the highly deregulated labour markets of the USA (Peck, 2002, Peck and Theodore, 2001), the level of self-employed does not exceed 25% (US Bureau of Labour Statistics, Employment and Earnings, 2008).

The conclusion to be drawn from these comparisons between construction and other sectors within the UK, and between the UK's and other countries' construction industries, is that there is something distinctly deviant occurring within the UK construction industry. It is freakish. The evidence serves to counter arguments of two kinds. Firstly, there is not a general characteristic of UK labour markets, its case law approach to labour markets, or any policy measures to stimulate enterprise and small business, that can account for the peculiarity of UK construction. Secondly, there is not a characteristic intrinsic to the construction industry that makes it a special case, because otherwise similar effects would be discernible in other countries. Rather the

UK construction industry stands out in its peculiarity both between industries in the UK, and between UK construction industries and other countries construction industries.

The ups and downs of self-employment in the UK construction industry

Turning our attention to the emergence of mass and excessive self-employment in the UK construction industry, certain broad patterns can be noted. Following a sharp measure of deregulation by the Thatcher government, to be discussed later, there were more than ten years of sharp increase in the level of self-employment. During this period, the overall level of employment remained relatively stable, so we can talk of a direct switch from direct to self-employment during this period. A sharp downturn of the construction industries in the early 1990s, saw a decline of the numbers in both employment statuses, but accentuated more for the directly employed. Following an industry recovery, self-employment picked up again, until 1995. Then, a campaign by UCATT and other trades unions resulted in minor changes in the regulatory framework, and a half-hearted attempt to tighten up on false self-employment. This period was the only one that has witnessed a switch back from self-employment to employment of roughly 200,000 construction workers. But, following a relaxation of regulation, and the cessation of all serious attempts to enforce the law, the rate of self-employment has begun to climb again. In the long boom in construction work, self-employment rose more rapidly than direct employment, so once more exceeding 50% of the total work force. Figure 2.3 below shows the rise and fall in directly employed and self-employed since 1981 in absolute

numbers. Figure 2.4 tracks the same changes, but this time in terms of the relative percentage of self-employed to employed.

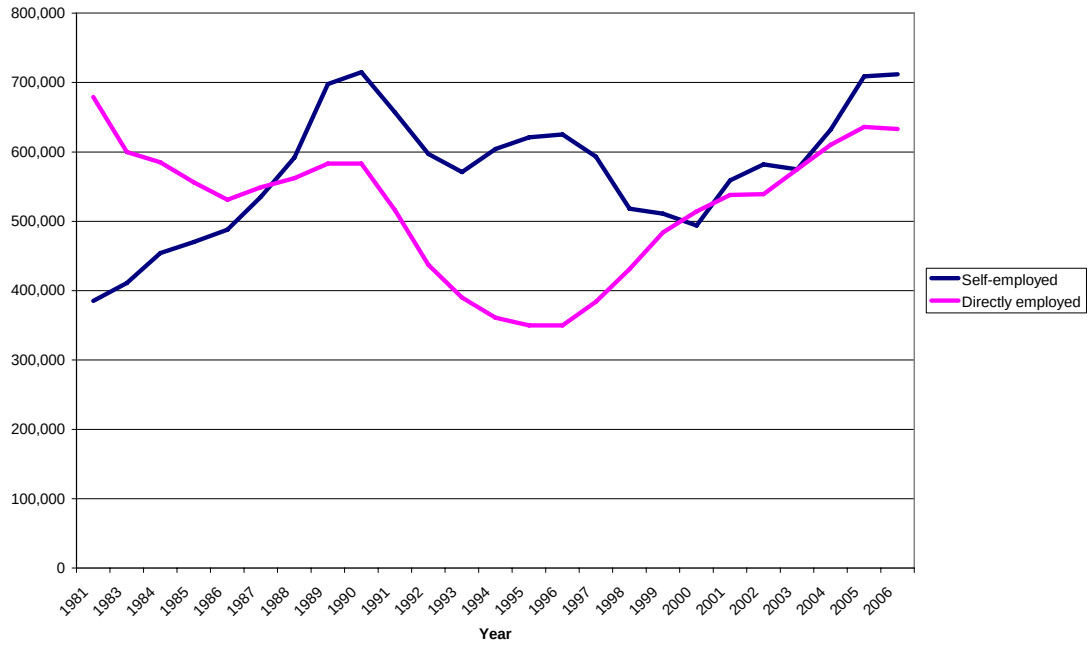


Figure 2. 3. The ups and downs of direct and self-employment in UK construction, 1981 -2006.
Source: Housing and Construction Statistics, BERR, 2007.

So, if we turn now to look at the same data in terms of proportions between employed and self-employed, we can isolate the trends from the cyclical effects of growth and contraction of the industry. The pattern becomes clearer. There was a steady increase in self-employment at the expense of direct employment until the regulatory tweak in 1996, and then, after a brief period of reversal, from 2000 the trend has once more been one of an increasing proportion of self-employed, reaching the rarified and legally unrealistic heights of over 50% by 2005.

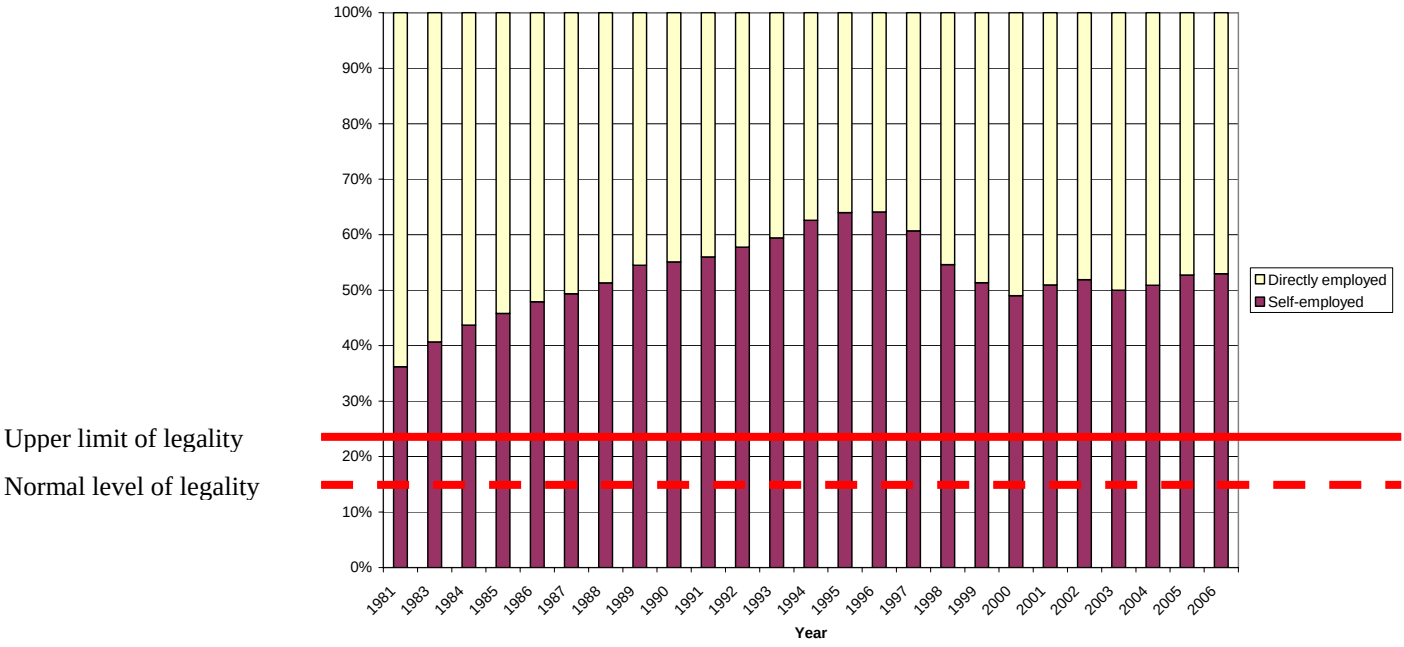


Figure 2.4. The proportion of directly employed to self-employed in the UK construction industry, 1981-2006. *Source: Housing and Construction Statistics*, BERR, 2007.

If we take our country comparisons as our baseline, and also use common sense and business logic to guide us, it is possible to make some reasonably robust judgements concerning the scale of false and illegal self-employment in the UK construction industry. We have seen that no other country exceeds 25% of their workforce as self-employed – and that assumes of course that all of these are all legal. That percentage can be taken as an upper limit of legality. Everything above that line can be thought of as being, in all probability, illegal self-employment. If the numbers had only just exceeded that line, then it would be arguable that there was no systemic or significant problem. But Figure 2.4 above shows just what the scale of the evasion economy has grown to be, and how endemic it has become since the 1980s.

Before providing judgements as to exactly how this might translate into numbers of false self-employed, there is some additional evidence that provides some

useful indicators. A survey by UCATT officials of sites to which they had access – and that means union recognition by the lead contractor – was undertaken in January 2008, across all regions including Scotland. This cannot claim to be a scientifically rigorous exercise. It might be thought that the union would seek to present a worst case scenario. Against that, as anyone who has undertaken research into illegal or informal economies will know, there is certainly a counter-balance to any possible bias in the fact that union officials would certainly be excluded from situations of extreme illegality, but also simply from those sites where employers were resistant to exposure of their employment practices. There are next to no sites in the sample from the major housebuilding construction companies, the champions of illegal self-employment. The sample is relatively small – 154 sites across the country. Yet with these precautions and health warnings in mind, the results of the survey still contain a powerful message, and are presented in Table 2.1 below.

Percentage self-employed	0-14%	15-24%	25-49%	50-74%	75-100%
Number of sites	34	2	28	34	56

Table 2.1. The proportion of self-employed on 154 construction sites, January 2008. *UCATT survey*.

The first point to emphasise is that more than a third of sites seem to comply with most normal definitions of self-employment. They include some large sites with over 200 workers, and many of these are public procurement sites where compliance with employment regulations is written into the contract. There is a perfectly legal and bona fide section in the industry. But then there is a gap with just a couple of sites with intermediate levels of self-employment before the number of sites with between

25% and 49% show a marked increase. By far the most frequent category, however, is of sites of over 75% self-employment, and indeed nearly 20% of sites had 100% self-employment. This is the hard core of the evasion economy – the phenomenon of mass false self-employment that defies all logic and sense, with every single worker on a large construction site putatively their own boss, running a profit and loss account. But, not to pick out these extremes, the case of one very large site in the London South East region, with 1500 manual construction workers of which 900 are self-employed, 350 of these migrant, is perhaps the most striking evidence of the evasion economy. It is not as if it is hidden – everyone knows what is going on. The sheer scale of the illegality and the tolerance of it by employers and taxation authorities alike is a demonstration of how entrenched and normalised tax evasion and deprivation of employment rights have become. If one accepts the upper limit of legality in Figure 2.4 above, three quarters of all the sites in this survey have self-employment above 25% and are affected to a lesser or greater degree by this corruption.

This contemporary evidence reinforces the earlier report, *Undermining Construction*, and previous research (Harvey, 1995, 2001, 2002). Some of the key points can be usefully summarised here. The 'normalisation' of the evasion economy was recognised by many. The Construction Confederation representing 5,000 construction companies and 75% of the total construction turnover in the UK, was advocating reform. Liz Bridge, Secretary of the Joint Taxation Committee reviewing reform proposals stated quite clearly that

> 'A substantial proportion of the construction workforce is mis-categorised as self-employed and should be employed.' Interview, 19.7.2001.

At a meeting of the Joint Taxation Committee in June 2001, it was noted in the minutes that the Inland Revenue had become

> 'discouraged from any vigorous attempt to enforce the law'.

Undermining Construction contained a number of reports from contractors working in the industry many of them expressing the frustration of the uneven playing field and the competitive pressures to go illegal – particularly when there was little risk of penalty for doing so. One contractor, Keith Walton, was quoted as saying:

> 'Our firm is being stifled because we are working within the law whilst our competitors are not.' *Interview*, 04.06.2001

Since 2001, and following the publication of *Undermining Construction*, there was yet a further attempt to revisit reform. The Inland Revenue established a working party on the Employment Status of Workers in the Construction Industry in April 2004, which met for over a year. There was much consensus across the industry and a positive position was taken to grasp the scale of the issue.

> 'The Joint Taxation Committee asked that we consider whether it is possible to redefine certain construction workers as employees for tax purposes, so that they are subject to both income tax through PAYE and Class 1 National Insurance Contributions.'

In effect, that would have reduced the percentage of self-employed below the normal limits, and restrict the status of self-employment to those genuinely in business on their own account. It was recognised that large numbers of genuinely self-employed would be required to transfer to a well-defined and tested status. The bulk of the false self-employed would be transferred to employee status.

However, once the opposition to reform from the housebuilders had been mobilised, the government and Inland Revenue appeared to lose the will to pursue the matter. The outcome of the process will be discussed in detail later, but in effect the

rules for genuine self-employment were made tighter, and the rules for false self-employed were made more lax. The consequence is there for all to see. The major change since 2004 has been the steady increase in the proportion of self-employed, especially the false self-employed category, manifest in the statistics cited above.

Having reviewed the evidence of the scale of the evasion economy, we are now in a position to estimate the numbers of construction workers who are falsely and illegally self-employed.

