

**CFMEU Submission to**

**Australia's Future Tax System Review**

**October 20 2008**

A handwritten signature in black ink, appearing to read 'John Sutton', written over a light grey rectangular background.

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## **Executive Summary**

- The Australia's Future Tax System Review Panel (the "Review Panel") has sought comments on problems with the current tax-transfer system.

### ***Background***

- Internationally Australia ranks lowly in terms of tax collected and public social expenditure.
- Since WWII wage and salary earners have increased their tax contribution as a percentage of GDP from 7% to around 12%.
- While for this same period the corporate tax contribution has remained around 3% of GDP rising only recently to about 5.5% but forecast to fall back to around 4%.
- Simultaneously corporate profits have risen to record highs as a percentage of GDP, labour productivity is at record highs, while wages as a percentage of GDP have fallen to record lows.
- The goods and services tax introduced in July 2000 is judged by an OECD study to have resulted in the '*poor getting poorer, the rich getting richer and the gap between the rich and poor widening*'.
- The public supports higher spending on health, education and the aged.

### ***Long Term Forecasts***

- The Australian Government predicts a fiscal gap of 3.5% of GDP by 2046-7.
- Expenditure on health, aged care and pensions will drive this gap.

### ***Key Principles of a Good Tax System***

- Australia's future tax system should be designed to ensure that taxation revenue is sufficient to meet social needs over the long term, based on the following principles;
- equity;
- transparency;
- durability;
- simplicity.

### ***Some Proposals for Increasing Tax Revenue and/or Closing Down Tax Rorts***

- The CFMEU view is that ordinary wage and salary earners are contributing more than their fair share to revenue and the looming fiscal gap should be funded through increased contributions by corporations, high income individuals and the closure of various tax loopholes.
- In this context the CFMEU recommends reform in the following areas;

- 1) Capital Gains Tax;
  - 2) Debentures;
  - 3) Company Tax Rates & Top Marginal Tax Rates;
  - 4) Superannuation;
  - 5) Death Duties;
  - 6) Family Trusts;
  - 7) Phoenix Companies;
  - 8) Negative Gearing in the Rental Market;
  - 9) Demerger, Merger & Acquisition Activity;
  - 10) Mineral Royalties;
  - 11) Fringe Benefits Tax Concessions on Work Vehicles.
- Addressing the effective high marginal tax rates of those marginally attached to the workforce.
  - The CFMEU also recommends that the tax system be reformed to stop bogus contractors, as discussed below.

### ***The Impact of Bogus Contracting on the Tax-Transfer System***

- The easy access to Australian Business Numbers (ABNs), combined with inadequacies in the taxation law dealing with the alienation of personal services income and insufficient compliance effort, is a significant problem with the current tax-transfer system.
- It is too easy to obtain an ABN and this is facilitating employment relationships being restructured as dependent contractors when the parties are really in an employer/employee relationship.
- The CFMEU is aware that apprentices, 457 Visa workers and backpackers are obtaining ABNs. The Cole Commission also found that ABNs are being misused to justify the treatment of persons who hold Australian Business Numbers but who are employees, as contractors

### ***Problems with Taxation Legislation***

- The current tests for establishing a personal services business incorrectly focus on establishing that a business exists, rather than proving that it is not a relationship of employment.
- The current tests are easy to satisfy and seriously undermine the ability of the legislation to curtail the significant tax avoidance that currently exists.

### *Cost to Society*

- The cost to society of sham contractual arrangements in the workplace facilitated by easy access to ABNs and the ability to alienate personal services income is very high.
- Having lax laws which enable individuals to understate their taxable income lowers the amount of tax paid (thus pushing the tax burden to others) and increases the eligibility of such individuals to income-tested government benefits (thus undermining the tax-transfer system).
- Sham contractual arrangements may not result in the best allocation of resources in the economy if it allows labour costs to be lowered and the prices of more efficient providers of services to be undercut. This is a serious distortion of competition.
- Workplace entitlements and protections and superannuation are also commonly lost in the arrangements where employees are purported to be dependent contractors. This too ultimately diminishes economic efficiency, as it transfers costs away from those who should be responsible for them to the wider community.
- It is inequitable that income derived in respect of personal services in an employee-like manner is treated in a different manner for income tax purposes to income actually derived by an employee.

### *Building and Construction Industry*

- The use of dependent contractors is particularly prevalent in the building and construction industry.
- The Building and Construction Industry Forum, established pursuant to a recommendation of the Cole Commission to assist in reducing tax avoidance in the industry, needs to be more active and give greater focus to dealing with the particular issue of dependent contractors.

### *Recommendations for Addressing Problems with Bogus Contractors*

- The CFMEU recommends that:
  - 1) the issuing of ABN's be constrained and that successful applicants be required to demonstrate through tangible evidence that they are operating a business. It should not be possible for apprentices, backpackers, 457 visa workers and workers doing general labouring to obtain an ABN;
  - 2) the penalties for making false declarations in order to obtain an ABN be substantially increased for both individuals and their advisers;
  - 3) the ATO be directed to undertake and publish analysis investigating whether the legislation in relation to the alienation of personal services income introduced as part of the New Business Tax System has raised the revenue estimated at the time and is more effective than the system it replaced;

- 4) the Government amend the existing legislation with respect to the alienation of personal services income to strengthen the provisions in line with that recommended in the Ralph Review;
- 5) the terms of reference for the Building and Construction Industry Forum be amended to increase the focus on dependent contracting arrangements and on improving tax compliance; and
- 6) the Building and Construction Industry Forum be chaired and led by a senior member of the Australian Taxation Office.

## **Introduction**

This submission of the Construction, Forestry, Mining and Energy Union, (CFMEU) is made on behalf of all three divisions of the CFMEU namely the Mining and Energy (M&E) Division, Forestry and Furnishing Products Division (FFPD) and the Construction and General Division (C&G). We represent approximately 110,000 members in these industries.

The CFMEU has had a long term interest in taxation policy. We are concerned to ensure our taxation system is equitable and generally operates in a way that promotes the living standards of the working people we represent.

We have a particular concern that the tax-transfer system is open to abuse through the use of bogus contracting mainly centred in the construction industry hence our focus on this issue in the last section of this submission.

This submission is made up of four sections.

The first section '**Background**' looks at where taxation revenue has come from post WWII and then looks at the Australian Government's projections for economic and demographic trends over the next forty years.

The second section sets out '**Key Principles of a Good Tax System**' that we believe should frame the design of Australia's taxation system.

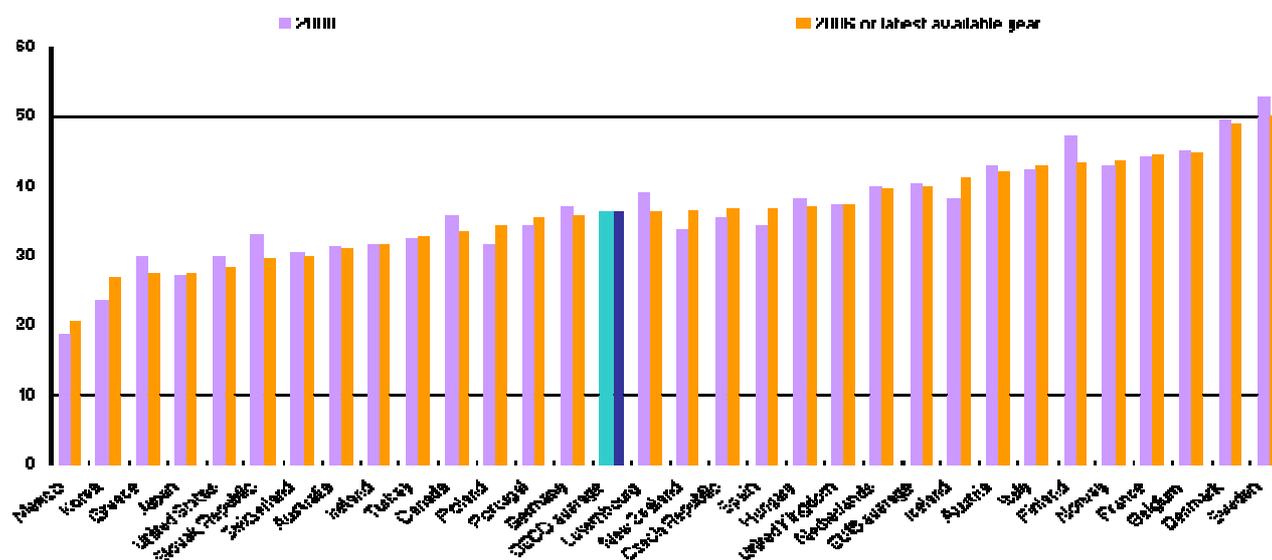
The third section '**Some Proposals for Increasing Tax Revenue and/or Closing Down Tax Rorts**' suggests ways to apply our principles practically to strengthen revenue for social expenditure and to provide for greater taxation equity.

