

ABN ABUSE

THE RISE OF SHAM CONTRACTING

ACTU submission: Treasury consultation 'Government Response to the Black Economy Taskforce Report: Designing a modern ABN system'

Change
THE RULES

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Sham Contracting and Abuse of the ABN System

The use of sham contracting (i.e. the practice of disguising an employment relationship as one of principal and independent contractor), is a widespread problem across the Australia economy. To be an Australian worker in 2018 is to lack bargaining power, face stagnant wage growth and increasingly to be put on ABN as an independent contractor so your employer can avoid paying leave entitlements and superannuation. In relation to the ABN system, it remains clear that manipulation of ABNs facilitates and legitimises sham contracting, wage theft, and phoenixing by attempting to put the ABN holder outside of the reach of the PAYG system and the ambit of industrial legislation.

The problem is particularly acute in the construction and cleaning sectors. Whilst legitimate contracting arrangements occur across all industries, there is little doubt that many so-called independent contractors are in fact employees. Sham contracting not only undermines employment standards and gives law-breakers a competitive advantage over legitimate employers and those making use of bona fide contracting arrangements, it also has serious implications from public revenue. It has been estimated that almost \$2.5 billion per annum of tax revenue is lost in the construction industry alone through the abuse of sham contracting arrangements.

Abuse of the ABN system is a central feature of the sham contacting problem in several industries. The ATO estimated in 2013 that about 9% of all ABNs being relied on did not belong to the person using that number. Many jobs are still being advertised on the basis that having an ABN is a prerequisite even though the position is clearly to be fulfilled by an employee. There are also many thousands of multiple ABN holders and completely 'inactive' ABN's. Some employers distribute ABN's that they have obtained to their new employees. These practices further undermine the integrity of the current ABN system. Holding an ABN often means virtually nothing in terms of the capacity of the holder to conduct a lawful and legitimate business operation.

Key Recommendations

1. Initiate an audit of all ABN holders and terminate the numbers of ineligible holders.
2. Introduce tighter controls to ensure only eligible individuals are issued an ABN.
3. Introduce a fee for individuals applying for an ABN.
4. Restrict ABN eligibility for individuals on temporary work visas where there are demonstrated risks of exploitation through sham contracting, such as student visas and working holiday visas.

5. Restrict the use or impose more stringent criteria for the issue of ABNs in certain industries where there is a high incidence of sham contracting, such as construction, cleaning and security.
6. Require ABN holders to have to renew their ABNs periodically and demonstrate that they are conducting a genuine business operation.
7. Ensure that the 'principal' who engages so-called contractors is ultimately responsible for the remittance of PAYG tax deductions for workers engaged in a sham contracting arrangements and pursue recovery actions against those entities, including in appropriate circumstances, director penalty notices.

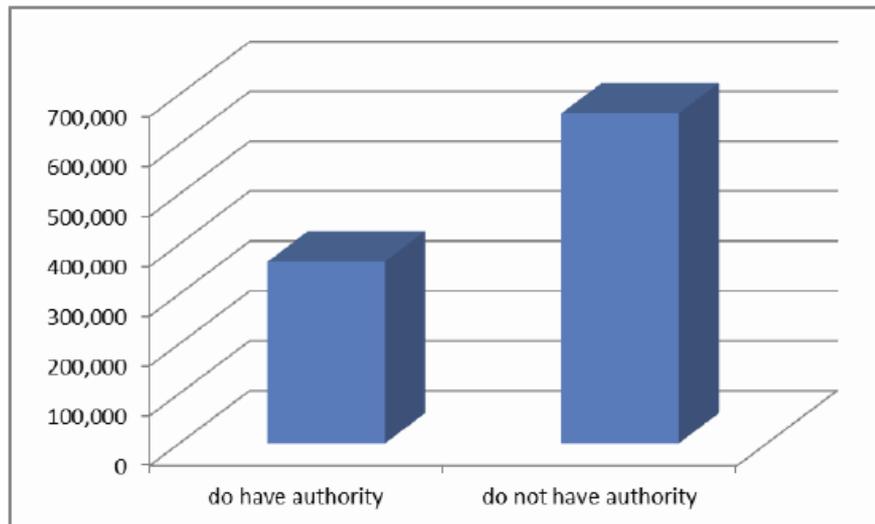
“Independent” contactors and disguised employment relationships