Self-employment as % of total manual workforce	Number of false-self employed
At 15% self-employment	510,250
At 20% self-employment	433,000
At 25% self-employment	375,750
At 30% self-employment	268,150

Table 2.2 The scale of false self-employment in the UK construction industry.

At the beginning of this chapter, we argued that false self-employment needed to be viewed as a systemic issue, resulting from the entrenchment of the evasion economy. This is a departure from the rather narrow and legalistic approaches that require proof of status for each and every individual. As a consequence, only a range of figures, rather than exact numbers can be advanced. They allow estimates ranging from the plausible at the top and bottom of the range to the highly probable. We also need to apply common sense and understanding of the construction production process. On this basis, we can be confident that the number of false self-employed in UK construction stands between 375,750 and 433,000. The lower figure would be close to the historic starting point of the explosion of the evasion economy. However, it was well known, and the subject of government reports, that even then there was a

considerable number of illegal and false self-employment. The 20% figure would place the UK construction industry above levels of any European construction industry, whilst the 25% figure would shift this country towards the US economic model. A best guess figure, therefore, and to keep it simple, a round figure of 400,000 illegal self-employed can be taken to be robust.

Migration and false self-employment

We have already seen that migrant construction labour has entered into the situation as they found it, and become part of the core of the evasion economy of false self-employment. On many sites where there is over 75% self-employment, migrants constitute an important proportion of this illegal workforce. But at this point, we need to make something quite clear. The UK evasion economy is what makes migrants illegal, not migrants behaving illegally on their own account. And we have strong evidence. First we will compare and contrast what happens when migrants enter the UK construction industry with their counterparts in other European countries. Then, we demonstrate the effects of the expansion of migrant labour on the growth of false self-employment in the UK. The regulations on migration specific to the UK are analysed, and seen to contribute directly to the expansion of self-employment. What makes this self-employment false and illegal only arises when they enter into engagement on UK construction sites under the specific regime operating here. In later chapter, we comment on the effect this has on reinforcing the skills gap that has arisen as a direct consequence of the dominance of false self-employment. High levels of false self-employment will be shown to be one of the major factors behind the absence of apprenticeships, producing a skills gap. Rather than addressing the systemic failure in reproducing skills in the economy, the UK imports skills through

migrant labour to plug the skills gap. Again, it is hardly possible to blame migration as the cause of the skills gap – it is only the effect.

There has been a long history of European construction industries employing migrant labour. Indeed, for a long time, at the height of the construction boom in Germany, that country was renowned for importing the disease of false self-employment through its use of migrant UK labour. Indeed, it is worth emphasising from the outset that the scale of migrant labour in the UK is relatively modest when compared with other European countries. In 2006 there were about 200,000 non-national construction workers in both Germany and France, 500,000 in Spain, and only 100,000 non-nationals in the UK. The boom in Spain's construction industry relied heavily on migrant labour. However, a view of current patterns of migration in the United Kingdom, Germany, France and Spain demonstrates quite clearly that only the United Kingdom combines migrant labour with self-employment to any significant extent. Indeed, all migrant labour shows higher ratios of self-employed to employed when coming into the UK than for the national workforce as a whole, where the ratio is approximately 1 self employed to 1 directly employed. The most extreme deviation in this direction occurs with migrant labour coming from the new accession countries, the EU 27, where there are 11 self-employed construction workers for every 1 directly employed. But the numbers coming from Bulgaria and Rumania are relatively low compared with those coming from the 10 new accession states. Consequently, overall, the level of self-employed amongst migrants to UK construction is 20% higher than would be expected from the national workforce, during the period 1996 to 2007.

The pattern elsewhere is exactly the reverse. In almost all cases, migrant labour tends to be more likely to be directly employed than self-employed relative to

the national workforce as a whole. In Germany and France, migrants from the EU 27 are 100% directly employed, and from the EU 15 the ratio is also shifted in favour of direct employment, although less markedly. Perhaps the most interesting case is Spain, whose migrant construction workforce recruits from North Africa as well as the rest of Europe. Here too, the overwhelming pattern is for migrants to tend to be more likely to be employed than self-employed, relative to the national workforce. For migrants outside Europe, there are 25 employed for every 1 self-employed, compared to 4 for every 1 in the national workforce.

	Nationals		EU15		EU25		EU27		Others	
	SE	DE	SE	DE	SE	DE	SE	DE	SE	DE
UK	1	1	4	3	4	3	11	1	1	1
Germany	1	5	1	7	1	1	0	1	1	11
France	1	3	1	7	1	1	0	1	1	8
Spain	1	4	1	3	1	8	1	20	1	25

Table 2.3. Ratio of self-employed to direct-employed migrant labour in the construction industry in four European countries, 2006 (rounded). *Source:* European Labour Force Survey. SE = Self-employed, DE = Directly Employed.

These figures clearly demonstrate that characteristics of the national labour markets determine the employment status of incoming migrant labour. There are two main explanations that can be offered for this marked contrast between the UK and the rest of Europe. The first is relatively straightforward. Legislation on migration from the enlarged Europe (the EU 25) with ten new states[3], and the new accession states of Bulgaria and Rumania (the EU 27), discriminates between employed and self-employed. The former are required to enter on the worker registration scheme,

[3] The ten new states accepted under the Accession Regulations, May 2004, were the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovenia and the Slovak Republic.

whereas the latter can enter without registration, according to the *Accession (Immigration and Worker Registration) Regulations*, 2004, (The Stationery Office, HMSO, and the *European Accession Treaty*, 2006[4].

But that can only be part of the explanation. The other important aspect is the distinction between false and genuine self-employment. Genuine self-employment requires the migrant to be able to communicate effectively and generate business with clients, submit tenders, manage their own tax affairs – effectively to work, in the language of many European labour markets, as an independent, or in UK terms, as their own boss. This is not just a language barrier, more a question of the independent self-employed having a greater need to understand legal and taxation systems and to acquire skills to deal with clients from a different culture than the directly employed. In most European contexts, this effectively acts as a barrier to migrants entering as self-employed or independents. But, remove these obstacles, and allow migrants into self-employment as paid workers, without having to manage their own business, tax affairs, or contracts with clients. At the same, time relieve their employers from the 'burdens' of paying national insurance, holiday pay, sickness pay and any of the normal entitlements of ordinary employment. Then migrant workers are sucked into the evasion economy, and join the ranks of the national false self-employed. If one combines these two explanations – regulate in favour of self-employment, remove the economic obstacles to self-employment – there is a more complete explanation of why there is excessive self-employment of migrant labour compared with the UK national workforce as a whole.

[4] The relevant regulation of the latter Treaty is *The Accession (Worker Authorisation and Worker Registration)(Amendment) Regulations*, 2007, No. 3012. (The Stationery Office, HMSO)

Main findings

This chapter has explored in detail the scale of the evasion economy and the emergence of false self-employment in the construction industry. The argument has been based on the extent to which reality departs from any economically sensible understanding of genuine self-employment. In particular, the phenomenon of mass self-employment is a contradiction in terms, and masks the phenomenon of false and illegal self-employment. The main findings of this statistical analysis can now be summarised.

- The UK construction industry has uniquely high levels of self-employment compared with any other sector in the UK economy. The level is three to four times higher than even those sectors where self-employment is typical.

- The UK construction industry has more than double the level of self-employment of any other advanced industrial economy.

- Self-employment has grown from near normality in 1979 to the heights of abnormality by the mid-1980s, when it peaked at over 60% of the total manual workforce. After a dip in the late 1990s, it has again began to rise, and stands at over 50% in 2007.

- The best estimate of the level of false self-employment in the UK construction industry ranges between 375,750 and 433,000 workers, with 400,000 being a robust round figure.

- Self-employment during the recent construction boom has been boosted by exceptionally high levels of self-employment amongst migrant labour in the construction industry. But the overall scale of migrant labour, at 100,000 in 2006, is relatively modest compared with other European construction industries.

Chapter 3

Lost £ billions and the costs of evasion

The fiscal costs of tax evasion

The last chapter took the first step in assessing the extent of false self-employment necessary to calculate the extent of the losses to the taxpayer arising from the evasion economy. A range of the most probable numbers of false self-employed was proven to be between 375,750 and 433,000, justifying the most likely round figure estimate of 400,000.

So, what are the fiscal consequences of false self-employment? To answer this, we need to itemise the tax and national insurance paid by employers, direct employees and the self-employed. In so doing, we identify the flipside to the fiscal consequences to the taxpayer, namely the incentives to evade paying taxes associated with direct employment, both to the employer and employee. As we shall see the incentives to adopt direct or self-employment are very different for engagers of labour and those engaged.

The table below identifies the difference in tax and National Insurance obligations for engagers of labour and workers.

		National Insurance	Income Tax
Employer of Directly Employed	Class 1 NI	12.8% of wage*	
Engager of Self-employed		0% of wage	
Direct Employee	Class 1 NI Income tax	11% of wage*	 20%*
Self-employed	Class 2 NI Tax on profits Schedule D tax exemption on allowable expenses	8% of wage*	 20%* Circa £6,000 tax free

Table 3.1 Fiscal differences between employment status, direct and self-employed.

From this table, it is clear that the main fiscal differences between employment and self-employment are the employer's National Insurance rate of 12.8% for an employee as against 0% for the self-employed. For the worker, the difference is far less marked, a difference between Class 1 and 2 of National Insurance of 11% as against 8%, and with taxes on income and profits falling at the same rate, the only tax difference being allowable expenses on Schedule D, available for the self-employed and not for the employee. On discussions with Inland Revenue and the self-employed, a figure of £6,000 per year on allowable expenses is conservative. Out of 'profits', the self-employed can claim payments to the partner for secretarial assistance, office expenses, and such like. So long as these claims are not excessive and therefore challenged, they need no documentary verification. At £6,000

* This rate is applicable between upper and lower thresholds or limits, and so does not apply to the whole wage. These exemptions from rates of National Insurance and taxation are taken into account when making the calculation of the total fiscal consequences of direct and self-employment. The upper and lower limits and thresholds were those set in the April 2007 budget.

per annum of allowable expenses, the self-employed obtains an additional £1,300 of net income.

Before making the final calculations of the range of possible fiscal losses to the taxpayer, the wage rates being paid to building workers need to be known. In this case, the relevant wage is that paid to direct employees in the event of the reclassification of the falsely self-employed to the legitimate employment status. Again, we can start with a range, and narrow it down to the best estimate. The Housing and Construction Statistics provide figures of average earnings only up to 2002, when they stood at £411 per week. Wishing to remain conservative in our judgements, it would be safe to say that the average building worker's wage in 2007 stands around £475 per week.

	Number of workers	**£300 Per week £**	**£400 per week £**	**£500 per week £**	**£600 per week £**
At 15% self-employment	510,250	1,418,719,510	1,837,940,910	2,257,162,310	2,684,274,190
At 20% self-employment	433,000	1,203,930,520	1,559,683,320	1,915,436,120	2,271,188,920
At 25% self-employment	375,750	1,044,750,330	1,353,466,530	1,662,182,730	1,970,898,930
At 33% self-employment	268,150	745,574,986	965,887,026	1,186,199,066	1,406,511,106

Table 3.2 Estimating the fiscal black hole of false self-employment

We are now in a position to estimate the reasonable range within which the scale of tax and National Insurance evasion arising from false self-employment falls. If we take the lowest reasonable figure for false self-employed at 375,750 and an average wage below the 2002 level we arrive at a minimum figure of £1.4 billion per year. If we take a higher but still reasonable figure of false self-employed at 433,000, and an average wage of £500 per week, the fiscal hit to the taxpayer reaches £1.9

billion per year. We can be reasonably certain that the true figure lies somewhere between those limits, and if we were to take our two round figures of 400,000 false self-employed and an average wage of £475 per week we obtain the closest justifiable estimate of **£1.7 billion** per year. As levels of false-self employment have fluctuated over the years, and wages have increased over the decade, the total losses over this period cannot readily be calculated. But a figure of £15 billion would not be far wrong.

Of this figure, the most significant proportion of the evasion economy undoubtedly arises from the employers of false self-employed not paying National Insurance. The extent of their evasion amounts to £985 million per year, or 58% of the total loss. A point made earlier is worth repeating: the difference between tax evasion and avoidance is that the latter is the perfectly legitimate use of all available means, allowances, and offsets, to reduce a person or company's tax liability. Tax evasion means deliberately not paying tax that one is legally obliged to pay. Of course, that has to be proved, and the illegality of false self-employment will be discussed later. But if a worker is in effect employed by an employer as opposed to engaged by a client, under a contract of services rather than a contract for services, then the engager is legally an employer, and liable to National Insurance at 12.8%. We have demonstrated that the employment status of 400,000 workers cannot be other than one of employment. Contractors on the large site mentioned above, for example, are not the clients to 900 separate and independent self-employed workers, in business on their own account. And they know it. So we are talking of evasion, not avoidance. The construction industry is an evasion economy.

Incentives and risks

If one side of the coin concerns the fiscal loss to the taxpayer, the other side concerns the incentives and risks for employers of labour and workers. The figures above might suggest that the balance of incentives for employers and workers is uneven, 58% as against 42% in terms of the difference in fiscal opportunity, but still considerable for both parties in the labour market. But this is only the tip of the iceberg, and as soon as we probe more deeply, the balance of incentives and risks shifts much further in favour of employers. The driver of the evasion economy is unquestionably the competitive pressure, resulting from the tax regime, on employers to drive out good employment for bad self-employment. In this section, we examine the relative gains and losses for employers and the false self-employed.