The fourth section '**The Impact of Bogus Contracting on the Tax-Transfer System**' looks in detail at the issue of dependent contractors and their consequences for the tax-transfer system.

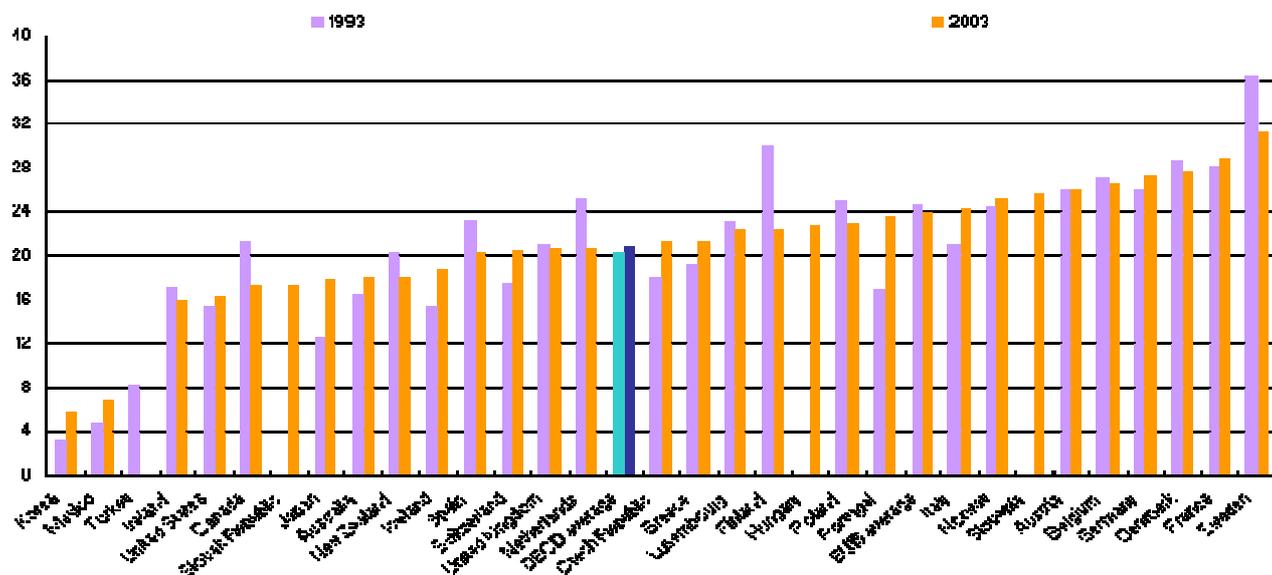
## Section One - Background

### The International Context

- Looking at OECD statistics<sup>1</sup> in the chart below shows that Australia not a high taxing country, ranking eighth lowest out of the OECD group of 32 countries, with the 2000 to 2006 trend on a downward trajectory.



- Similarly the following OECD chart also shows that Australia does not rank highly in terms of public social expenditure as a percentage of GDP also ranking eighth lowest, although here the trend is moving in a positive direction.

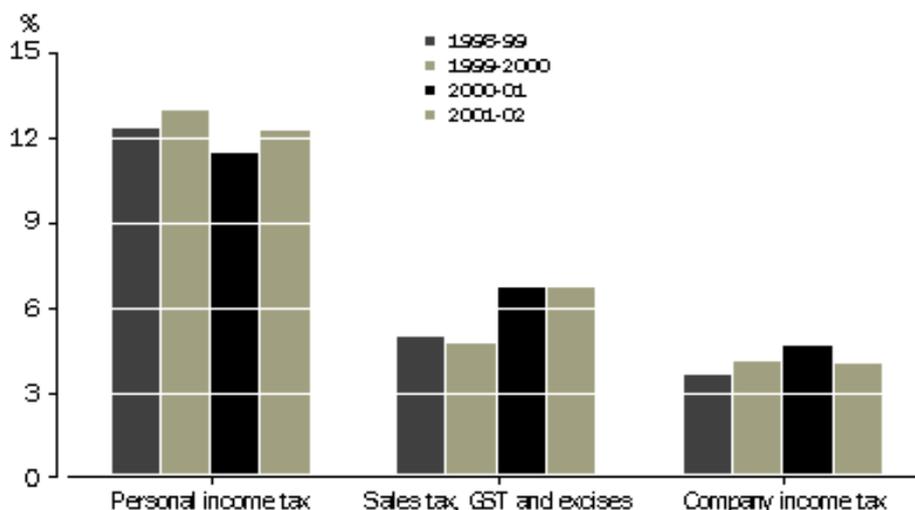
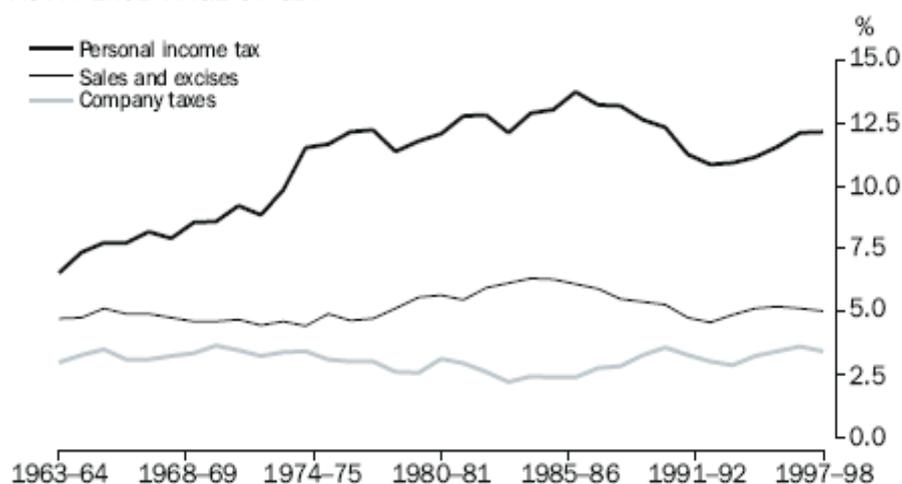


<sup>1</sup> OECD Factbook 2008: Economic, Environmental and Social Statistics

## Revenue & Income Received Over Time

3. The following ABS<sup>2</sup> charts give an historical overview of taxation receipts and the relative contribution of individuals and corporations. Clearly over the long term the amount contributed by individuals has greatly increased whilst company taxes have hardly moved as a percentage of GDP. The ABS ceased to produce charts and figures that show personal and company income tax revenue as a percentage of GDP after 2001-02, however the following Access Economics<sup>3</sup> charts confirm these trends.