Data from the ABS would suggest there are over 1 million “independent contractors” in Australia. Nearly one third of them are engaged in the construction industry. In fact, the CFMEU have suggested that between 26% and 46% of so-called independent contractors in their industry are engaged on sham contracts. The construction industry has historically been a sector that uses a large number of contractors. These include both genuine independent contractors and “sham” contractors who should be classified as regular employees. In recent decades the use of so-called independent contractors has increased significantly in other sectors of the economy including the public and private sectors. One example of this trend is the professional, scientific and technical services industry which is now the second largest employer of “independent contractors” with roughly 16% of all contractors operating in this sector.

However, a large proportion of the workers that fall into this category are not really “independent”. Many of them are economically dependent on a single employer and have limited discretion over when or how they work. In many cases these bogus contractors work alongside regular employees doing the same or similar tasks and even using tools, equipment and other inputs supplied by the same employer. One key difference between a genuine independent contractor and a regular employee is the level of control or independent authority the person has over the performance of their work.

The classic example of a genuine independent contractor would be the tradesperson who has established their own micro enterprise, who undertakes work for different and multiple clients from one week to the next, supplies their own tools and materials and can make decisions about the work schedule and work methods without instructions from a supervisor. It is evident from data compiled by the ABS that a majority of workers currently classified as “independent contractors” would not meet the above-mentioned criteria. In fact, a massive 64 % of people who are classified as “independent contractors” indicated they do not have authority over their own work.

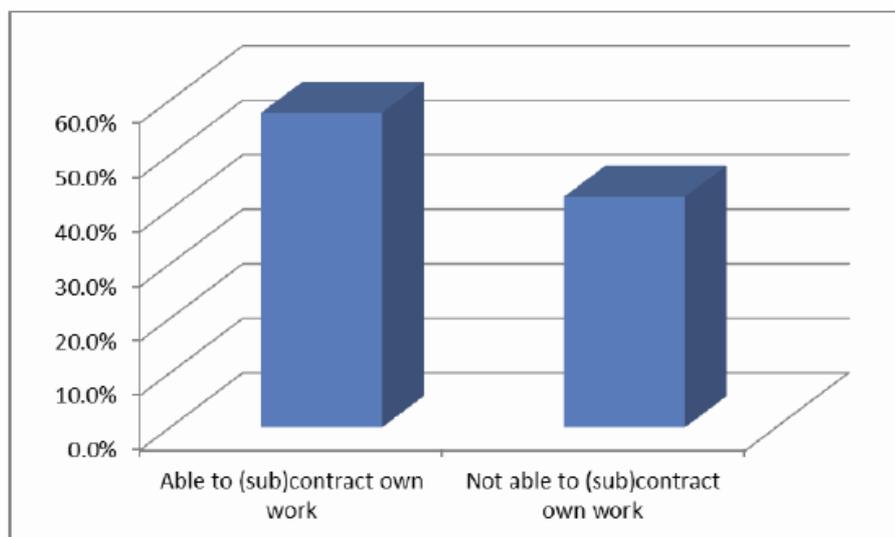
Figure: Proportion of persons classified as “independent contractors” who reported they do not have authority over their work



Source: 6333.0 Characteristics of Employment ABS August 2016, released May 2017

If an independent contractor does not have authority over their work, (and are actually economically dependent on one employer), then this is a significant indicator that they are in fact employees and entitled to all the benefits and rights that accrue to other permanent employees they work alongside. A similar test of whether a contractor is truly independent or bogus is the ability to sub-contract out work they are engaged upon. As can be seen in Figure below roughly 40% of so-called independent contractors report that they are not allowed to sub-contract out work.