For employers

The argument has already been made, supported by interviews with contractors and the Construction Confederation, that the mere effect of a choice between paying or not paying the employers 12.8% National Insurance imposes inescapable competitive pressures for employers to engage self-employed workers. But, although National Insurance is undoubtedly the principal trigger, the cost differential of employing self-employed illegally as against employees legally is much greater than National Insurance alone. Ultimately, once the step has been taken to go down the route of lowering labour costs, there is a real risk of 'degenerative competition' (Wilkinson, 1981), with employers investing less and less in the employment relation, so leading to the extreme and casualised labour found in false self-employment. It is a relationship of zero commitment, and zero investment. Later we analyse the impact on skills, but here we focus on the monetary investment, and the immediate short-term monetary incentives to self-employment. False self-employment means employing workers without paying sick pay, without the costs of

managing such systems. Although now entitled under European legislation to holiday pay, in many cases holiday pay is invisible or absent in the pay packets of the false self-employment – effectively time off of any kind is unpaid. Time off for visits to doctors, for child-care needs, for compassionate leave, and many other such attributes of genuine employment are stripped out of false self-employment. Of course, with false self-employment there are no occupational pension schemes, and in future, under the second state pension, the drive to invest as little as possible in the workforce will increase when the employers obligatory contribution of 3%, low though it is, will be evaded in false self-employment. A while ago, it was estimated that the real difference in monetary investment in the employment relation between employment and self-employment was between 25% and 30% (Evans and Lewis, 1989). The trigger of the National Insurance 12.8% thus sets of a competitive drive to the bottom, the lowest level of employment commitment to employees.

The loss to employers are long term, in productivity gains, and in managerial control and efficiency in the organisation of the construction process, and above all, in the barriers to innovate that result from a low skills, low commitment culture. The result of the casualisation of the construction labour force through false self-employment and labour only subcontracting has been a damaging fragmentation in the organisation of production (Harvey, 2002). Degenerative competitive pressures – the Gresham's law of labour markets – have become 'locked in', making it difficult if not impossible for many contractors to buck the trend and break the culture. The short-term cost advantage of false self-employment has become a major obstacle to long term productivity gains through skills enhancement, and organisational and technical innovation. What is needed is framework that encourages genuine self-employment and the benefits of flexibility in combination with genuine employment

stimulating investment in skills and productivity. The distorted competitive pressures arising from current regulatory incentives need to be corrected to achieve a favourably balanced labour market and workforce, more in line with other major advanced economies.

For the employee

Where the short-term cost-cutting competitive pressures on employers are all one way, the picture is very different for the employee under false self-employment. In effect, false self-employment downloads all risks onto the employee. Risks of having an accident, bad weather, falling sick, periods of unemployment, and last but not least poverty in old age are borne by individual workers. In periods of prolonged boom in the industry, such as we have witnessed since the early 1990s, some of these risks are mitigated. But evidence of what occurred during that earlier period demonstrated that the category of false self-employed were more than twice as likely to experience periods of unemployment than either the genuine self-employed or employees (Harvey, 2002). It is known that over half of all self-employed have no other pension coverage than basic state pension (Clery, et al. 2007). Those with interruptions in employment and with variation in earnings are the least likely to invest in private pension schemes which depend on both regularity and consistency of earnings. Again, historical evidence in times of a downturn in construction industry, result in real wage cuts as well as interrupted earnings. The false self-employed in the construction industry are amongst the most vulnerable to the risks of economic uncertainty (Burchell et al. 1999). The result is often poverty in old age. It is known that self-employed people in general anticipate continued working into their seventies and eighties, partly as a consequence of inadequate pension provision and security for the self-employed. For manual trades, and in particular construction workers, the

prospects are similar, but combined with yet greater uncertainty and declining incomes. The most likely outcome for many is dependency on means tested benefits, Pensioner Tax Credits, Housing Benefits, and the like.

So, when calculating the fiscal cost to the taxpayer of the loss of National Insurance and income tax revenues, only the most tangible and identifiable costs have been estimated. If the means-tested benefits were to be included, the cost to the tax payer would be significantly increased. The main point to be made here, however, is that the longer term risks and costs to the false self-employed far outweigh any short-term gains from paying Class 2 National Insurance and making claims under Schedule D income tax.

Perhaps the greatest myth is that the individual worker could make any rational economic calculation of the costs and benefits of being employed or self-employed. An economic genius equipped with the most sophisticated modelling software and powerful computers could not make a rational choice, simply through lack of the necessary information about future developments in the construction economy, about future changes in regulatory or pension institutions, about the likelihood of an accident, or of dependents' circumstances. And, in any case, in current market conditions and on many construction sites, workers in general are not presented with a choice. The only opportunity they have, whether national or migrant, is to work as false self-employed.

Government complacency

One of the more shocking and puzzling aspects of the evasion economy has been failure of the government to tackle the issue of false self-employment, despite its objectives of increased spending on health and education, and its determination to keep within sound financial rules. A recent statement by a junior government minister

gives some insight into the deep level of ignorance and complacency surrounding this issue.

Appearing before a Select Committee for the Department of Business, Enterprise and Regulatory Reform (BERR), on January 22, 2008, Stephen Timms acknowledged the presence of between 100,000 and 200,000 bogus (his term) self-employed construction workers. He stated the figure of £340 million as the consequent loss to the Treasury. And he said he would do nothing about it.

> "How the industry organises itself is a matter for the industry. I don't think it is for Government to regulate how companies are organised."

Miserably briefed, it is worth dwelling for a moment on the extent of the errors which he voiced. Firstly, were he to be correct about the maximum figure of his admission of bogus self-employment and the level of self-employment reduced by 200,000, it would mean that the proportion of remaining self-employed in the workforce stuck at 38%. If the level of self-employment was reduced by his lower figure of 100,000, the proportion remaining would only drop to 45%. That would mean around double the level in the USA, three times the level of most European countries, and three and a half times the level for any other sector in the UK. These estimates indicate a deep lack of understanding of the nature of industrial and economic organisation in the construction or any other sector. Secondly, even on his numbers of bogus self-employment, the loss to the taxpayer though the lack of employer's National Insurance contributions alone would amount to £500 million per year. On the basis of the calculations set out above, the true figure would be close to £900 million per year. A trivial amount?

But more astonishing than factual error is complacency. So, it does not matter to the government if companies break the law. It is up to them to enforce the law, he

says. We can stand down the police force and enforcement agencies. After the credit crunch and the Northern Rock failure? After the misappropriation of pension funds? What does it matter if a couple of hundred thousand people do not pay their legally owed taxes? Maybe we can all stop doing so, if Mr Timms does not mind.

Of course, government complacency does not explain how the evasion economy has become so normalised and entrenched in UK construction. It may be a source of embarrassment, but we need deeper explanations as to how such complacency has become possible, how such things come to be said so easily, and before a Select Committee of Parliament. Let us not blame Mr Timms.

Main findings

This chapter has taken the examination of the evasion economy a step further, by identifying the fiscal consequences arising from mass false self-employment. Let us summarise the main findings:

- The main difference in fiscal costs relating to employment status are constituted by employers' and employees' National Insurance, of which the main difference arises from employers paying no National Insurance for falsely self-employed employees.
- Given a range of estimates of the scale of false self-employment and level of wages, an upper and lower range of estimates was established for the loss to the tax payer, between **£1.4 billion** and **£1.9 billion** per year. The most likely round figure estimate of a loss stands at **£1.7 billion** per year.
- Employers are responsible for 58% of this loss, at just under **£1 billion** per year, with employees responsible for **£0.7 billion** per year.

- The tax incentives to false self-employment were shown to increase considerably when other costs associated to employment status are included. The burden of risk for sickness, unemployment, care of dependents, and old age retirement were downloaded exclusively onto the false self-employed.
- The effect of this mixture of incentives and risks has resulted in a vicious spiral resulting in a minimum investment in the employment relation and a high level of casualisation. This is identified as a root cause of the failure to develop skills and consequential barriers to innovation and productivity gains.

Chapter 4

The Evasion Economy. Causes and origins.

Introduction

In April 2007, the last in a long line of regulatory reforms of the taxation regime peculiar to the construction industry was implemented. It is called the New Construction Industry Scheme – or new CIS. Its three stated objectives can be fully endorsed. They were:

1. to reduce the regulatory burden of the Scheme on construction businesses
2. to improve the level of compliance by construction businesses with their tax obligations
3. to help construction businesses to get the employment status of their workers right.

However, as with previous attempted reforms, there has been a failure to address systemic regulatory failure, and indeed, as will be argued, the current reform only exacerbates the problem, particularly with respect to objectives 2 and 3. With respect to the first objective, the opportunity was missed to simplify regulation, while introducing some operational reforms. Her Majesty's Revenue and Customs (HMRC) persisted in seeing the problem as one of whether individuals were properly classified as self-employed under the tax rules, rather than one of the tax system of classification itself. The construction industry is the only sector in the country that has two types of self-employed, not one. We see this system as at the heart of the problem, not whether people are correctly or incorrectly designated within it, which is the consequence not the cause. The issue is one of flawed regulation, not over-regulation. This flawed regulation has introduced serious labour market distortions

that have bedevilled the industry for three decades. HMRC not only failed to analyse the nature of the problem, but also, even with their own limited horizons, failed even to correct what they had identified as a level of illegal self-employment. In an exercise undertaken at the time, HMRC came up with a speculative and inadequate number of 120,000 illegal false self-employed. The new system has failed to redress this situation, let alone tackle the true scale of the evasion economy. There has been no shift back in to direct employment. There have been no serious attempts to enforce the rules on employment status on contractors in the industry. All the evidence points to the new system having had the contrary effect, facilitating and further entrenching illegal false self-employment.

The previous two chapters examined the economic and fiscal realities of the evasion economy. In this chapter, we identify its causes and origins in the legal and taxation systems as the central institutions of the construction labour market. The argument can be stated in simplified form at the outset. There are two institutional modes through which employment status of individuals is designated: by law and by taxation classification. We will argue that the law has produced a situation of uncertainty and lack of clarity. It is widely recognised that no one legal criteria, no clear combination of criteria, is able to resolve employment status, to an extent that each individual case needs to be weighed and judged on its circumstantial merits.[5] On its own, this uncertainty and lack of clarity does not generate mass false self-employment however. In most industries, as we have seen, there are quite normal and

[5] As the HMRC advice on determining employment status confirmed: 'Recent court cases indicate *there is no single satisfactory test governing the question whether a person is an employee or self-employed* (our emphasis). One must consider all the factors that are present in, or absent from, a particular case; weigh those pointing to employment against those pointing to self-employment; and then *stand back and consider the picture that emerges* (our emphasis). The result may be that a person is considered to be in business on his own account (self-employed) or is an employee.' HMRC, 2008 *Are your workers employed or self-employed? – advice for contractors*. CIS leaflet 349. See also Freedman, 2001 who argues that 'great weight is placed by the courts on the facts of each case and there is no definitive list of factors or weighting of factors to be taken into account', p. vii.

internationally comparable levels of self-employment, higher in some sectors than others, but nowhere excessively so. A taxation regime unique to the construction industry, however, with two classes of self-employment, introduces further confusion to legal interpretations, and by institutionalising a subsidiary form of self-employment, creates the conditions for tax evasion explained in the previous chapter.

This chapter will review the legal and tax regimes to support this argument. It will show how the special tax regime, when coupled with an uncertain and unclear legal classification, produces a phenomenon of mass false self-employment unique to the construction industry. But the clinching proof will lie in a demonstration that the historical patterns of switching between direct to self-employment are directly attributable to the changes in taxation regulatory systems.

In this chapter, therefore, we first examine the legal institutions of employment status, as they have evolved. We then trace the parallel historical development of the special construction tax regime since the 1970s. And finally, we demonstrate the direct impact of the latter on the emergence of false self-employment on a mass scale in the early 1980s, and its subsequent ups and downs.

Self-employment and the law

Throughout this report, false self-employment has been equated with illegal self-employment. In this section and the next, we justify that characterisation. In the terms of the OECD:

> 'In some countries…taxation systems, and perhaps labour market policies as well, might have encouraged the development of "false" self-employment – people whose conditions of employment are similar to those of employees, who have no employees themselves, and who declare themselves (or are declared) as self-employed simply to reduce tax liabilities, or employers' responsibilities.' OECD Employment Outlook 2000, 156.

Workers who are assigned self-employment status by themselves or by their engagers to reduce of tax liabilities are illegal in so far as courts would adjudicate them to be employees, were the case to be tested before them. Here, however, we are additionally arguing that the taxation system itself introduces conflicts with legal definitions. There is a long history of legal and taxation systems of classification being out of kilter with each other (Deakin and Wilkinson, 2005; Daunton, 2002). Indeed, the famous 'binary divide' between employment and self-employment found its sharpest expression as early as the Finance Act of 1922 when a separate tax schedule for self-employed was instituted, only to be more fully enshrined much later in employment law in 1946 National Insurance Act, following the Beveridge Report.