COMMONWEALTH GOVERNMENT REVENUE  
AS A PERCENTAGE OF GDP



<sup>2</sup> ABS 5506.0 Taxation Revenue 1997 -1998 & 2001-02

<sup>3</sup> Access Economics Budget Outlook 2006

Chart 30: Taxes on individuals (as a share of GDP)

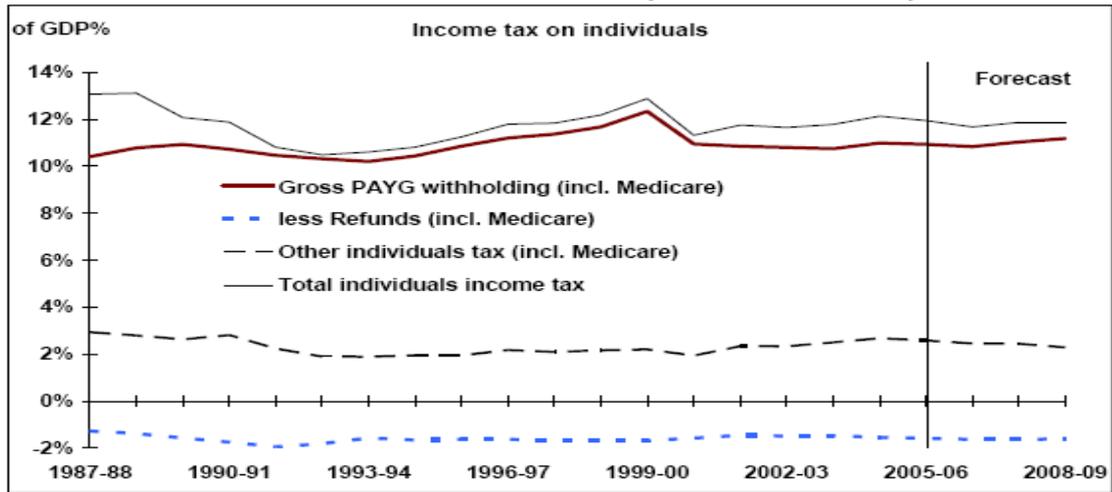
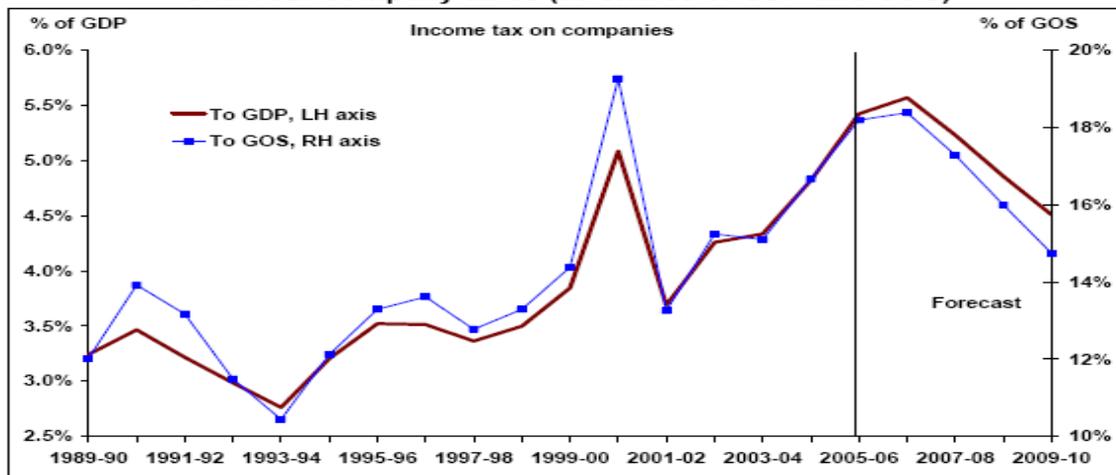
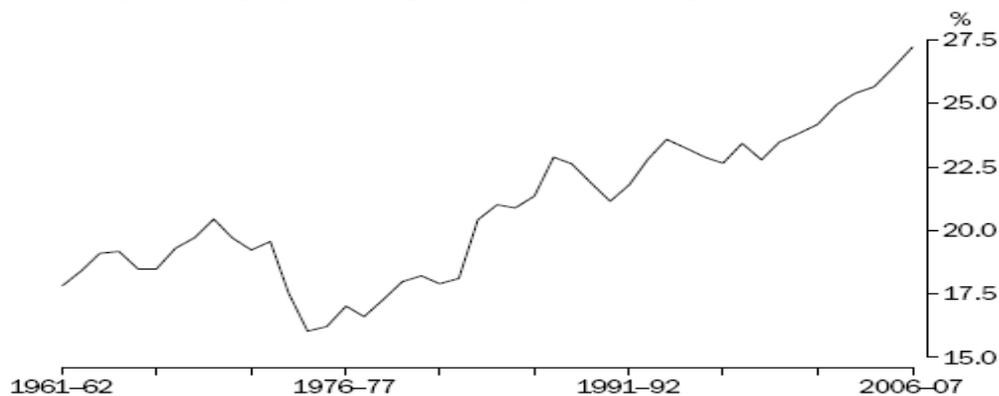


Chart 32: Company taxes (as shares of GDP and GOS)



4. These trends are further confirmed in Reserve Bank of Australia (RBA) statistics<sup>4</sup> which show the same pattern extending back to the year 1949-50. This pattern has occurred despite the overall growth in corporate profitability and fall in the wages share of GDP since the mid 1970s as the next two charts<sup>5</sup> show.

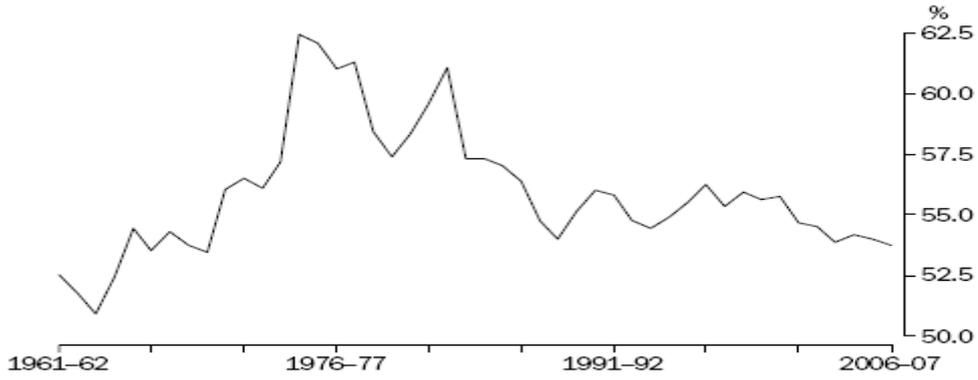
PROFITS SHARE OF TOTAL FACTOR INCOME



<sup>4</sup> <http://www.rba.gov.au/Statistics/OP8ExcelFiles/2-17.xls>

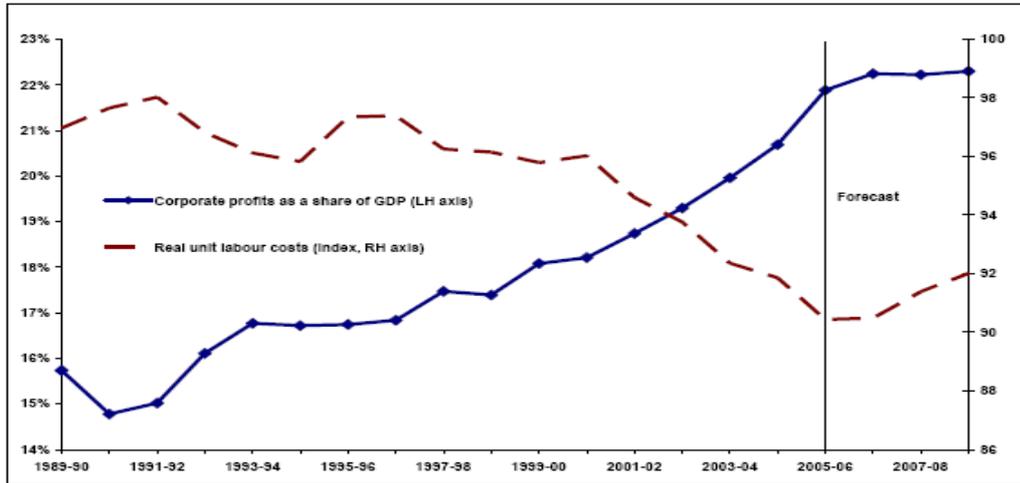
<sup>5</sup> ABS 5204.0 Australian System of National Accounts 2006-07