Figure: Proportion of persons classified as “independent contractors” who reported they are not able to sub-contract out own work



Source: 6333.0 Characteristics of Employment ABS August 2016, released May 2017

The problem of using sham or bogus contactors to disguise what should be a regular employment relationship has expanded considerably in recent years. In 2011 ABS data indicated there were 406,200 people classified as “independent contractors” who claimed they had no authority over their own work. This represented about 40% of all so-called independent contractors. By 2016 this ratio had increased to 64%. That is a very rapid increase in just 5 years. This casts serious doubt over the “independence” of almost two-thirds of all workers now classified as “independent contractors”.

Sham contracting arrangements are an attempt to deny workers the protection provided by labour laws and institutions like the Fair Work Commission and trade unions. They also seek to place workers beyond the reach of basic industrial standards such as the minimum wage and annual leave, sick pay, superannuation, or other benefits that are considered standard provisions in a country as wealthy as Australia. Instead these people must try and extract a fair deal for themselves from their much more powerful employers on the basis of commercial law.

They are unable to collectively bargain and attempting to do so can lead to them falling foul of laws designed to prohibit price fixing among companies. Many are forced to assume responsibility for expenses such as insurances, including workers’ compensation, that should properly be borne by the employer. Needless to say most of them end up failing to get a fair deal and are exploited.

There are also impacts beyond the immediate exploitation in the sham arrangement between the business and the worker. Where the business is transferred, and the employment is transferred, the new owners can be blindsided by sham contracting arrangements, which crystallise employee entitlements post-transfer without them being forewarned. The impacts of the sham contracting deceit reverberate beyond the immediate parties to the sham arrangement.

In fact, government authorities have recognized that bogus or sham contracting strategies are widespread. For example, in the past the Fair Work Ombudsman has called particular attention to such practices in cleaning services and call centres. Nevertheless little action has been taken to reverse these trends. The ACTU fears that this trend towards bogus or sham contracting will continue in the coming decades unless the Federal Government reforms our workplace laws and makes specific changes to the ABN regime.