The legal institutionalisation of the binary divide has been continuously evolving, since it emerged towards the end of the nineteenth century. The legal distinction is between a contract **of** service (employment) and a contract **for** services (self-employment). There are now four main groups of criteria for discriminating between the two employment statuses, **control**, **integration**, **economic reality**, and **mutuality of obligation**. These four have successively emerged as tests of employment status, building up precedents through case law. Thus the first to emerge as the principal test was that of control. If a worker is under the control of the engager of services, for example determining when, how, where and to what standard the labour services are performed, then this control was taken to indicate employment, not self-employment. But there are many examples of workers who are clearly self-employed, yet come under the control of their client: window cleaners, cleaners of domestic households, personal service providers, are cases in point. So **control** became one test amongst others.

Integration was a later significant additional test focusing on whether a person was part of an employing organisation or not, subject to disciplinary or grievance procedures of that organisation, and owing obligations to that organisation, not undermining its reputation whilst engaged in working for it, and so on. There are many professions, such as doctors or lawyers, who have considerable control over their how, when, and to what standard they work, but are part of an organisation, hence employed. Nonetheless, case law yielded significant counter example – a famous case of a free-lance video-camera operator exemplified a worker who, when filming, was necessarily thoroughly under the control *and* integrated into the organisation producing films.[6] Yet, in every other respect he was self-employed, providing his own equipment, submitting invoices for work undertaken, and working for multiple clients.

Such cases brought to the foreground the **economic reality** test of whether someone was in effect in business on their own account, taking financial risks in making profits or losses, through assuming the responsibility for setting the price for undertaking the service, providing the necessary equipment, or being able to pay someone else to undertake the service in their place. Meeting the independent business test then became a critical indicator – although not the sole one – of self-employment status.

Finally, and more recently, a further test has emerged to address occasions when, when, unlike the video camera operator, there were no signs of operating a business or satisfying an economic reality test, but a lack of any obligation between the engager and engaged. The key test cases invoked here was one concerning guides

[6] *Hall v Lorrimer*, 1994.

to take visitors around power stations[7], and another, irregular wine waiters[8]. The lack of **mutuality of obligation** goes both ways, if the engager is under no obligation to offer the contract for services to a particular worker when work became available, and if the worker is under no obligation to accept a contract if offered. The key point is independent choice for either party connected irregular and/or intermittent supply of services.

The **mutuality of obligation** test has introduced a new level of lack of clarity and uncertainty into the legal determination of employment status, because it risks confusing casualised employment with self-employment.[9] Casual workers are often engaged successively by multiple employers. This is a mark of their insecurity and extreme dependency on opportunities for employment, and is frequently accompanied by involuntary periods of unemployment. This test makes it hard to distinguish between casual workers, the most dependent employees, and the genuinely independent workers who may choose to work intermittently, at times of their own choosing, and for multiple clients. In the construction industry today – and in the docks in earlier periods – hiring by the day, being picked at random from a group on a street corner, is a mark of extreme economic dependency combined with absence of mutuality of obligation. For dock labour, there was no question but that the engagement was one of employment. Today, in the construction industry, these occurrences frequently fall into the evasion economy of false and illegal self-employment.

[7] *Carmichael v National Power, plc*. 1999
[8] *O'Kelly v Trusthouse Forte*, 1983.
[9] Mutuality of obligation 'has had the effect of excluding from protection workers in casual employment relationships, where the existence of mutual obligations to provide work (in the case of the employer) and to accept any work which is offered (in the case of the worker) is in doubt.' Burchell et al., 1999. 7.

As these different tests have emerged, supported by many precedents of case law, legal classification has become complex, uncertain and unclear. As we have just seen, three tests (control, integration, economic reality) might point unequivocally in one direction (employment status), only for the fourth test to point in the other (self-employment). In the words of an authoritative work on labour law we are faced with

> 'an open-ended multiple test, in which any one of a number of factors could turn out to be essential in tipping the balance on one side or another.' (Deakin and Morris, 159)

The table 4.1 below, adapted from Burchell et al 1999, lays out the four tests and some of the criteria grouped within them.

		Direct	Self
Control	• Duty to obey orders as to when and where to work • Determination of hours of work, breaks, etc. by engager • Supervision of mode of working	Yes Yes Yes	No No No
Integration	• Subject to engager's disciplinary or grievance procedure • Integration into organisation of team or coordinated patterns work • Subject to engaging firm's or contract's safety policy • Inclusion in occupational benefit schemes	Yes Yes Yes Yes	No No No No
Economic Reality	• Self-determination of method of payment and level of payment • Freedom to hire others in substitution • Providing own equipment • Investing in own business • Submission of invoices for completed work • Payment of own tax and NI • Personal coverage of sick pay, holiday pay	No No No No No No No	Yes Yes Yes Yes Yes Yes Yes
Mutuality of obligation	• Duration of employment • Regularity of employment • Continuity of engagement between contracts • Right to refuse work without adverse effects on future engagement	Long Yes Yes No	Short No No Yes

Table 4.1 Legal tests of employment status.

From the multiple criteria contained under these four tests, it is clear that there is much scope for ambiguity and contrary indications, a veritable feast for legal interpretation and discretion. In the above table, there are just eighteen possible indicators listed, and the only unambiguous cases occur when all go one way to point to direct employment, or all go the other way, to point to self-employment, as

illustrated. In many instances, there are combinations of positive and negative indicators, producing conflicting signals under the four tests. It is somewhat disturbing, therefore, that the HMRC's Employment Status Indicator, a website designed to assist contractors and workers to determine their employment status, conflicts with the legal basis for testing employment status. It can yield an outcome for determining the status of self-employment based on one criterion alone[10] – correcting work at one's own expense – thus controverting the principle of weighing all the factors in a complex of contrary indicators.

Yet, the uncertainty and lack of clarity in the law does not of itself generate mass false self-employment, as we can see from sectors other than construction. It is a necessary, but not sufficient, condition. Moreover, even with this ambiguity and lack of clarity, the vast majority of the false self-employed within the construction industry fall unambiguously and clearly in the category of employed. On major construction sites where this phenomenon occurs the typical false self-employed worker fully meets the first three tests, and many, if not a majority also meet the fourth.[11] We can characterise this typical false self-employed worker as follows.

Control

- The worker is engaged for a duration determined by the engager, who also determines lunch and tea breaks. The engager has total control over working time.
- A labour-only subcontractor is the worker's typical engager, often in a long chain of sub-sub-sub-contracting.
- The worker is supervised by the labour-only sub-contractor, and tasks are assigned, as to when, where and how the work on site is to be undertaken.

[10] For those interested, they can test out the system on https://esi2calculator.hmrc.gov.uk/esi/app/index.html. Affirmatively answered questions relating to correcting work at one's own expense prove to be a decisive indicator of self-employment. This is peculiar in so far as many disciplinary procedures typical of employment entail the reduction of pay for unsatisfactory work, or the correction of errors in one's own time. It is certainly not legally correct that this one indicator on its own should be sufficient to override all contrary indicators. It betrays a clear bias towards self-employment.

[11] The evidence for this is given in previous research, Harvey 1995, 2001, 2002.

Integration

- The worker is subject to the main contractor's safety and disciplinary procedures.
- The worker is frequently a member, often long-standing one, of a work team or gang, which is itself integrated into a hierarchical and sequential organisation of the production process (e.g. a bricklayer in a line).
- The worker (see below) is entitled to holiday pay

Economic reality

- The worker assumes no financial risk on his/her own account by setting their own price or estimating the duration for completion of the service.
- The worker's method and rate of pay, normally a wage, but sometimes a price, is fixed by the engager not the worker, often by advertisement.
- The worker does not submit tenders for the contract, in competition with others.
- The worker never engages a substitute to work in his/her place, or pays them to do so, even if they might sign a piece of paper to the effect that they can.[12]
- The worker provides no capital equipment (e.g.diggers, scaffolding, etc.) or materials, other than the normal tools of the trade (including electrically powered tools).
- The worker does not invoice the engager for work undertaken, or materials provided.
- The worker has tax deducted at the normal standard rate of income tax at source by the engager.

Mutuality of obligation

- The worker is regularly engaged by the same contractor/subcontractor across successive contracts, when work becomes available in the sequence of the production process.
- If the worker refuses an offer of continuous working with the same contractor when available to do so, it is likely to jeopardise future opportunities to work for that contractor. There is a two-sided recognition of mutuality of obligation, even in conditions of some discontinuity.

Given that this description is typical for those we have described as the 'mass self-employed' present in large numbers on major construction sites across the country, there can be little doubt that they can be deemed not only false, but illegally, self-employed. When providing numbers ranging from 375,000 to 433,000 for the illegally self-employed, this refers to workers fitting the above description.

[12] To protect themselves from charges of false employment, many engagers use phoney contracts that bear no relation to the reality of the engagement.

Worker, employee or self-employed?

We have just reviewed the criteria for legally deciding employment status, noting potential sources of confusion and ambiguity. Before leaving the sphere of the law, however, unfortunately there is a further layer of complexity. A number of Acts of Parliament[13] have used the concept of worker, rather than employee, to cover anyone who 'undertakes to do or to perform personally any work or services for another person'. The term worker therefore has been used to include the 'dependent self-employed' (Deakin, 2001; Freedman, 2001) under its umbrella. A worker, under this legislation, has some benefits such as a right to holiday pay. But many of the rights attached to employment status, such as Job Seekers Allowance and sick pay, are still not included. This has created a half-way house, both in terms of rights and status. There have been many industrial tribunals pursued by the construction trades unions to claim holiday pay for the false self-employed under this legislation. Although these cases have in general succeeded, in the next chapter we shall see that many of the dependent self-employed are deprived of basic rights, including holiday pay. In general, the status of worker is not a resolution of illegal and false self-employment. Rather than opening up new areas of rights for those deprived of them, in many ways this legislation has made the status of the false self-employed even more complex, and does little to tackle the central problem of the evasion economy.

The tax trap of illegal self-employment

It can be argued that the evolution of the legal classification generated by the binary divide between employment and false self-employment has always responded

[13] The Equal Pay and the Wages Act, 1986; the National Minimum Wages Act, 1998, the Working Time Regulations Act, 1998, and the Employment Relations Act, 1999.

to changes in economic organisation of firms (Deakin and Wilkinson, 2005), and, recently, in an age of flexibilisation, the increasing use of external labour services – outsourcing. The development of taxation systems has been driven by quite different imperatives – most significantly, the gathering of revenue to finance the full range of public services, and activities of the state. In this respect, stable employment relations, as they emerged in the 20th century, became the principal 'fiscal handle' for taxation, and income tax finally emerged as the pillar of the fiscal constitution of the state following the 2nd World War, when it became universal to all forms of employment (Daunton, 2002).

However, back in the 1960s and early 1970s, much employment in the construction industry was deemed to be so irregular as to not afford any reliable fiscal handle on which the Inland Revenue could gain purchase. Many payments made by employers to wage workers went untaxed – some of this practice earning the title of 'the lump'. The unique construction taxation system owes its origins, in significant part, to this background. The Phelps Brown Report (1968), amongst many of its other recommendations, in effect proposed the regularisation of the industry by endorsing mass self-employment. The ensuing Construction Industry Contracts Bill, 1970 (Conservative) was followed by Denis Healey's Labour Finance Act of 1975 which offered amnesty to tax evaders, at the same time as establishing a self-employment tax system for the industry that for the first time created the two-tier, two status, self-employment classification.

This was the critical and first foundation for the evasion economy, to be followed by two major taxation reforms, the original Construction Industry Scheme in 1999, and the 'new' Construction Industry Scheme of April 2007. In its first 1975 manifestation, a unique construction industry tax regime was established. One form of

self-employment classified tax-paying workers as genuine businesses on their own account. The other form, where tax was deducted by the engager at source, was described by the Inland Revenue official responsible for overseeing the system as ‘quasi-PAYE for quasi-employment’ (Harvey, 1995).

It is worth dwelling on this system for a moment, as it was under this regime, and in two phases, that the phenomenon of mass self-employment became entrenched. The first type of self-employment entailed registration of the self-employed with what was then called a 714 certificate, an identity card with a photograph. The person was required to meet a business test of self-employment. Evidence of turnover, business address, and other details supposedly demonstrating a genuine form of self-employment that passed the economic reality legal test, created a ‘business class’ self-employment. The key feature of this self-employment – in common with that in all other sectors – was that taxation was through self-assessment of gross turnover, and on an annual basis. The 714 certificates were later to fall into disrepute, partly because they were widely traded in informal markets.

The other, second-class, form of self-employment was peculiar in that no attempt was made to tax or identify the individual. Instead, the ‘fiscal handle’ of taxation was the contract. So, each time a self-employed worker was engaged under the so-called SC60 tax certificate, tax was deducted at source by the engager for the contract, and, in principle although not always in practice, the tax so collected was transferred to the Inland Revenue. An important consequence of this system is immediately evident. There were no records or means of tracking the number of individuals working under the SC60 system. In short, the system opened the door to an uncontrolled expansion of the numbers of workers engaged under the system. There can be little doubt that, already by 1979, inflated numbers of workers were

being taxed as self-employed, well above the upper limit of legality of 25% of the workforce. In all other sectors, it has been found that the most certain proof of employee status is when the engager deducts tax at source (Burchell et al., 1999). Responsibility for managing one's own tax affairs is a key component of any economic reality test for being in business on one's own account. The SC60 system therefore enshrined an ascription of self-employed status to a characteristic definitive of employee status under law. Furthermore, by imposing the responsibility for collection of tax on the engager, the client for services, effectively the tax system treated engagers as employers. In no other area of self-employment are the clients of contracts for services obliged to collect taxes owed by the providers of those services. A domestic householder does not collect the taxes owed by their window cleaners. So the SC60 tax regime treated both parties to the contract as being in an employment relation, not a relation of a client to an independent contractor for services.