WAGES SHARE OF TOTAL FACTOR INCOME

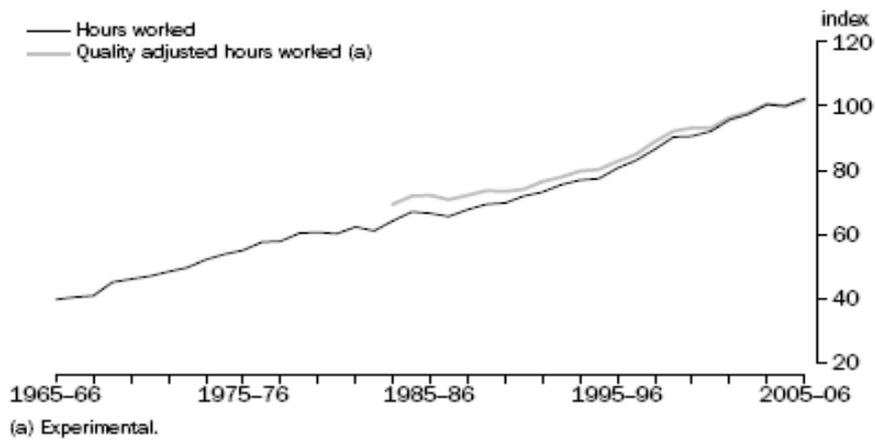


This process is further demonstrated over the last twenty years in the next two charts<sup>6 7</sup> showing real unit labour costs declining with productivity and profits increasing.

Chart 17: Capital and labour cross paths



LABOUR PRODUCTIVITY, (2004-05 = 100.0)



5. As Access Economics bluntly puts it<sup>8</sup>;

<sup>6</sup> Access Economics Budget Outlook 2006

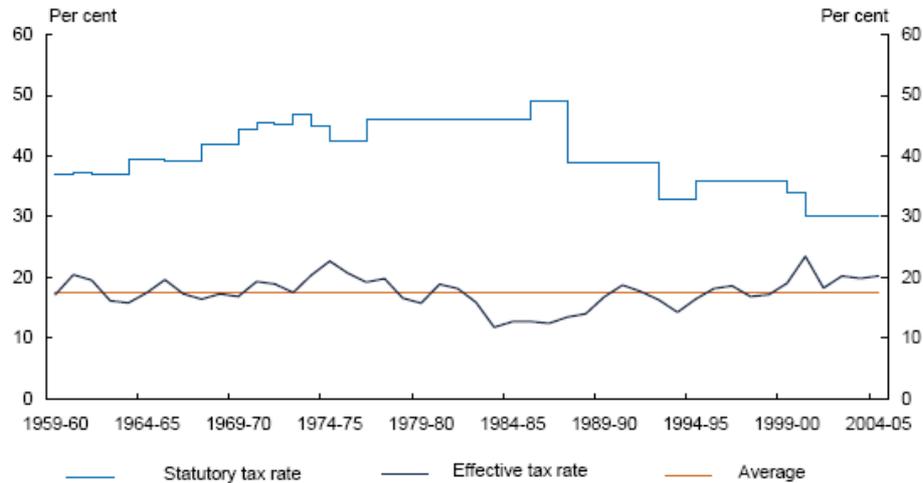
<sup>7</sup> op.cit.

*Australia has achieved a degree of additional labour market flexibility since the early 1990s. That process seems to have permanently boosted the profit share at the expense of the wage share.'*

6. Another way of looking at corporate tax revenue is to consider the statutory versus actual tax rates for corporations as the next chart<sup>9</sup> shows.

International comparison of Australia's taxes

**Chart 5.4: Statutory and effective corporate tax rates<sup>(a)</sup>**  
Australia, 1959-60 to 2004-05



(a) Pre 1974-75 there were separate tax rates for public and private companies. The chart is based on an average of the two rates.  
Source: Australian Treasury estimates.

7. It is interesting to see that the effective corporate tax rates bear little relation to the movements in the statutory rates.
8. The picture is clear, workers have nearly doubled their contributions to general revenue as a percentage of GDP, increased their productivity, reduced unit labour costs, and their wage share of GDP has declined nearly 20% since the high point in the mid 1970s, whilst corporate taxation contributions as a percentage of GDP have barely increased. In addition it is also necessary to consider the regressive effects of the goods and services tax (GST) as we do next.

<sup>8</sup> Access Economics Budget Outlook 2006

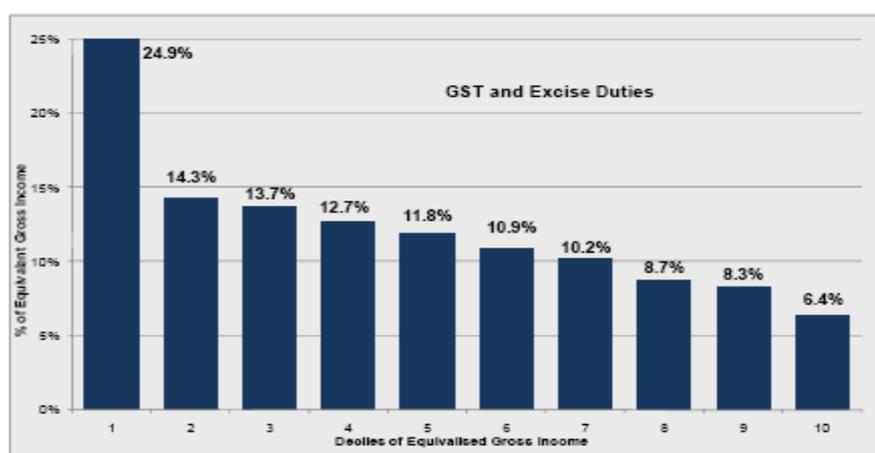
<sup>9</sup> Australian Treasury Estimates

## Consumption Taxes

9. A 2008 OECD<sup>10</sup> study on the effects of the introduction of the GST introduced in July 2000 revealed the following about its regressive effects;

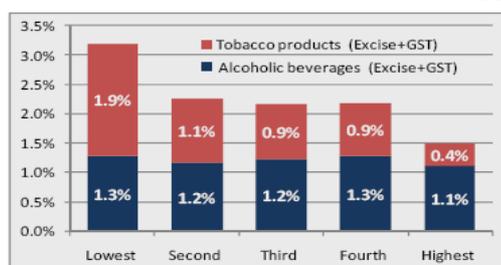
*Figure 9 (panel b) shows the findings for GST and Excise duties across deciles of equivalised individuals ranked by gross income. The impact of these taxes on the lowest decile is nearly four times that for the highest decile: when adjusting the results to quintiles, the experience for the lowest quintile is around 2.5 times as high as that for the highest quintile.*

### b. Australia 2001-02

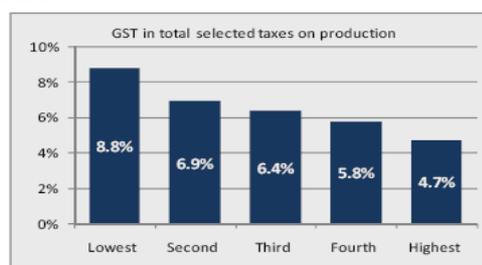


Source: Harding, Lloyd and Warren (2005), Figure 1

### c. Australia 2003-04



Source: ABS 2006, Cat No 6537.0 2003-04, Table 5



10. While the overall effect of the GST has been regressive it is worth noting that its introduction has at least increased the absolute amount of tax paid by the wealthy. Although their consumption of goods and services as a percentage of their income is less than low income earners their absolute expenditure on goods and services is much higher in dollar terms.