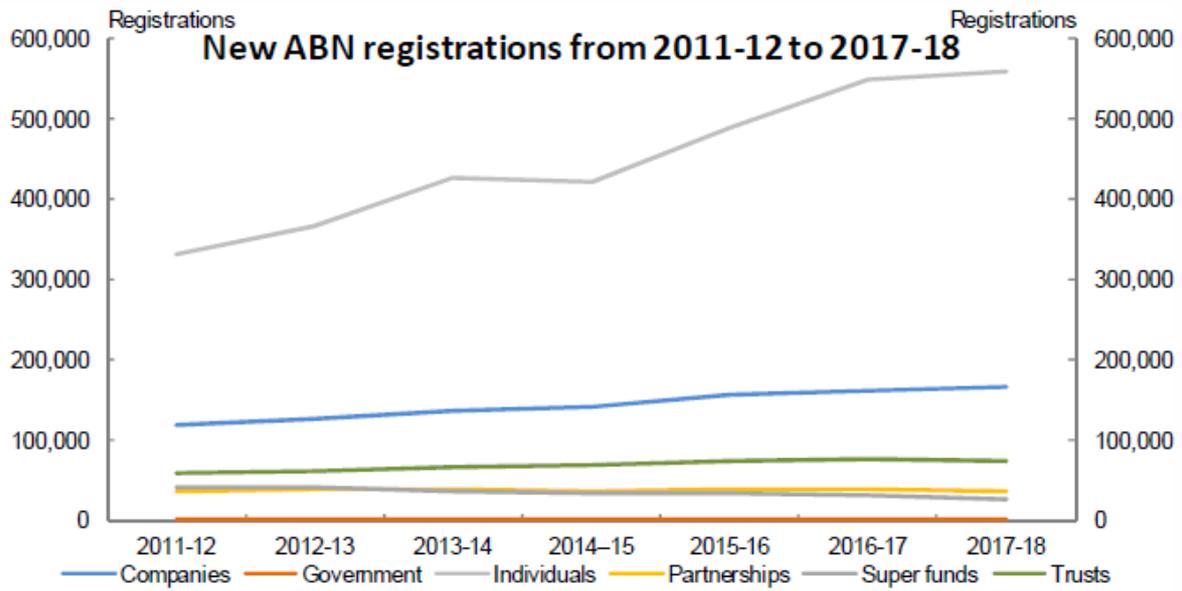
Recognition of a growing problem

The Treasury consultation paper 'Tackling the Black Economy Designing a modern Australian Business Number system Consultation paper' does recognise sham contracting and misuse of the ABN system as a growing problem.

'The Taskforce expressed concern that not everyone obtaining an ABN is entitled to one. Some of the examples provided to the Taskforce included:

- Applications for multiple ABNs and the establishment and use of multiple corporate entities over time for what is essentially the same enterprise, to facilitate avoidance of employee, creditor, consumer and tax obligations (referred to as phoenixing);
- Individuals working as employees (and not entitled to an ABN) but applying for ABNs ostensibly as independent contractors, often due to a demand from their employer (referred to as sham contracting).
- This allows the employer to avoid responsibility for employee entitlements, thereby reducing their labour costs and potentially offering the employer an advantage over their competitors.
- Individuals incorrectly obtaining an ABN when not entitled to them to avoid the 'no ABN withholding' rules.
- Individuals not carrying on an enterprise and therefore not entitled to an ABN obtaining an ABN in order to register for GST and fraudulently claim GST input tax credits'

Interestingly the graph below in the Treasury document shows the number of new ABN registrations from individuals rising significantly from 2011-12 to 2017-18 and the paper states 'the sharp increase in individuals applying for an ABN raises the question whether the ABN entitlement rules remain appropriate'.



The dramatic rise in the number of individual ABN's concurs with the unions movement's experience on the ground that sham contracting is a widespread problem. Significant reforms as to how the ABN system is managed are desperately needed.

Workers at great risk of exploitation should not be eligible to hold ABN

Particular workers are at greater risk of exploitation ABN misuse. The following categories of temporary residents should not be eligible to hold ABNs:

- persons on working holiday / tourist visas including people holding subclass 417 (Working Holiday) or subclass 462 (Work and Holiday) visas; and student visa holders.

These categories of workers are known to register for ABNs and take part in sham contracting. Many are compelled by their employers who make ABNs a condition of engagement. They remain eligible for ABNs.

There are strong policy considerations which weigh in favour of restricting eligibility for ABNs where the risk of involvement in sham contracting is high. In high risk industries like construction, there is no reason why people on these types of visas should legitimately require ABNs. In fact, the availability of ABNs has led to widespread practices whereby unscrupulous labour hire firms have required, or actually organised, ABNs for backpacker or student workforces on high-rise construction sites. In addition to the obvious facilitation of sham contracting arrangements, the easy availability of ABNs has also led to increased safety risks which not only put overseas workers and students at greater risk, but also undermine the safety of the industry as a whole.

To prevent continued OHS abuses, sham contracting and wage theft:

- work holiday visa holders should not be entitled to hold ABNs, and must be engaged directly by an employer;
- student visa workers must not be entitled to hold an Australian Business Number and must be engaged directly by an employer, not a labour hire provider.

There is precedent for the screening of certain categories of workers from ABN eligibility. The ATO ABN tool has for a number of years denied ABN access to workers such as apprentices and general labourers whose working arrangements cannot align with genuine independent business operations.