Additionally, however, the very fact of a two-tier system created an artificial and distorting division within the self-employment status between those classified as passing a proper business test, and those not subject to any equivalent business test: a division between those truly in businesses on their own account and those not required to meet such a test, not so clearly in businesses on their own account. We shall see that this division has been exacerbated by subsequent reforms.

Even before Thatcher came into power, therefore, the tax regime sanctioned and established uncontrolled acquisition of self-employment status, and a classificatory ascription in conflict with key legally accepted definitions of genuine self-employment. Soon after coming to power, the Thatcher government, supported by major housebuilding companies, gave free license for unlimited expansion of false self-employment. A new administrative system of self-declaration of self-employment

status was initiated, where a worker filled in a self-employment form, C11. This applied to those on the second-class self-employment, SC60 system, and gave a further regulatory boost to the evasion economy. It was under this system that the dizzy height of over 60% of the total manual construction workforce in the UK became self-employed.

This Thatcherite move, however, cannot be characterised as deregulation. Quite the contrary, by not policing the boundary between two legal employment statuses, the measure introduced unrestricted competition between high and low taxed labour into the market. It is a prime example of flawed regulation of labour markets, establishing severe market distortions. It was as if legal and illegal tender were considered to be mutually exchangeable, without policing or restriction. These are the market regulatory conditions for Gresham's law to operate. Illegitimately low taxed labour drives out legitimately standard taxed labour.

The next alteration of the tax regime occurred in 1997, following a campaign led by UCATT, other construction unions, supported by major employer organisations. In effect, the administrative policy of 1980 was rescinded and tests for self-employment were re-instated. A leaflet (IR148/CA69) was issued requiring contractors to comply with the new arrangements by April 1997. According to the Inland Revenue's own estimates, between 180,000 and 250,000 construction workers changed from self-employment to employment in the two years that followed the new administrative regulation.

However, the 714/SC60 continued in place until he next major reform of the construction tax regime in 1999 when the Construction Industry Scheme was introduced. This reform failed to address the fundamental flaws of the previous system, and retained the two-tier classification of the self-employed. However, there

were significant changes, notably the replacement of a contract-based SC60 tax system, by a worker-based system in which an identified individual self-employed worker had their tax deducted at source by the engager, under what was then called CIS4 registration. The main new features of the reform were as follows:

- A new two-tier self employment system. The first tier was now 'superior business class' self-employment status, CIS 5/6, with a threshold of a £30,000 annual turnover and a business test. This set conditions for gross payments and self-management of tax by the self-employed. The second tier, CIS4 self-employed worker had tax deducted at source at a lower rate than standard rate (18% as against 22%).
- A workplace identity card system for both classes of self-employed was introduced, with a photograph (a compulsory system, a significant but relatively unremarked innovation). The card also carried the National Insurance number.
- An obligation was placed on contractors engaging the CIS4 self-employed to deduct tax at source and provide Inland Revenue with taxation vouchers for each payment and transfer the tax owed by the self-employed to the Treasury.

In some respects, the previous business class became 'superior business class'. By imposing a threshold of £30,000 annual turnover as a condition for a self-employment status where the self-employed retained responsibility for paying their tax (the gross payment method), the new rule in effect excluded a significant proportion of genuine self-employed from the normal rights and responsibilities of self-employment. By so doing, this new regime sharpened the distinction between the

business class self-employed and the dependent self-employed. The certification and voucher system for the latter equally clearly placed greater obligations on the engager, even more consistent with those of an employer. It should be emphasised that thresholds and business tests of this kind operate in no other sector of the economy, for the simple reason that millions of genuinely self-employed working for private clients would be excluded from their legitimate self-employment status by virtue of the £30,000 threshold. So the conflict between law and taxation classification of status in the construction industry became more acute, not less, with the Construction Industry Scheme.

Moreover, far from utilising the new identity card system, and the shift to taxing individuals rather than contracts for the second-class self-employed, in order to control and police employment status, 1,063,728 CIS 4 certificates were issued to individuals within months of the introduction of the new scheme. This was at a time when the total construction industry workforce did not exceed 1 million. At the time, Inland Revenue documents on the new scheme affirmed that 'the registration card in particular was not proof of self-employment'. Maybe not. But, it was certainly the rubber stamp. The second class self-employed were exempted from the more rigorous test of the business class self-employed, and, in effect walked through an open door to self-employment status. As Jane Kennedy state in a Parliamentary written answer (Hansard, 21 November, 2007)

> 'There was no other qualifying test, so refusal was extremely rare….. At the close of the former scheme, there were some 1.9 million CIS 4 holders.'

With the influx of migrant labour into the evasion economy of false self-employment, there is evidence that many have entered without any significant test of self-employment. In answer to written parliamentary questions, John Healy, Financial

Secretary to the Treasury, (Hansard, 16 April, 2008), provided the following statistics for those issued temporary, 3 month, self-employment CIS4 registration without National Insurance numbers:

2004-5	74,000
2005-6	77,000
2006-7	76,000
Total	227,000

Table 4.2 Number of temporary registrations of migrant self-employment

From the Labour Force Survey statistics discussed in Chapter 2, it is clear that not all 227,000 remained in the UK construction industry. The point to remark on here is the ease with which migrants can enter into false self-employment and became part of the UK construction evasion economy.

The 1999 CIS reform, having failed to address the fundamental labour market distortions and identify its own taxation system as their cause and origin, provoked considerable disquiet in the industry, both for important sections of employers and for all trades unions. Consequently, an employment status review was initiated in 2004, leading eventually to the New Construction Industry Scheme referred to above, and introduced in April 2007. However, for reasons that will be discussed more fully in the final chapter, once again an opportunity was missed. The two-tier self-employment system remains almost unaltered from its predecessor, with a superior business class self-employment, allowing gross payments on condition of a £30,000 turnover threshold and a business compliance test, and the same false self-employment class with their tax deducted at source by their engagers. Most of the reforms are operational and administrative, relating to how tax is returned to HMRC and how it is accounted for (the previous voucher system and certificates have been dropped).

There are contradictory elements in the new system that give little confidence that much will change. The identity card system has been dropped (ironically). In its place an electronic internet registration and verification procedure using National Insurance and Unique Taxation Reference numbers have been implemented. On the one hand, engagers of labour services are now obliged to sign, on a monthly basis when submitting their taxation returns, that they have checked the employment status of the providers of labour services.[14] There are penalties for false declarations. On the other hand, the Electronic Status Indicator, discussed above, can be used both by engagers and engaged. For the engaged, registration to be self-employed can now be accomplished over the internet, by simply answering questions appropriately. It is difficult to see that this will pose any barriers to entry into false self-employment, indeed the reverse. However, as the system has only just been introduced, statistics on the employment status composition of the workforce are unavailable.

On the evidence so far, HMRC have not penalised any contractor or self-employed person for false declaration of employment status.

> At present, no instances have arisen where penalties have had to be imposed because of an incorrect declaration of employment status by a contractor. (Jane Kennedy, Financial Secretary, HM Treasury, Hansard, January 31, 2008).

If the introduction of the New Construction Industry Scheme was intended to bring about the stated objective of shifting many of the old CIS4 self-employed into employee status, there are no signs on the ground that this has either been pursued or achieved.

[14] The HMRC leaflets explain to engagers: 'Under the New CIS, you 'll be signing a declaration every month to say that you've considered the employment status of the workers you've paid within CIS and that none of them is an employee.'

The critical proof of the causes of illegal mass self-employment.

Reviewing the history of the tax regulation system, it is clear that what had originally been motivated by the need to get some fiscal handle on a chaotic industry has become institutionally entrenched into a unique two-tier employment status taxation system. The term for this is path dependency. Once locked into the two-tier system, all subsequent reforms have modified, even sharpened, the divide. From all the evidence, the superior business class self-employment has been contained and limited in number. For all other sectors of the economy, self-assessed taxation is the norm for self-employment. The critical evidence is that the second-class self-employment status, a taxation status in conflict with key legal tenets of employment status, has been responsible for the expansion and entrenchment of the evasion economy. The lack of clarity and complexity of legal status classification provided the necessary conditions for the tax employment status classification to have a major impact. If the legal classification was less open-ended, requiring each individual worker's case to be judged on its full merits and complexity, there would have been less scope for the tax classification system to generate mass illegality.

The expansion and contraction of mass self-employment, above the upper legal threshold, maps precisely onto the changes and measures taken by the taxation regime. In no other industry or sector have such measures been introduced, or such an explosion of self-employment occurred. Therefore, it is not a general trend or feature of the economy or labour market that is in evidence. Instead, when the first two-tier self-employment taxation regime (the 714/SC60 regime) was instituted in 1975, the officially registered self-employed roughly doubled to approximately 30-35% of the

total construction manual workforce. Following the 1980 Thatcher administrative ruling, the real explosion began, pushing the level of self-employment from below 40% up to 62% by 1996. An administrative reform reintroducing tests for self-employment in 1997 then reduced the level of mass self-employment to 48% in 1999, still a grossly inflated proportion. Following the introduction of the Construction Industry Scheme in that year, the downward shift was halted, and since then, after some fluctuations around 50%, the figure has begun to climb again (see in particular, figure 2.3). Given the growth of construction employment and the influx of migrant labour, self-employment has recently accelerated more rapidly than employment. Although no evidence is yet available to demonstrate the impact of New Construction Industry Scheme introduced in April 2007, given the tinkering nature of these latest reforms, it is difficult to see that the upward trend will be checked.

At each point in this history, changes in the taxation system directly produced changes in levels of mass self-employment. The evidence is thus overwhelming that the cause and origin of illegal mass self-employment lies in the two-tier taxation classification system unique to the construction industry. This system is in conflict with the legal conception and regulation of employment status in all other sectors of the economy. It sets in train competitive pressures and incentives that drive out legal employment, replacing it with illegal self-employment. The evasion economy is a systemic failure. This taxation system and the incentives it incorporates, not how individuals are correctly or incorrectly allocated within it, is where the problem lies. It is the reform of this system that we propose in the final chapter. The answer lies not in more regulation, but in simpler, more consistent and coherent regulation necessary for more efficient labour market functioning.

Main findings

- The legal system for determining the employment status of the employed or self-employed has become complex, unclear and uncertain. The four standard tests cannot be applied consistently in conjunction with each other, and in many cases conflict.

- In spite of the ambiguity of the law, the empirical reality of the vast majority of the false self-employed in the construction industry is that they are also unambiguously illegal, on application of the four tests.

- The lack of clarity of legal classifications of employment status provided the conditions under which a contrary tax classification of employment system produced a major impact on construction labour markets.

- The construction industry taxation regime uniquely instituted a two-tier classification of the self-employed. This firstly imposed more stringent conditions for the self-employed to act as businesses on their own account responsible for their tax affairs than in any other sector of the economy. Secondly, it established a deduction-at-source self-employment tax status where the engagers of labour assumed responsibilities for managing the taxation affairs of those they engaged. This is normally one of the strongest indicators of employee status. For both parties to the contract, this tax status conflicts directly with key legal tenets determining the status of self-employment as one of being in business on one's own account.

- The construction tax regime in the course of its development was shown to directly account for the explosion of false and illegal self-employment, and the subsequent changes in scope and scale of the evasion economy.

- The Construction Industry Scheme registered 227,000 self-employed without National Insurance numbers, predominantly migrant labour, in the period 2004-2007, so facilitating their entry into and expansion of illegal self-employment in the industry.

- The problem of mass illegal self-employment rests with the conflictual legal and tax systems of classification, not in workers being misallocated within an unproblematic regulatory system of employment status.

Chapter 5

Employment deficits: the skills gap, vulnerability and pensions.

The employment deficit

So far, the evasion economy has primarily been described in terms of the tax evasion economy. But it is much more than that. False self-employment can also be seen as direct employment stripped of all or most of its normal attributes: employment in terms of control, integration, economic reality, even mutual obligation, but no investment, and none of the standard employment rights. In some ways, this minimalist employment is the most vulnerable, subordinate and dependent form of employment, at the opposite end of the scale of genuine, independent, entrepreneurial self-employment. The impulse to drive down all costs of labour, triggered by tax evasion, has induced evasion of all social and economic obligations of employment. Degenerative competition of this kind is economically and socially damaging. In this chapter, we demonstrate the consequences of the evasion economy in this broader sense, first in terms of underinvestment in skills (the skills gap), then in terms of vulnerability and deprivation of employment rights, and finally in terms of pension rights, and the shift of responsibility from employers onto the state.

Mass self-employment and the skills gap

The stark contrast between patterns of employment and self-employment in different European countries has already been noted (Chapter 2). The main facts of the skills gap in the UK construction industry compared with other European

countries are also well known. In the UK, only 36% of the manual workforce achieves National Vocational Level 3 compared with 83% in Germany (Richter, 1998). The proportion of trainees to the manual workforce for carpentry and bricklaying is 4% in the UK, 9% in The Netherlands, 18% in Denmark, and 22% in Germany (Innovative Manufacturing Initiative, 2002). The skills gap reflected in this contrast has not always been so extreme. In this section, we show, first in statistical terms, that the shift from direct to mass false self-employment has been a main contributor to the decline in training. We then demonstrate the nature of the causal link between mass false self-employment and under-training.