11. However as this OECD study concludes in the quote below their overall effect is still regressive and this fact must be taken into account in designing Australia's future tax system;

<sup>10</sup> OECD Social, Employment and Migration Working Papers No.64: A Review of Studies on the Distributional Impact of Consumption Taxes In OECD Countries, Warren, N (2008).

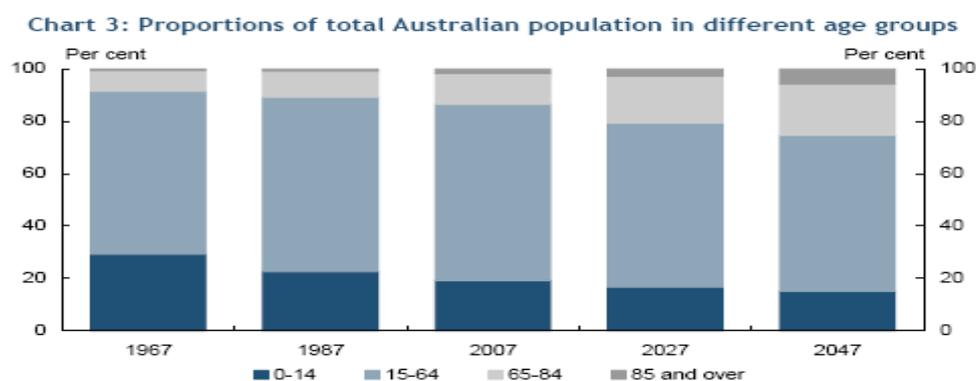
*In general, the income share of the 1<sup>st</sup> decile relative to that of the 5<sup>th</sup> decile falls moderately with the inclusion of consumption taxes, while the share of the 9<sup>th</sup> decile relative to the 5<sup>th</sup> increases much more significantly. At its simplest, the inclusion of consumption taxes results in the ‘poor getting poorer, the rich getting richer and the gap between the rich and poor widening’.* (Our emphasis)

## Forecast Projections Relevant to Revenue

12. The Australian Government’s second Intergenerational Report<sup>11</sup> in 2007 (IGR) gives a good indication of the demographic trends that Australia will be facing until 2047. These two charts below show the dimensions of the challenges facing the taxation system.



Source: Australian Bureau of Statistics data and Treasury projections.

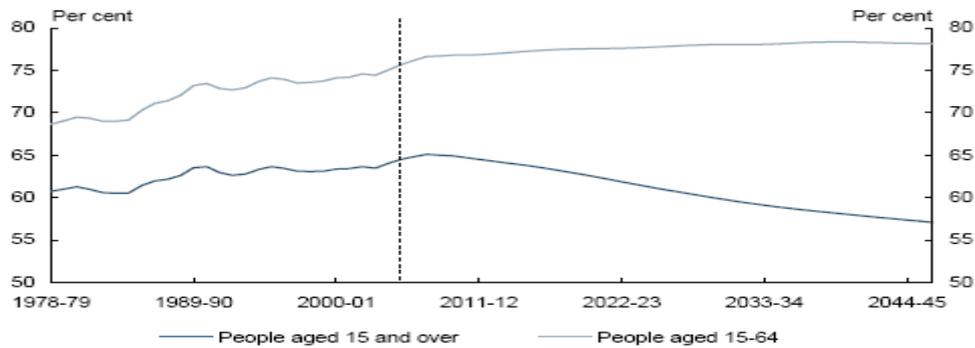


Source: Australian Bureau of Statistics Historic Australian Population Statistics 3105.0.65.001 Table 19 and Treasury projections.

Although the population of working age Australians is projected to grow by over 20% in this period, as a proportion of the population it is projected to decline by 8%. This will have implications for participation rates as the IGR shows in the following chart.

<sup>11</sup> Australian Treasury, Intergenerational Report, 2<sup>nd</sup> Edition, 2007.

Chart 4: Historic and projected labour force participation rates

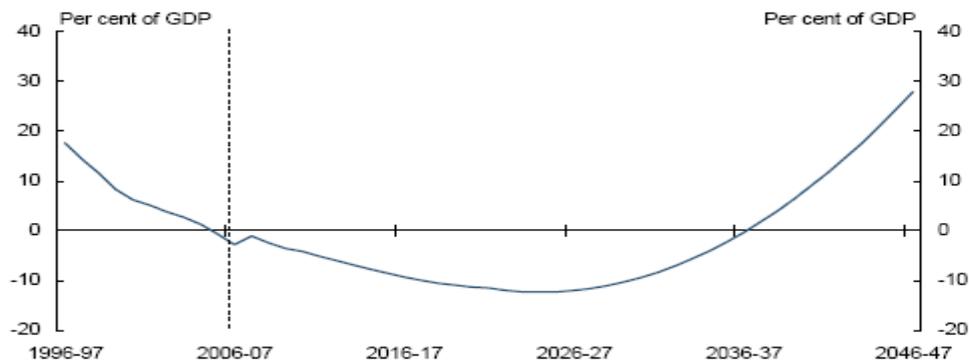


Source: Australian Bureau of Statistics data and Treasury projections.

13. So participation for those aged 15 and over is on a downward slope with only the increased participation by older workers 65+ holding the rate up.

14. As the chart below shows the projected path of net debt has it falling until the middle of the 2020s and then sharply rising after that.

Chart 8: Projected path of net debt



Note: The projections of net debt include net interest payments. The small increase in Australian Government net debt in 2007-08 reflects the expected change in the financial asset composition of the Future Fund as it moves towards a portfolio allocation consistent with the benchmark return specified in the Australian Government's investment mandate.  
Source: Treasury projections.

The RBA<sup>12</sup> sums up the challenge ahead well in the following quote;

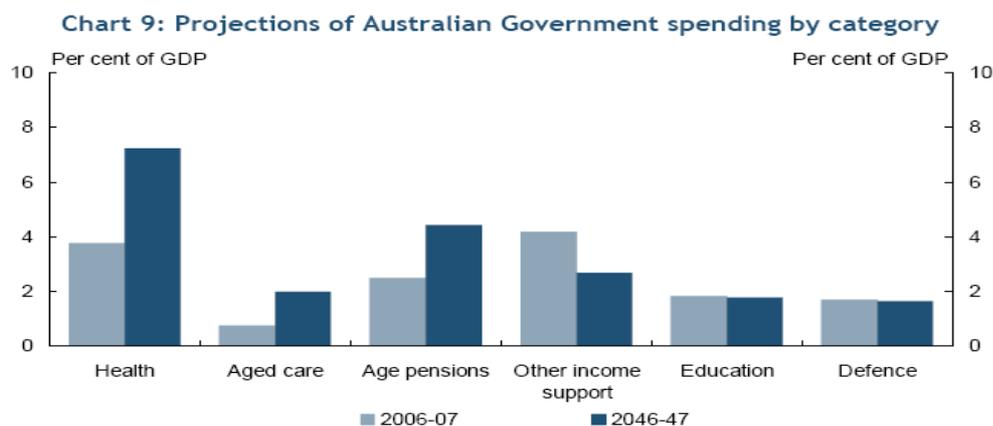
*All G-20 countries face the inevitable challenge of demographic change with its significant economic and social consequences. The challenge is to ensure the transition boosts, rather than detracts from, economic development, growth, and living standards. A combination of policies will be required to meet this challenge, including improving public finances, encouraging labour force participation, and promoting productivity growth.*

15. The 2006-07 budget papers contained data showing that overall Australian Government revenue as a percentage of GDP peaked in 1986-87 at 26.1 and

<sup>12</sup> RBA Background Note prepared for the Meeting of the Group of Twenty Finance Ministers and Central Bank Governors Melbourne - 18-19 November 2006

has declined to 22.9% in 2006-07. With no growth projected in the current forward estimates.