The level of sham contracting and wage theft amongst temporary visa holders is dramatic. Audits of foreign-language job advertisements conducted by Unions NSW in 2016 and 2017 reveal 'endemic' levels of below-Award cash-in-hand jobs being promoted to temporary migrant workers, with the large levels of wage theft and tax evasion occurring in the hospitality and cleaning

industries. According to the Lighting up the black market – enforcing minimum wages report, 97% of hospitality jobs were below Award minimums, and the average advertised rate was \$13.60/hour - \$5.79 below the Award. In turn, 65% of audited cleaning jobs advertised wages below the minimum Award rate of \$18.66/hour. These findings are consistent with previous research conducted by Monash University and Fairfax, which found that 80% of foreign language job advertisements offered below the award or minimum rate of pay, with many being openly advertised as 'black jobs'.

Recent research from Melbourne Law School found that 75% of businesses think the risk of getting caught by the Fair Work Ombudsman (FWO) for underpaying workers is '50/50 or higher'; and 21% think it is either 'unlikely' or 'highly unlikely'. Worker exploitation is currently a low-risk business decision due to insufficient enforcement, and inadequate scrutiny and deterrence measures. That is why reforms to tackle wage theft must be extensive – please see the full ACTU submission to the Black Economy Taskforce 'The Shadow Economy: A Story of Wage Theft Tax Avoidance & Exploitation' for more information.

Restrict the use of ABNs in certain industries where there is a high incidence of sham contracting

There has been a high incidence of sham contracting in several industries including construction, cleaning and security. The Government should not only initiate an audit of all ABN holders and terminate the numbers of ineligible holders but implement a more rigorous process for the issuing of ABN's in industries where there is a high incidence of sham contracting.

Obtaining and Maintaining an ABN

The ACTU supports the proposal that ABNs should be renamed Australian Business Licences (ABLs), and that applicants should be required to demonstrate by declaration that they are in fact operators or proposed operators of a business 'fit and proper persons' to hold a licence, including by providing relevant information such as:

- the nature of the proposed business or undertaking;
- ownership of previous businesses;
- previous bankruptcies;
- directorships of previous companies that have entered into liquidation or external administration;
- directorship disqualifications; and
- outstanding court or tribunal orders against the applicant or any entity owned/operated by the applicant

An ABN applicant should also be required to do basic business modules in the Business Services Business Training Package (or equivalent). This would be reasonable as other occupations are required to conduct training program to perform their duties.

For example, an electrical contractor licence which allows a person to be a sole trader electrician must have various qualifications. A qualified business person for an electrical contractor licence must prove the following:

- must be competent to perform the business aspects of performing electrical work, and
- must have completed the following units of competency within the last 3 years:
 - UEENEEE101A - Apply Occupational Health and Safety regulations, codes and practices in the workplace

- UEENEEG175A - Develop compliance policies and plans to conduct an electrical contracting business,
and either
 - BSBSMB401A - Establish legal and risk management requirements of small business (within the last three years), or
 - a business qualifications of diploma level or higher (e.g. Bachelor of Business) regardless of the time of completion, or
 - a course of instruction equivalent to BSBSMB401 (within the last three years).
- OR

ABN applicants should also be required to demonstrate their capacity to perform the necessary paperwork i.e.

- Proof of access to an accounting / invoicing system; and / or
- Name their accountant; and / or
- Explain how they will fulfil their business obligations etc

Furthermore, given the nature of workplace exploitation and sham contracting the Government should consider penalties for companies who “force” workers onto ABN.

Australian businesses would also benefit from a public awareness campaign advising the community about the rising number of ABN registrations and the ATO’s audit of ABN holders. It can also warn the community of the impact of the audit which will affect ABN holders as well as those business who require employees to have ABNs, when they are not legitimate independent contractors. The campaign can also set out the key characteristics of sham contracting, which the ATO uses when cancelling ABNs.

