



Race to the Bottom

**Sham Contracting in Australia's Construction Industry
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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.