16. The chart below from the IGR shows the projected increases in government expenditure over the next forty years.



Source: Treasury projections and assumptions.

17. The IGR predicts by maintaining current policy settings that Australian Government spending will rise by 4.75% of GDP by 2046-7 with a 3.5% of GDP fiscal gap developing over that period.

18. It is clear from the analysis contained in this section that since at least 1949 ‘pay as you go’ wage and salary earners have been carrying an ever greater burden of contributions to taxation revenue while their productivity has also been increasing. Simultaneously their share of wages and salaries as a proportion of GDP has been dropping as corporate profits have been increasing. Topping off this long term transfer of taxation from capital to labour has been the introduction of the regressive GST in the last decade. What is also clear from this section is that without substantial increases in revenue collection over the long term an unsustainable fiscal gap will open up for the Australian Government.

19. Therefore an essential task of this Review must be to identify where the increases in taxation revenue will be funded from without further increasing the burden placed on ‘pay as you go’ wage and salary earners. We will make our suggestions in this regard in sections three and four of this submission.

## Neo-Liberal Ideology and Changing Public Opinion

20. A key article of faith of the neo-liberal approach is often expressed in the view that all government needs to do is to ‘get out of the way’ and let business get on with building prosperity. In terms of taxation policy this translates to mean that ‘higher taxes are bad for economic growth’. However as has been recently stated;

*...it is hard to find a significant statistical correlation between size of government – levels of government spending and taxation – and economic performance.*<sup>13</sup>

21. A practical demonstration of the possible correlation between high taxes and above OECD average growth in GDP per capita can be seen in the respective performance of Finland and Sweden. Between 2001 and 2006<sup>14</sup> this has been achieved with taxation revenues of 43.5% and 50.1% as a percentage of GDP<sup>15</sup>.

22. Neo-liberal advocates implicitly proceed from the basis that public opinion backs them. Newspoll opinion polling from 2004 that directly posed the contrasting policy options of tax cuts from a large surplus against spending on health and education suggests that the opposite is the case. The evenness of these views across demographic cohorts and party affiliation is also noteworthy.



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THINKING NOW ABOUT PERSONAL INCOME TAX AND FEDERAL GOVERNMENT SPENDING. IF THE FEDERAL GOVERNMENT HAS A LARGE BUDGET SURPLUS, DO YOU THINK THIS SURPLUS SHOULD BE SPENT...?

	SEX			AGE			HOUSEHOLD INCOME			POLITICAL SUPPORT	
	TOTAL	MALES	FEMALES	18-34	35-49	50+	LESS THAN \$30,000	\$30,000 TO \$59,999	\$60,000 PLUS	COALITION	ALP
	%	%	%	%	%	%	%	%	%	%	%
ALL OR MAINLY ON HEALTH OR EDUCATION	72	69	76	71	73	73	79	71	69	68	80
SPENT ON BOTH EQUALLY	16	17	15	18	16	13	14	14	17	18	12
ALL OR MAINLY PERSONAL TAX CUTS	9	11	7	9	10	9	5	12	12	13	7
UNCOMMITTED	3	3	2	2	1	6	2	3	2	3	1

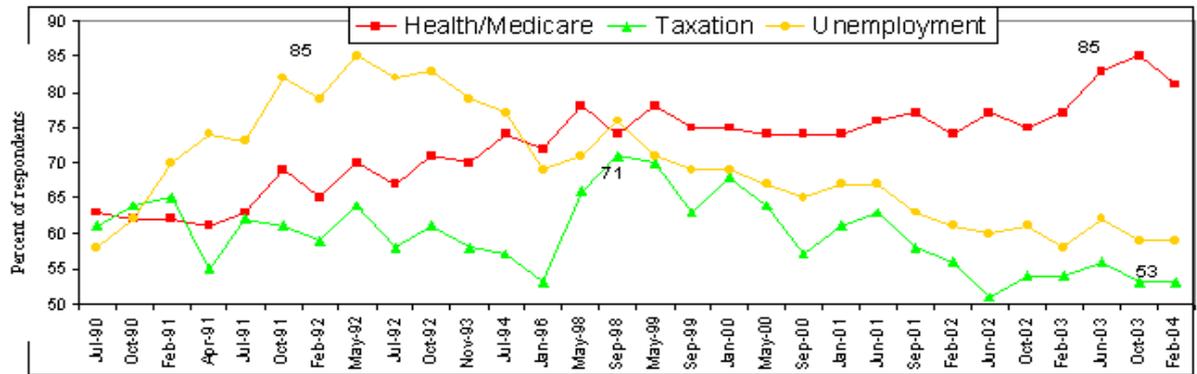
23. Longitudinal research<sup>16</sup> has shown over time increasing public support for spending on health with concern over taxation levels trending down.

<sup>13</sup> Argy, F., (2007), Australia's Fiscal Straitjacket, Centre for Policy Development, Occasional Paper No.4.

<sup>14</sup> OECD Factbook 2008

<sup>15</sup> ibid.

<sup>16</sup> Federal Parliamentary Library, Research Note no.57 (2003-04), Less tax or more social spending: twenty years of opinion polling.



24. Public attitudes to taxation and social expenditures are well summarised in the following quote from this research;

*In terms of more spending on social services, there are popular items such as health services, old age pensions and family benefits, and unpopular items such as unemployment benefits, single parent payments and assistance to minority groups. Consistent with several international findings, most Australian opinion polls show public acceptance for higher taxes to pay for the popular broad-based items of health services and old age pensions. Health polls are unambiguous in the preference for higher spending and better services, reflecting health's character as a public good of enduring national, personal and electoral concern.*

25. There is then, with the IGR findings in mind, a fortunate congruence between what the public supports increased spending on (health and aged care/pensions) and what will be required.

26. This research also shows that there is a cynicism and mistrust in regard to increased taxes if the public are not confident that the extra revenue raised will be spent on these concerns;

*there was a deep sense of disconnection from the taxes people pay and the public services which these finance. The preference in different polls by the same respondents for both higher health spending and less tax may reflect this disconnection: If people could be sure that the money was genuinely going to improve the priority public services, they would be willing to countenance higher taxation.<sup>17</sup>*

27. This suggests that to finance increased revenue the public would favour it being raised via hypothecated taxes such as the Medicare levy.

<sup>17</sup> *ibid.*

28. In the context of the long term divergence between statutory and effective corporate taxation rates, the option of increasing the use of hypothecated taxes (particularly directed at the corporate sector and upper income brackets) to fund the looming fiscal gap is one that this Review should seriously consider.

## **Section Two - Key Principles of a Good Tax System**

29. Predicated on the notion of social inclusion, Australia's future tax system should be designed to ensure that taxation revenue is sufficient to meet social needs over the long term. The principles we advocate here should ensure that this is the case, These principles are;
- a. equity;
  - b. transparency;
  - c. durability;
  - d. simplicity.