ABN's held by individuals should be subject to annual renewal processes

ABNs – particularly those held by individuals – should be subject to annual renewal processes, including by the holder providing a statutory declaration confirming the nature and legitimacy of their commercial enterprise. Prompts should be provided, at this stage, to make it clear that occupations at particular risk of sham contracting are required to work under the direction, control and supervision of their employer and as such they are considered employees for taxation and superannuation purposes and not entitled to an ABN.

Enforcement

We agree with the observation in the Black Economy Taskforce's Final Report that more needs to be done for employees, some of them visa holders, who find themselves trapped in sham contracting arrangements. These people should be encouraged to come forward, and if appropriate, benefit from an amnesty.

It should otherwise be a strict liability offence where:

- someone applies for an ABN on behalf of an individual, associate or an individual with an ABN entity, without the individual's consent;
- an entity seeks to coerce or mislead an individual to incorrectly apply for an ABN, or an entity seeks to suggest or incite an individual to set up an interposed entity to which payments are made in order to avoid employer obligations;
- an entity seeks to require another entity to have an ABN as a condition of gaining work where the work involves a contract of service; and
- offenders should additionally be precluded from obtaining an ABN, and have existing ABNs cancelled.

We note that section 8K of the Taxation Administration Act 1953 (Cth) provides a range of penalties for multiple offences under s8C, which includes giving incorrect information in respect to an ABN application. The ACTU is not aware of any prosecutions having been brought in relation to ABN offences. We continue to call for the ATO to initiate and publicise a number of prosecutions involving alleged breaches of the legislation dealing with providing false information for the purposes of obtaining an ABN.

Case study: Cleaners on sham contracts

One of Australia's largest listed companies, Spotless, is allegedly implicated in underpayments of some of the lowest-paid workers in Australia¹.

The case argues that Spotless was an accessory with a third-party contractor in a scheme primarily designed to defraud 58 Myer cleaners of wages and entitlements.

Cleaners working in Myer in Melbourne had their wages, penalty rates, leave entitlements and superannuation stolen from them in a bold-faced scheme to pay workers a flat rate of \$20 an hour – well below award rates of pay and conditions.

Spotless held the cleaning contract with Myer. But Spotless sub-contracted some of its Myer cleaning through a smaller contractor, INCI Corp. In turn, INCI Corp underpaid its workforce, and engaged cleaners on sham ABN contracts.

The case demonstrates that rather than a “few bad apples” scenario, the culture of wage theft and sham contracting extends to mainstream commercial activities. Given the strength of the case, our affiliate United Voice is confident it will successfully argue for a significant range of penalties to be payable by Spotless.

Workers were asked to sign documents at the flat hourly rate showing they were “subcontractors” of INCI Corp.

While cleaning the stores, the cleaners wore Spotless uniforms with Spotless insignia and used equipment and cleaning products supplied by INCI Corp.

In response to what it sees as unfettered corporate greed, United Voice has launched landmark legal action in the Federal Court that alleges “accessorial liability” on the part of Spotless. The Union is confident that the case will reveal the lengths major listed companies go to in avoiding meeting their legal requirements to pay fair wages to workers.

¹ <https://www.theaustralian.com.au/national-affairs/1m-penalty-sought-for-spotless-contracting-pay-scam/news-story/e1c22d53b271a3624fad3f651687111f>

Conclusions and Policy recommendations

There is growing problem of sham contracting and misuse of the ABN system. The ACTU recommends following reforms to stop worker exploitation and loss of government revenue to the ABN system;

1. Initiate an audit of all ABN holders and terminate the numbers of ineligible holders.
2. Introduce tighter controls to ensure only eligible individuals are issued an ABN.
3. Introduce a fee for individuals applying for an ABN.
4. Restrict ABN eligibility for individuals on temporary work visas where there are demonstrated risks of exploitation through sham contracting, such as student visas and working holiday visas.
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