In the pre-1979 period, local authority direct labour organisations (DLOs) had been a major source of provision of skilled craftspeople to the construction industry, exhibiting the highest proportions of trainees in their workforces, and exporting their 'surplus' into the private sector. After Thatcher's introduction of compulsory competitive tendering and reduction in the provision of social housing, Direct Labour Organisations were decimated, so cutting off a major source of supply of skills to the industry as a whole. The remnant local authority provision of construction traineeships and apprenticeships has also shown further drastic reductions, cutting by half the number of training placements between 2002 and 2007.

However, the most significant shift occurred in the private sector. The two Figures below demonstrate that the drop in the rate of traineeships to the overall construction workforce was cut by one third (Figure 5.1) in the period that coincided with the most dramatic rise in mass self-employment. Thus, if the same proportion of trainees to total workforce operated today as in 1974, the number of trainees would have to rise from 46, 000 to nearly 70,000.

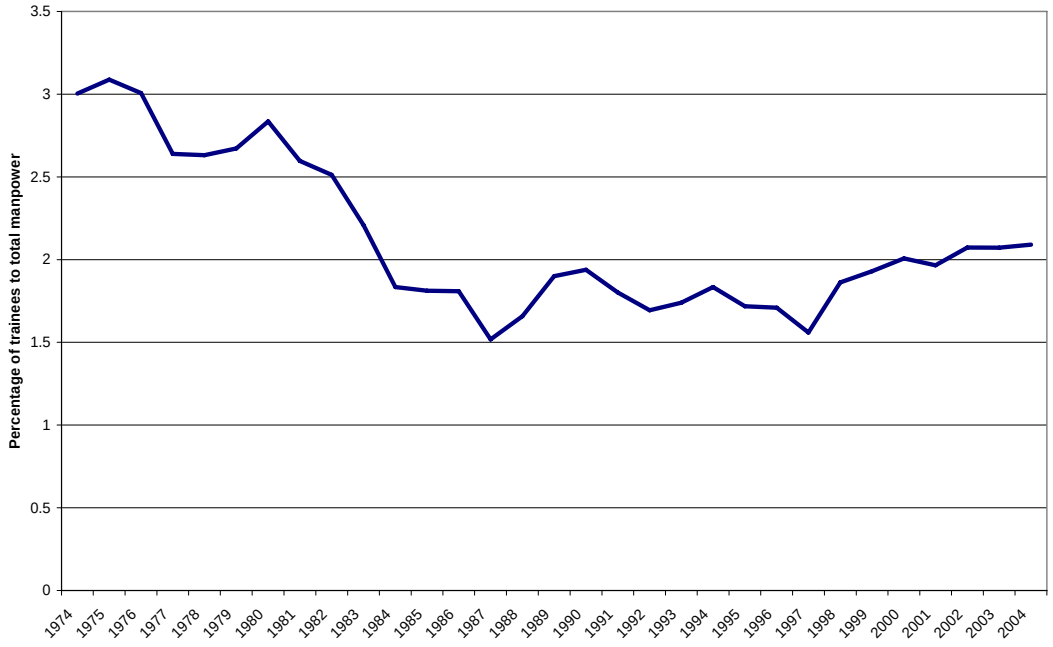


Figure 5.1 The decline in training in the UK construction industry. *Source: CITB-Construction Skills*[15]

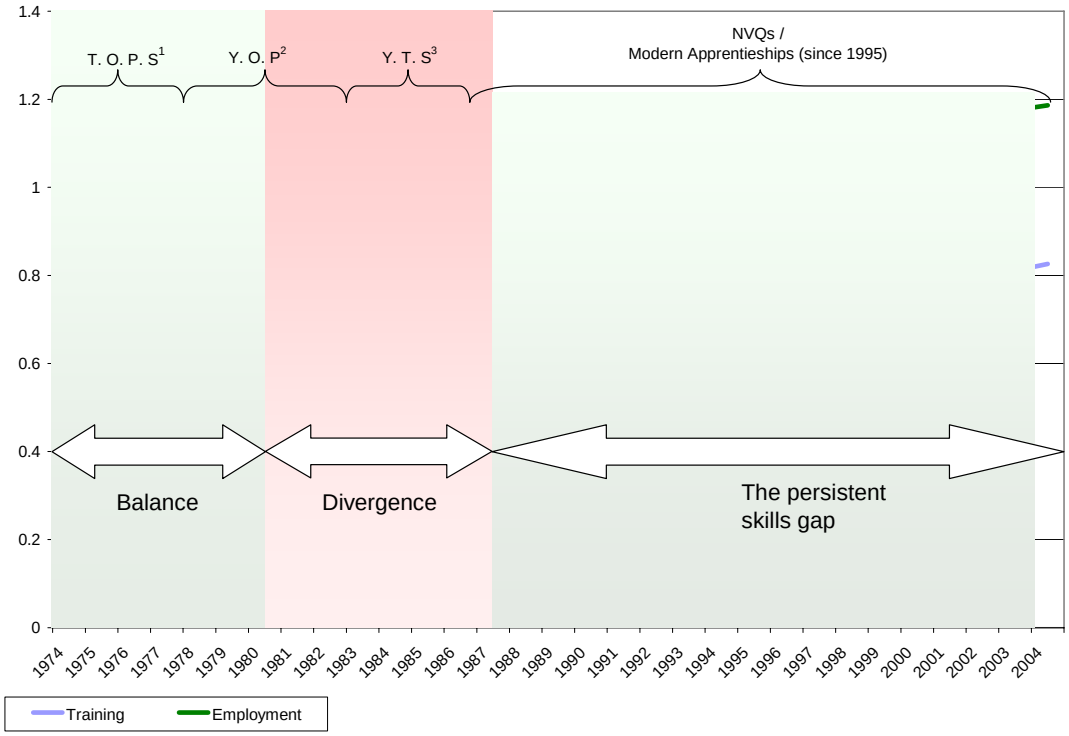


Figure 5.2 The emergence and persistence of the skills gap in UK construction.

[15] We are most grateful to Kirsty Woolsey and Martin Turner, Research Analysts at ConstructionSkills for this data, which I have adapted for this report.

This can be taken as the skills gap, by UK historical standards, created by the decline in DLOs and growth in mass self-employment, an annual shortfall of 24,000 or more. This assumes, of course, that the required skills level has remained static since 1974, when in other European levels, trainee ratios to the workforce have reflected demand for increasing levels of skill.

However, as is shown in Figure 5.2, once the divergence opened up between the total workforce and the percentage of trainees, the gap never closed. There has been a persistent and cumulative lack in training for skills within the UK industry. The stabilisation of high levels of mass false self-employment persisted with the rise and fall of the total workforce, as did the gap. Each year there is a lack of replacement of skills, the skills gap grows. To make up the cumulative shortfall, it has been estimated by the CITB that over 87,000 trainees are needed every year for the next decade, double the level of current training. This gap, as Figure 5.2 shows, has persisted despite the implementation of new training provision, on the supply side of training, leading to the introduction of NVQs and the Modern Apprenticeship.

These broad statistical relationships between training and false self-employment, however, require explanation. Why does mass self-employment lead to low levels of training? It has been powerfully argued that the absence of a clear link between qualification and wages, especially as secured by collective bargaining, results in a lower social valuation of skills, both by employers and employees (Clarke, 2005; Clarke and Hermann, 2004; Clarke and Wall, 1998). In many European countries, payment is directly related to recognised qualification. Clarke has also shown that the UK construction industry has failed to develop and modernise the concept of skills appropriate to the modern industry, and is still largely bound to the traditions of the established crafts, exemplified by bricklaying and carpentry.

The downward competitive pressure focused narrowly on cost rather than quality of labour, and the descent into the minimalist employment relation, drives out investment in training by employers. Thus, according to CITB figures, 75% of firms in the contemporary construction industry do not offer any apprenticeship training. The labour-only subcontractor, as the dominant type of firm engaging labour, constitutes the core of the trainee-free zone in the industry. For them, their false self-employed workers are paid to work, not to assist the training of trainees. The employment relation is stripped of everything except the exchange of a wage for immediate labour performance. Everything above and beyond that minimalist relationship disappears. The employer commitment to develop skills over a period of time disappears along with the employer commitment to employ over a period of time. As a consequence, the industry as a whole is the loser, having abandoned any collective stakeholding in the interests of the industry to maintain levels of skill. The resultant skills crisis, arising from the lack of national regeneration or expansion of skills, inevitably leads to importing skills through migrant labour. The phenomenon has been seen in other sectors where there has been a failure to regenerate skills, as in the National Health Service. Uniquely in the construction sector, migrant labour has entered into the evasion economy that is the cause of the skills gap in the first place. It stimulates further the downward spiral.

Underinvestment and deprivation of employment rights

The narrow focus on the exchange of a wage for immediate labour performance has consequences for every aspect of this most vulnerable and dependent form of employment. Although technically many such workers may be entitled to working hours prescribed by the European legislation and the 1998 Working Time

Regulations Act, many construction sites employing mass self-employment work a 10-hour shift, five and a half days a week. A 55 to 60 hour week has been common in the industry for decades. This has encouraged an extensive rather than intensive approach to productivity, using longer hours to make up for efficiency and technological advance. There is no overtime pay, simply a flat rate for the shift. As noted in Chapter 4, such dependent workers are also entitled to holiday pay, yet the evidence on the ground from surveys and recent UCATT officials' reports suggest that absence of holiday payments is widespread.

Beyond these normal attributes of employment, however, the false self-employed have no rights to sick pay, unemployment benefit, or redundancy pay, however long they have been working for the same contractor. Yet, personal insurance provision against these risks is also rare, partly because dependent waged employment of an irregular and income-fluctuating kind has none of the characteristics of entrepreneurship and independent business opportunities. There is no culture of the independent and genuinely self-employed amongst those who are not genuinely self-employed – and why should there be? Although partially masked by the recent boom in the industry, historically the false self-employed have experienced particularly high levels of insecurity of employment, subject to instant dismissal, and to major downward fluctuations in wages. Turnover rates on large sites have reached exceptionally high figures, of 400% in the course of a year (Harvey, 2001, 2003). Visits to the doctor, absences to meet urgent child-care needs, are used as pretexts for dismissal. As dependent and falsely self-employed workers, without control over their own time, they are deprived of the rights of any normal employment relation. Conversely, they lack the discretion to choose how they organise their working time enjoyed by the genuinely self-employed.

From recent investigations by UCATT officials, it appears that many of the practices that have applied to the false self-employed are now extending to agency workers who by law and in principle enjoy employee status. Migrant workers supplied by agencies, particularly vulnerable to exploitation, have been found to work excessive and illegal hours. Holiday and sick pay are frequently absent, and non-payment of wages has been observed on a number of occasions. Some of the major agency labour suppliers, such as Hays and ICDS have been involved, and they have been supplying labour to construction sites managed by leading contractors, Persimmon, Robert MacAlpine, Bovis, Taylor Woodrow, Balfour Beaty, and others. These practices undoubtedly reflect the dominant and corrosive influence of bogus self-employment.

The right to retirement and pensions

The binary divide between employee and self-employee status becomes particularly significant in relation to retirement and the right to pensions. Research and information on the self-employed, pensions and retirement is woefully inadequate. There are no data on the construction industry, the largest sector for self-employment, that takes into account the specific characteristics of construction self-employment. More importantly for this report, it goes without saying, there is no information on the pension or retirement prospects for the bogus self-employed. So much has to be inferred from what little data there is.

Paying Class 2 National Insurance entitles the self-employed to the same basic state pension as the employed. However, this assumes continuity of employment over 40 years for full entitlement. For the self-employed, periods of unemployment reduce their entitlement to basic state pension, unlike the employed who can register as unemployed, so maintaining their contribution record. From previous work, it is

known that the dependent 'second class' self-employed in construction (SC60 and CIS4), are vulnerable to unemployment (Harvey, 2003). During the long boom, this risk may have diminished. Post credit crunch, the pattern can be expected to re-appear. We can infer that many of the false self-employed in the construction industry will be entitled to reduced basic state pensions.

> 'There are large numbers of people in the UK who are heading towards inadequate incomes in retirement. ..between 9.6 and 12 million people, who are concentrated in certain groups, including the self-employed.' (Sainsbury, et al. 2006)

We can add that the dependent, irregularly employed, construction sector self-employed, as the largest self-employed group, will be highly represented in those with inadequate incomes in retirement.

The official view of the self-employed is that they are independent, entrepreneurial individuals that assume their own financial risks, including that of old age. However, in general terms, although a higher proportion of self-employed than employed invest in personal pensions to supplement their state pension (46% compared with 21%), this leaves over half without any pension entitlements other than their basic state pension. Unlike their employee counterparts, the self-employed have no occupational pensions, and their engagers have no commitments to their employees beyond the last hour they work for them. Moreover, it is well known that the self-employed are a highly heterogeneous group. The genuine, entrepreneurial, high-earning, self-employed are the most likely to be able to contribute to personal pensions (*Security in Retirement: towards a new pension scheme*, 2006; Clery et al. 2007). Those on irregular, middle and low earnings of less than £30,000 per year are the least likely to have any additional pension provision.