### **Equity**

30. In essence all forms of income including all capital gains, however described, should be equitably taxed. There are two dimensions to equity in this context, horizontal and vertical.
31. Horizontal equity means that persons or businesses in similar circumstances will have similar tax burdens. As section one of this submission shows, this has not been the case for at least the last 60 years in Australia with personal contributions rising from double to quadruple that contributed by business as a proportion of GDP.
32. Vertical Equity requires the system to be progressive using the 'equal marginal sacrifice principle' requiring those, both individual and corporate, with the greatest income to contribute proportionally more than those on low incomes. Additionally for those surviving on government benefits vertical equity in our view means that this group rather than paying tax should be in receipt of tax credits to lift them onto the federal minimum wage.

### **Transparency**

33. In essence this means taxation legislation, assessments and determinations should be easily understood by all taxpayers. All residents and corporations should be subject to the same standard of service, treatment and access by the Australian Tax Office regardless of their income and status. A transparent system is one that does not contain loopholes for use by wealthy individuals and corporations who can afford to employ accountants and lawyers to minimise their taxation contributions.

### **Durability**

34. The design of a taxation system should incorporate the following facets to ensure its durability;

- Ø Broad Base - taxes should be spread as widely as possible over the population and business to minimise the average worker's pay as you go contribution;
- Ø Convenience - taxes should be enforced in a manner that facilitates voluntary compliance to the maximum extent possible;
- Ø Efficiency - tax collection efforts should not cost an inordinately high percentage of tax revenues;
- Ø Predictability – the collection of taxes should reinforce their inevitability and regularity.

### **Simplicity**

35. Australia's future taxation legislation should be designed and written simply to both lower the cost of compliance for taxpayers and the cost of enforcement for government.

## **Section Three - Some Proposals for Increasing Tax Revenue and/or Closing Down Tax Rorts**

36. As was shown in the first section of this submission Australia will need to increase revenue collected in real terms in the period ahead as our society meets the challenge of an aging population. The following are some suggestions for enhancing revenue collection.

### **i. Capital Gains Tax**

The 50% discount on capital gains where assets are held for more than a year was originally introduced as an incentive to long term investment. Our view is that this time period is too short and the concession should be graduated for investments of between five and ten years. Our proposal is that the concession would operate at the 10% level after five years with an additional 10% applied each year after that reaching a maximum of 50% after ten years.

The current financial crisis has shown the destructive consequences of very short term investment practices such as 'short selling'. This Review is well placed to discourage these and other such practices that cannot be considered productive investment. To rein in these practices this Review should consider increasing capital gains tax rates beyond the current highest marginal rate for investments where the assets are held or borrowed for less than one year.

### **ii. Debentures**

The interest withholding tax exemption on debentures cost revenue \$1.03 billion dollars in 2007-08, its abolition would enhance revenue collection from corporations.

### **iii. Company Tax Rates & Top Marginal Tax Rates**

The differential between company tax rates and the top marginal tax rate needs to be narrowed to remove the incentive for medium to high income earners to incorporate. The optimal way to achieve this narrowing is to lift the corporate tax rate and drop the top marginal rate at the same time. Revenue neutrality can be achieved by this process if desired.

### **iv. Superannuation**

The recent moves in terms of the taxation treatment of superannuation greatly aggravate unfairness and waste in the superannuation system. Chief among these are the concessions given to salary sacrifice superannuation contributions and the self employed.

In the 2007-08 income year, the concessional contributions cap amount for people aged 49 and under is \$50,000. For employees aged 50 and over, the concessional contributions cap is \$100,000. Presuming that these contributions come from income that would otherwise be taxed at the top marginal rate (45% plus 1.5% Medicare levy), this represents a reduction in tax of 31.5% that is overwhelmingly claimed by very high income earners. In addition the full concession for the self employed is worth an average \$916 million per year for 2006-2011. By contrast the tax concession on superannuation co-contribution for low income earners is worth an average \$352 million per year for 2006-2011.

There is good reason to allow some portion of tax preferred retirement benefits to encourage individuals to save for retirement and take pressure off the aged pension. However from an equity perspective the current concessions are clearly out of balance and should be redesigned to predominantly assist low to median income earners.

Conversely recent research<sup>18</sup> indicates that 25.5% of the self employed have a nil superannuation balance. This is a long term concern for government outlays. This Review should ensure that the self employed carry a fair and equitable burden in providing for their own retirement. It is more equitable that the self-employed be made to provide for their retirement through mandatory super contributions rather than through subsidies or concessions to which other are not entitled.

#### **v. Death Duties**

Australia is one of the few countries in the OECD not to impose some form of taxation on inherited wealth. We suggest that estates worth more than two million dollars should have at least a nominal rate of 10% applied to them. This amount should be indexed to ensure that ordinary families are not affected into the future, merely those with the highest wealth.

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<sup>18</sup> Association of Superannuation Funds of Australia, (2008), *The Self Employed and Saving for Retirement*

#### **vi. Inappropriate Use of Trusts**

The family trust rules provide a concession to the 'test individual' of a family trust and their family group by allowing the transfer of losses and debt deduction to members of a family trust so reducing their taxable income. This loophole should be eliminated. A capital gains discount of 50% also applies here to assets held for more than a year, this should be reformed in the manner already described in this section.

#### **vii. Phoenix Companies**

Some businesses cheat the taxation system by liquidating their companies whilst owing tax instalments to the ATO. This Review needs to ensure that the tax compliance processes are integrated with ASIC and corporations law to end this type of activity.

#### **viii. Negative Gearing in the Rental Market**

This is a poorly targeted measure aimed at increasing the stock of rental properties. This Review should consider better targeting this concession with additional revenue generated allocated to both building public housing and rent subsidies to low income tenants in the private rental market. Consideration should also be given to encouraging property trust investment in housing rental stocks as currently they predominantly invest in commercial property.

#### **ix. Demerger, Merger & Acquisition Activity**

Capital gains occasioned through demergers are given concessional capital gains tax treatment, similarly mergers and acquisitions receive concessional capital gains tax treatment. Neither of these is justified and can lead to corporate restructuring that has no basis in commercial reality beyond the available tax benefits. These concessions must be eliminated. Compliance attention should also focus on deterring pre demerger and merger share price inflation designed to minimise capital gains tax.

#### **x. Mineral Royalties**

The taxation of mineral extraction by governments in Australia is made confusing by overlapping State and federal jurisdictions, responsibilities and opportunities.

State Governments have primary responsibility for land under the Constitution, and so are the primary administrators of mineral royalties. They also form a substantial part of State revenues in certain States, and are a key source of income in the absence of income taxes which go solely to the Commonwealth.

However, in offshore mineral extraction the Federal Government is the primary determiner and recipient of royalties.

Ideally the rates of mineral royalties should be harmonised across State and Federal jurisdictions so that investment decisions are not distorted by either inter-state competition, and so that optimal rates are not compromised by that competition.

Mineral royalties should be, and mostly are, determined on an "ad valorem" basis; they are a percentage of the sale price and so go up and down with mineral prices. There should be provision for ad valorem rates to be escalated to higher percentage levels where prices reach "super profit" levels. This enables the Australian public to derive a greater benefit from mineral booms, without compromising investment decisions.

The recent introduction by the Queensland Government of a higher rate of royalty (10% rather than 7%) on coal revenues in excess of \$100 per tonne is an example of this, with the only problem being that it is a single-state exercise.

#### **xi. Fringe Benefits Tax (FBT) Concessions on Work Vehicles**

The current FBT concessions on employer provided vehicles encourages the purchase of bigger vehicles and also increases with greater usage. From an environmental standpoint these are not sustainable practices and this concession should be redesigned to both encourage the purchase of smaller cars and not to reward excessive vehicle usage.