Last but not least is the issue of retirement, normally defined at age 65 for the employee, but open-ended for the self-employed. Without adequate pension provision, and without determinate age for cessation of work, the self-employed are far more likely to continue working after the wage of 65 – *if they are able*.

> 'For the self-employed, their definition of retirement ….is the point when all work ceases.' (Clery et al. 2007, 176)

In an industry with a notoriously high accident rate, and reliant on physical fitness and strength to undertake many of the operations, the prospect of continuous working until incapacity or death is a common condition for the bogus self-employed. Again, there are no adequate statistics for this hidden consequence of the evasion economy. These are the life conditions of the forgotten people who build the houses and buildings we continue to inhabit. They build retirement homes and homes enjoyed by the retired. They are the least likely in society to benefit from them.

Pensions: the future threat

As a post-script to the review of the consequences of false self-employment for vulnerability and poverty in old age, a final twist is about to occur with the introduction of the new mandatory second state pension for employees. In terms of the discussion in Chapter 3 of the fiscal and cost gap between employee status and self-employed status, the pension reform will increase the cost differential by a significant margin from 2012. Employers will be obliged to contribute 3% of the salary, and employees at least 4%, in addition to the difference already existing between National Insurance costs. *In the absence of measures to prevent false self-employment in the construction industry, this will significantly increase competitive pressures to drive down genuine employment yet further*. We have seen how the tax

system has induced the expansion of illegal self-employment. As it stands, the pension reform introduces similar labour-cost incentives, and can only intensify the trend towards illegality. If the evasion economy exists on the current scale in 2012, there can be little doubt that it will expand yet further without strong countermeasures. For the bogus self-employed, this will sharpen the contrast between their prospects for retirement and old age and that of their employed counterparts. They will be left stranded with reduced basic state pensions, and means tested benefits – at a significant cost to the state. Their employee counterparts will enjoy the benefits of a certainty of retirement with better pension provision. Little time is left to reverse and shrink the construction industry evasion economy, and prevent this disastrous outcome.

Conclusion

False and illegal self-employment has all the attributes of employment but with none of the costs. In this chapter, the concept of the evasion economy has been broadened from the significant yet narrow aspect of the fiscal costs of tax and National Insurance evasion. Evidence has been given of evasion in the broader sense of a degraded and minimalist employment relation, underinvestment in skills, a shift of the burden of retirement from employers to the state, and deprivation of normal employment rights to holiday and sickness pay, redundancy and unemployment. All risks are downloaded onto the false self-employed, with none of the gains. There is a societal responsibility to maintain employment standards, the enforcement of the law to ensure equity – and indeed efficiency in the working of markets. There has been a chronic failure of successive governments to recognise and address this societal

responsibility, and to tackle an economy of evasion at the heart of one of our principal industries.

Main findings

- The growth of illegal mass self-employment has directly contributed to the significant skills gap, and **a shortfall of at least 26,000 trainees per year**. With the dominance of the labour only subcontractor, **75% of construction firms offer no training**. It would take **a doubling of the present level of training** to over 80,000 for every year over the next decade to redress the skills gap. In the meantime, **the construction industry is reliant on migrant labour to meet the demand for skills**.

- The rights to holiday pay and to normal working hours are routinely breached, with excessive working hours and no provision for holiday pay.

- Without effective control over their time as their self-employed status should entitle them, the false self-employed are deprived of basic rights to respond to needs of child-care, sickness and injury.

- The false self-employed in the construction industry are particularly prone to poverty in old age and dependence on means-tested benefits. A common prospect is to work until incapacity or death, without the benefits of retirement. **Over half of the bogus self-employed are without personal pension, and a significant proportion will be entitled to less than the full basic state pension.**

- The pension reform act coming into effect in 2012 will increase competitive pressures to drive out good employment practices with false and illegal self-employment, unless there are powerful measures in place to restore genuine employment status within the industry.

Chapter 6

What needs to be done? Proposals for reform

The report has demonstrated the existence of mass false self-employment in the construction industry. The number of false self-employed can reliably be estimated as standing between 375,000 and 433,000 construction workers. The phenomenon refers to a type of employment that has arisen on large construction sites, where the main suppliers of labour are labour-only subcontractors. It does not refer to the hundreds of thousands of genuine self-employed, who bear financial risks, and are properly in business on their own account. The report recognised the contributions made to the industry by the genuinely self-employed, and the virtues of entrepreneurship and flexibility that they exhibit. The key aim of any reform must be to distinguish and re-establish the true meaning and reality of employment and self-employment for the benefit of both. The immediate and identifiable fiscal costs to the taxpayer are considerable, estimated at between £1.4 billion and £1.9 billion per year.

The support for reform is widespread amongst employers' associations, including the Construction Confederation, the Health and Safety Executive, and trades unions. The industry has suffered from the blight of false self-employment with detrimental effects on the management of construction process and especially the disappearance of effective skills training. The erosion of direct employment has led to a steep decline in on-site training, with 75% of firms not offering any training places. It is necessary to restore a collective stakeholding by the industry in the skills infrastructure essential for a productive, modernising and technologically advanced industry.

The report was able to identify and demonstrate the key cause and origin of the growth of mass illegal self-employment in a conflict between a tax regime peculiar to the construction industry and the legal case law on employment status. The case law itself gives rise to opportunities for uncertainty and complication in assessing employment status. The tax regime introduces tax incentives and the use of an instrument for revenue collection that directly conflicts with one of the main legal tests, the 'economic reality' test for self-employment of being in business on one's own account. A defective but unambiguous tax incentive, combined with a conflict between taxation and legal regulation of status, has driven out genuine direct employment from the industry, and replaced it by bogus self-employment. Several reforms in the construction taxation regime have signally failed to rectify the situation, and the most recent one show clear signs of continuing to promote the economy of tax evasion. There is a major and imminent risk that the pension reform to be introduced in 2012 will add to the competitive pressures towards illegal self-employment unless the industry can be first restored to health.

The purpose of the reform therefore has the following aims:

- to correct major labour market distortions
- to recover £1.7 billion of legal tax revenue
- to restore normal employment rights of legal employment, and eradicate the illegal exploitation of vulnerable, particularly migrant, labour
- to re-establish the basis for investing in home-grown skills
- to promote productivity and innovation by investing in employment
- to bring the construction industry into line with all other sectors of the economy with regard to employment status

- to ensure that construction workers are as enabled to enjoy retirement and pensions as are workers in other industries

The proposals

The main fault-line in the regulatory regime lies in the unique two-tier taxation self-employment status. One category of self-employed currently has a stiffer test than in any other industry as a consequence of a turnover threshold for gross payments that excludes many genuine self-employed. The other category involves taxation at source that places obligations on engagers of labour typical of employers, and deprives the engaged of responsibility for managing their own tax affairs, normally a principal indicator of being in business on one's own account.

It is therefore proposed that the construction industry is brought back into line with all other sectors of the economy, and at the same time to simplify the tax regime by adopting **a single taxation employment status**. We propose abolishing the threshold for self-employed status for all genuinely self-employed construction workers, that creates a special category of 'business class' self-employed. We propose abolishing the secondary, taxed-at-source, self-employed tax status. It conflicts with the law and facilitates unlimited access to false self-employment status.

> Proposal 1
> A single self-employed tax status should be established in which all self-employed are paid gross, and are responsible for their own tax affairs

It is recognised that initial responsibility for determining and enforcing correct employment tax status must rest with HMRC, and we suggest that they remain responsible for issuing certificates of gross payment self-employment status. The

default category, as in other sectors, is the direct employment status. There will therefore be two one self-employment tax status for those meeting an appropriate test, and the directly employed. As in all other industries, and particularly on large-scale construction projects, it is anticipated that the large majority of workers will be directly employed. There will be an important minority of genuinely self-employed, around 20% to 25% of the workforce – not a target, but an estimate of the current realities as opposed to fictions of employment practices.

Proposal 2 Her Majesty's Revenue and Customs remain responsible for issuing certificates of eligibility for self-employed status, on the basis of appropriate criteria.

All self-employed construction workers will have certification with personal identity for working in the construction industry. This continues with existing practice for those receiving gross payments under the New Construction Industry Scheme. It is anticipated that a considerable number of those currently in false self-employment, with their tax deducted at source, will transfer to this new certification. Conversely, a greater number of those currently in false self-employment will shift into direct employment.

We recognise that employers also have a responsibility to ensure that those they engage are genuinely in self-employment, and we suggest that current obligations are retained for monthly declaration of payments to self-employed workers. In order to ensure a return to a level playing field for all contractors in the industry, responsibilities must be shared between all those empowered with assessing employment status. The genuinely self-employed also have an obligation to demonstrate that they are genuinely in business on their own account, and able to provide evidence to that effect, once a track record has been established. In particular,

whereas some criteria for status can be tested prior to engagement, many cannot, and only become manifest at the time of, and following, engagements. This provides a rule of thumb for the respective responsibilities of HMRC, engagers of labour, and the self-employed themselves.

The central criteria for assessing employment status remain those established by case law. However, in issuing certificates or enforcing correct legal status, it is valuable to establish a set of indicative norms, especially to determine whether a worker is in business on his/her own account. Much work has already been carried out in this regard,[16] and the main indicative norms are listed below

Proposal 3
Indicative norms for assessing economic reality of self-employment for certification

- Self-determination of method of payment and level of payment, including price setting.
- Evidence of submitting tenders for work
- Freedom to hire others in substitution
- Providing capital equipment
- Providing materials at own expense
- Investing in own business, office, and infrastructure
- Submission of invoices for completed work
- Payment of own tax and NI
- Personal coverage of sick pay and holiday pay

As suggested above, some of these norms cannot be assessed prior to a person entering into genuine self-employment for the first time. However, many of them are

[16] A number of additional criteria have been suggested, such as VAT registration, payment of Public Liability Insurance, provision of materials, lists of appropriate trades. Many of these have difficulties in implementation or come into conflict with other indicators of genuine self-employment.

assessable after a period of activity of being in business on one's own account, and evidence can be required. Some criteria might be considered requisite (self-determination of financial risks through price-setting, submission of invoices, tendering for work), others merely indicative (evidence of hiring others, ownership or hiring of capital equipment). We therefore suggest a provisional certification for those entering into self-employment for the first time, to be reviewed after an appropriate interval prior to full certification. The costs of implementation and administration are not significantly greater than those that apply to the current gross payment tax self-employment status. As the self-employment tax status of gross payments by clients is being extended to all self-employed in the construction industry, it is essential that the monitoring and evaluation process is robust but not burdensome.

It is legitimate to ask whether this simplification of the tax regime is an oversimplification with respect to the complexities of the construction industry. One area of concern raised by the report relates to the confusions arising between casual, highly dependent engagements and genuine self-employment for multiple clients on an intermittent and irregular basis. As a general guideline, lack of mutuality of obligation between engager and engaged should not override the other three tests if these indicate the worker is employed, not in business on their own account, and under the control, including for the timing, hours and frequency of work, of their engager. For genuinely self-employed workers the ability to choose when and how to work, to retain significant control of their own flexibility, is a benefit of self-employment status. As stated earlier, the casual employee exhibits the strongest contrast with genuine self-employment, having no independence, control or self-management of their working time, let alone operating as a business on their own account.

The other ‘real world’ source of complexity concerns the switching from one employment status to another. The current proposal, by removing the threshold for genuine self-employment, enables dual status workers. There is nothing to prevent a worker from being employed for some period, and self-employed for another, provided that the worker can pass the test for self-employment certification set out above. (There is no incentive for either engager or engaged to adopt false direct employment.) The risk of creating an evasion economy rises when attempts are made to assign individuals into either one category or another in ways that do not reflect the realities of the situation. In particular, by assigning individuals to self-employment status in these circumstances encourages tax evasion and illegality.

The proposed simplification of the tax regime brings the construction industry back into line with the tax regulatory frameworks of other industries. However, it is important to stress that there is no regulatory quick fix to an evasion economy that has become deeply embedded over decades. The growth of mass false self-employment has profoundly affected the structure and organisation of the industry (Harvey, 2003). The nature of the firm, both large contract management companies and labour-only subcontractors, has emerged as a consequence of the environment of the evasion economy. A major implication of eliminating the evasion economy is that it will induce, over time, a radical change in the organisation of the industry. The same principle applies to regenerating the skills infrastructure. It will take time to change the culture and organisation of firms to enable and foster a collective stakeholding in investment in skills and provision of on-site training. Historically, the construction industry has always relied on a substantial and positive contribution from migrant labour, stretching back to the 18th century. The proposals to restore the infrastructure for developing home-grown skills is aimed at reducing a reliance on imported skills

arising from the systemic training failure within the UK. The move from a minimalist, short-termist, cost-cutting conception of the employment relation to one of investment in employment can only develop over time, and in a favourable environment. The proposed changes to tax regulation are a necessary component for bringing about such change, but only if accompanied by initiatives by the industry and social partners to change the culture and organisation of their sector.

Some arguments against reform rebutted

The evasion economy in the construction industry has grown and become normalised since the 1980s. There are entrenched interests, but also simply ingrained habits of thought, which present obstacles to reform. There are fears and anxieties about changing the reality people in all positions and organisations have come to accept. Here we rebut some of the main arguments against reform.

1. Industry is overburdened with regulation – 'let business sort it out for themselves'

There is a government drive to reduce the regulatory burden on industry, and a correlative view that self-regulation is suffocated by state regulation. There are two answers to this point. First, what is being proposed here is not more regulation, but simplification, consistency and clarity of regulation. The current tax and legal regulation is complex, unclear and contradictory. It is also out of line with all other industries. Moreover, faulty regulation has caused major market distortions which the current proposals aim to correct. Second, all markets require regulatory frameworks – Gresham's law of bad money driving out good, or, more topically, sub-prime mortgage markets threatening the functioning of the whole credit system, demonstrate

the need for regulation for proper market functioning. What we are proposing here is the restoration of the robust distinction between false and genuine self-employment to eliminate widespread tax evasion and illegality, employment of good coin, rather than counterfeit self-employment. In this respect, business – in this case the clear majority of construction industry organisations – recognise the need for this reform of the tax regulatory system to restore a level competitive field. This is the responsibility of government. As argued in the previous section, regulatory reform by government will only address part of the problem. There will be plenty left for business to do in reorganising themselves in a new regulatory environment more favourable for the development of the skills base.

2. The reforms will suffocate the entrepreneurialism of self-employment

The current proposal is aimed at promoting genuine entrepreneurial self-employment. Entrepreneurial self-employment involves assuming the risks and challenges of being in the business on one's own account, including, of course, managing one's own tax affairs as part and parcel of achieving financial success. There are many, indeed an increasing number, of construction skills and services that can innovatively be delivered by the genuinely self-employed. The current proposals remove a significant barrier to entrepreneurial self-employment by removing a turnover threshold as a qualification for full self-employed status.

As a counterpart, the proposals entail the elimination of a debased form of self-employment which in reality is characterised by lack of independence, control, and assumption of financial risk. Alongside the restoration of genuine self-employment, the proposals seek to restore investment in the direct employment status as one in which life-time development of skills can occur. The aim is to achieve a

more balanced labour market combining direct employment and self-employment in the most efficient, forward-looking, and technologically competent mix.

3. The shift to direct employment will drive up the costs of labour in a labour-intensive industry

The short answer to this objection – no doubt a major anxiety of government – is clearly that an expansion of direct employment will increase costs of labour. It is always cheaper not to pay taxes than to pay them. The real question is why successive governments have allowed tax evasion – not legal avoidance – on a massive scale. One answer to this mystery must lie in the fact that it has been allowed to grow to a massive scale. The illegal price of labour has become the normal price. To restore legality will mean making industry pay taxes which they have become accustomed to evading. No doubt, a government decision to confront this issue head-on will take courage.

The more substantial answer to the question, however, addresses evasion in the broader sense, the lack of investment in the employment relation over the long term, the most obvious manifestation being the skills gap. For far too long, the industry has been reliant on 'extensive' rather than 'intensive' productivity gains, cheap labour worked for long hours, and paid for immediate performance. Undoubtedly, the shift to higher investment in employees will take time before it yields the full productivity benefits. The UK construction industry has one of the highest labour-capital ratios, the lowest usages of prefabrication and advanced construction technologies. This, in part, is born of the reliance on cheap, casual, low-skilled labour. The shift to high-skilled, capital intensive, intensive productivity,

culture will take time. But this shift is essential if the industry is to develop its full innovation potential.

4. The proposals will lead to a loss of revenue to the taxpayer rather than the contrary

One of the abiding fears of the Inland Revenue, now HMRC, has been to accord self-employed in the construction industry a gross payment taxation status because of the attached risks of tax avoidance. A major rationale for introducing a two-tier self-employment tax status was to ensure taxation at source at least of a proportion of the self-employed. The proposals do entail an expansion of gross payment taxation status, as a mark of genuine, entrepreneurial, self-employment. We note that other countries do not exhibit the same anxieties about revenue collection from the self-employed.

The main answer, however, is that both industry and revenue collecting technologies have progressed enormously since the 1970s when the two-tier tax status was introduced. As was already established with the Construction Industry Scheme, tracking and identification of individuals has advanced considerably, and the New CIS has availed itself of electronic monitoring and control. We believe that there are now the available technologies to ensure revenue collection from a single, gross payment, self-employment tax status. The resistance of the Inland Revenue/HMRC to reform arises partly out of fear of departing from their institutional routines. But there has also been a consistent approach to deliberately downscale the problem of evasion, as it amounts to an admission of major systems failure on their part. No organisation likes to do that.

Of course, the main rebuttal is that any significant shift to direct employment will result in substantial retrieval of lost taxpayers' revenue. We have estimated the gains to the tax payer conservatively at £1.7 billion per year.

A time for change

It might be thought that any time is a good time to recover £1.7 billion of taxpayers revenues lost through evasion. Following two failed reforms of the two-tier tax system to address the systemic faults of the evasion economy, however, we believe that now is finally the time to deal with the fundamental issues. The need for reform has become increasingly manifest with the over-reliance on migrant skilled labour to plug the skills gap of an industry that, because of mass false self-employment, has lacked the necessary skills infrastructure. The need for reform has become more urgent because of the impending implementation of the Second State Pension, which drives a greater cost wedge between direct employment and self-employment status. Unless a robust boundary is re-established between genuine self-employment and employment, the degenerative competitive pressures for false self-employment to grow will intensify.

We believe we have advanced a case for urgent reform, and rebutted many of the standard resistances and objections to changing a culture of evasion that has become normalised. The industry needs to break from its past as never before. The restoration of employment rights to hundreds of thousands of illegally self-employed is not only a restoration of justice, but a pre-requisite for an industry advancing into

the 21st century, building and advancing home-grown skills, and developing the innovation required for an ecologically sustainable built environment.

References.

Burchell, B., Deakin, S., and Honey, S. 1999. *The Employment Status of Individuals in Non-Standard Employment.* Department of Trade and Industry, March.

Clarke, L. 2005. 'From craft to qualified building labour in Britain: a comparative approach', *Labour History*, 46, 4, 473-493.

Clarke, L., Hermann, G. (2004), "The institutionalisation of skill in Britain and Germany: examples from the construction sector", in Warhurst, C., Grugulis, I., Keep, E. (Eds),*The Skills that Matter*, Palgrave Macmillan, Basingstoke, pp.128-47.

Clarke, L. and Wall, C. (1998). 'UK construction skills in the context of European developments', *Construction Management and Economics*, 16, 553-567.

Clery, E., McKay, S., Phillips, M. and Robinson, C. (2007) *Attitudes to pensions: the 2006 Survey*. Research Report no 434. Department of Work and Pensions. London.

Daunton, M. 2002. *Just Taxes. The Politics of Taxation in Britain, 1914-1979*. Cambridge University Press. Cambridge.

Deakin, S. and Morris, G.S. 1995. *Labour Law*. Butterworths. London.

Deakin, S. and Wilkinson, F. 2005. *The Law of the Labour Market. Industrialisation, Employment and Legal Evolution*, Oxford University Press.

Department of Work and Pensions, 2006. *Security in Retirement: towards a new pension scheme*.

Evans, S. and Lewis, R. (1989). 'Destructuring and de-regulation in the construction industry', in Tailby, S. and Whitstone, C. *Manufacturing Change. Industrial Relations and Restructuring*. Blackwell. Oxford.

Freedman, J. 2001. *Employed or Self-Employed? Tax classification and the changing labour market*. Tax Law Reform Commission Discussion Paper 1. Institute of Fiscal Studies. London.

Harvey, M. 1995. *Towards the Insecurity Society: The tax trap of self-employment*. Institute of Employment Rights. London.

Harvey, M. 2001. *Undermining Construction. The corrosive effects of false self-employment*. Institute of Employment Rights. London.

Harvey, M. 2003. 'Privatisation, Fragmentation and Inflexible Flexibilisation: The UK Construction Industry from the 1970s.' in Philips, P., and Bosch, G. *Building Chaos. An international comparison of construction industries*. Routledge. London. 188-209

Her Majesty's Customs and Revenue, *Are your workers employed or self-employed? – advice for contractors*. CIS leaflet 349 http://www.hmrc.gov.uk/employment-status/index.htm#1

Innovative Manufacturing Initiative. 2002. *Standardisation and Skills. Final Report*. University of Westminster. London.

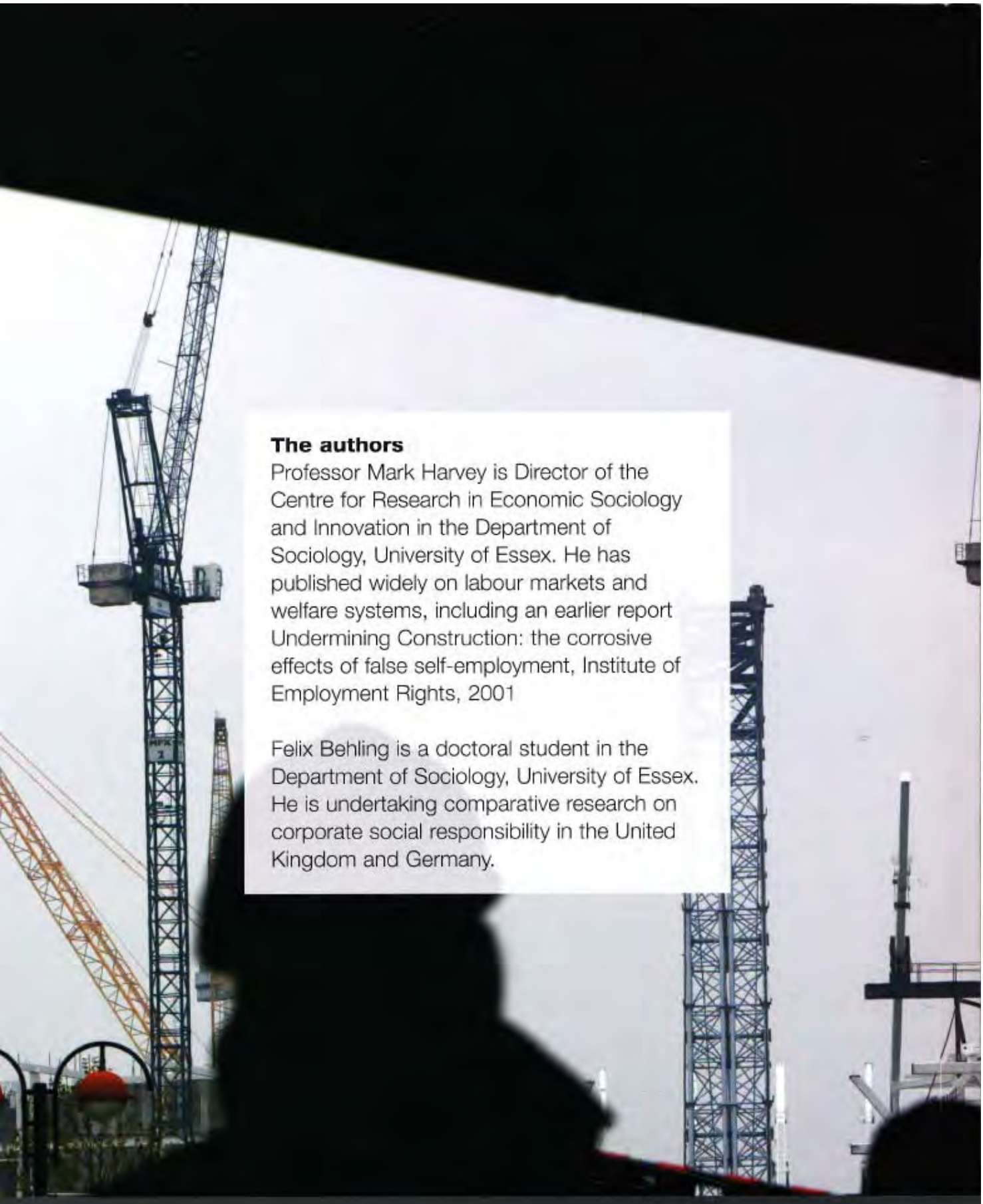
Peck, J. 2002. "Labor, Zapped/Growth, Restored? Three moments of neoliberal restructuring in the American labor market." *Journal of Economic Geography*.

Peck, J. and Theodore, N. 2001. "Contingent Chicago: Restructuring the spaces of temporary labor." *International Journal of Urban and Regional Research.*

OECD 2000. 'The partial renaissance of self-employment', Employment Outlook, 155-195.

Philips, P., and Bosch, G. 2002 Building Chaos. An international comparison of construction industries. Routledge. London. 188-209

Richter, A. (1998) ‘Qualifications in the German construction industry: stocks, flows and comparisons with the British construction sector’, *Construction Management and Economics*, 16, 5, 581-92.
Sainsbury, R., Finch, N., and Corden, A. 2006. *Self-employment and retirement*. Department of Work and Pensions, Research Report 395.
Wilkinson, F. 1983. ‘Productive Systems’, Cambridge Journal of Economics, 7, 413-429.



The authors

Professor Mark Harvey is Director of the Centre for Research in Economic Sociology and Innovation in the Department of Sociology, University of Essex. He has published widely on labour markets and welfare systems, including an earlier report Undermining Construction: the corrosive effects of false self-employment, Institute of Employment Rights, 2001

Felix Behling is a doctoral student in the Department of Sociology, University of Essex. He is undertaking comparative research on corporate social responsibility in the United Kingdom and Germany.

UCATT Head Office
UCATT House, 177 Abbeville Road, Clapham, London SW4 9RL
Telephone: 020 7622 2442 **www:** www.ucatt.org.uk **email:** info@ucatt.org.uk