#### **Strengthening Revenue through Encouraging Labour Force Participation**

37. The Review needs to address the high effective marginal tax rates (EMTRs) of those marginally attached to the workforce. High EMTRs on low income earners must be addressed to end the current situation where finding part time or casual work actually makes couples with dependent children (recipients of family tax benefit), people with disabilities (recipients of disability support pension) and the

unemployed (recipients of newstart and other allowances) worse off. Careful attention must be paid to ensuring that the interface between the tax and welfare systems is designed to encourage workforce participation and reward job creation not stifle it.

38. Addressing the high EMTR issue would assist with easing capacity constraints in the economy. It would also assist those on low incomes in their transition from being welfare recipients to tax paying workers, further enhancing the revenue base in the long run.

## **Section Four - The Impact of Bogus Contracting on the Tax-Transfer System**

### **Introduction**

In inviting submissions to its inquiry, the Review Panel sought comments on problems with the current tax-transfer system.

Due to the interaction between taxes and transfer payments, any inadequacies in the taxation system will lead to abuses in the transfer system. The CFMEU believes that laxness in the taxation law dealing with the alienation of personal services income and the issuing of Australian Business Numbers (ABNs) is allowing taxable incomes to be understated and transfer benefits overclaimed.

The CFMEU is aware that in the construction industry, if not also in other areas of the economy, practices to alienate personal services income persist. The easy access to ABNs and the ease with which people can satisfy the test for conducting a personal services business mean that people can - or are compelled to by their “employers”- structure their legal form, but not substance, so they are considered to be contractors rather than employees (“dependent contractors”). The very low level of compliance activity by revenue authorities assists in this process.

This results in people performing the same work but with different legal forms paying different levels of tax. Significantly, employees pay much higher tax. This is inequitable and contrary to good tax policy. It also:

- leads to lower tax revenue for governments;
- allows individuals to access income-tested benefits which they would not otherwise be entitled to;
- denies people in similar situations the same workplace entitlements; and
- reduces economic efficiency by transferring the responsibilities of employers to others in the community and allowing an unfair competitive advantage to those employers who utilise “bogus” dependent contractors.

Consistent with the terms of reference for the Review Panel to make recommendations to improve the tax-transfer system to enhance overall economic and social well-being, including ensuring there are appropriate incentives for the promotion of efficient resource allocation, the tax legislation in regards to the alienation of personal services income needs to be urgently reviewed and the easy access to ABNs curtailed.

This section provides an overview of the relevant taxation legislation and outlines the large costs to society of dependent contractors. It then shows where weaknesses exist in the current law in this regard and shows that, by utilising these deficiencies, avoidance is, and remains, a significant issue.

## **Taxation of Contractors**

In order to address the prevalence of dependent contractors and the evasion and avoidance of tax through the alienation of income a range of measures have been adopted by governments. This sub-section provides a brief history of those measures, dating from the introduction of a prescribed payment system in 1983.

The CFMEU believes that the legislative measures in place are inadequate to address the alienation of income by contractors and that contractors continue to avoid their tax responsibilities. This is undermining the tax-transfer system.

### ***Prescribed Payments System & Previous Labor Government Policy***

In 1983, the Prescribed Payments System (PPS) was introduced to require tax instalments to be withheld from payments under contracts which involved the performance for a “prescribed person” of particular types of “work”. Specifically, the PPS applied in the following industries:

- building and construction,
- road transport,
- motor vehicle repairs,
- joinery and cabinet making, and
- cleaning industries.

These industries were identified on the basis of a history of poor compliance and a high level of cash transactions.<sup>19</sup>

The PPS was supplemented by a Reportable Payments System (RPS) in December 1994 to prevent tax evasion in other high risk industries (namely, fishing, clothing, smash repairs and fresh fruit and vegetable suppliers).<sup>20</sup> Under the RPS, a person making a “reportable payment” was required to report the amount to the Australian Taxation Office (ATO) and to withhold tax where the payee did not quote a tax file number.

In 1995, the then Treasurer Ralph Willis also became concerned with the use of interposed entities in labour market contracts to alienate income. In the 1995-1996 Budget, it was stated that:

“In other cases, individuals form an entity such as a company through which they provide personal services. Such entities may be used with the intention that the personal services income, which would otherwise be assessed to an individual, is received by an entity and then alienated.....The revenue impact of

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<sup>19</sup> ATO (1997), Improving Tax Compliance in the Cash Economy, pg. 14

<sup>20</sup> Ibid.

these practices is difficult to quantify. However, if action is not taken to prevent an expansion of the practices, the impact on the income tax base could be in the order of several hundred million dollars per annum. The Government's objective is to ensure that the appropriate tax is payable by individual taxpayers on income which is clearly derived from the personal services provided by the individual.”<sup>21</sup>

Relevant legislation was introduced into Parliament to close this loophole. Action by non-government senators ensured the legislation was not passed prior to the 1996 election. The new government did not implement the policy. Accordingly, the scope of the problem grew as flagged by Treasurer Willis.

### ***Ralph Review***

In 1999 the Review of Business Taxation (the “Ralph Review”) examined the issue of income alienation and found that it was increasingly becoming the practice to make payments in respect of personal services to individuals through an interposed entity, thus allowing tax to be avoided.

Accordingly, the Ralph Review recommended that:

“Recommendation 7.2: That where a company, trust or partnership (the “interposed entity”) is, or is to be, interposed between a person or entity requiring services (the “service requirer”) and the individual who performs or is responsible for performing the services (the “service provider”), payments received by the interposed entity in respect of the services be treated for income tax purposes as the income of the service provider where:

- i. the interposed entity receives 80 per cent or more of its receipts in respect of personal services, either directly or indirectly, from one service requirer, or associate of that service requirer, during the year of income; or
- ii. the services are provided to the service requirer in an employee-like manner as determined by a range of specific criteria; or
- iii. the interposed entity is unable to obtain from the Commissioner of Taxation a decision that the 80 per cent / one service requirer test in paragraph i. should not apply.”<sup>22</sup>

The criteria referred to in paragraph ii. above suggested by the Ralph Review included:

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<sup>21</sup> Budget Statements, 1995-1996, Budget Paper No. 1, pg.4-8.

<sup>22</sup> Review of Business Taxation, A Tax System Redesigned – More certain, equitable and durable, July 1999. pp.286-287

- the manner in which the services are being carried out having regard to the level of control exercised by the service requirer in relation to matters such as the time of work and actual hours of work required and where the services are to be performed;
- whether the same services are also contracted to the public at large in the year of income;
- the use by the interposed entity of substantial income producing assets as the predominant source of earning income, with the provision of personal services being incidental;
- whether incidental services are provided in conjunction with the sale of trading stock;
- the extent of the infrastructure provided by the interposed entity;
- whether more than one person is contracted to, and actually provides the services to, the service requirer; and
- the degree of any entrepreneurial risk in the way that services are provided.<sup>23</sup>

The Ralph Review also made a recommendation in relation to the deductions that could be claimed in these circumstances. Specifically it recommended:

“That where:

- in accordance with Recommendation 7.2, payments in respect of personal services are treated for income tax purposes as received by the individual who performs the services, or
- payments are made directly to an individual engaged as a dependent contractor in similar circumstances,

the availability of taxation deductions for related expenses be limited to those that would be allowable if the individual:

- were employed by the service requirer to whom the services have been provided; and
- incurred the expenditure related to that activity.”<sup>24</sup>

Combined, these two recommendations aimed to:

- to ensure that payments in respect of personal services would be treated as the income of the individual who performed the service and so ensure that income in respect of personal services derived in an employee-like manner is treated in

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<sup>23</sup> Ibid. pg. 291.

<sup>24</sup> Ibid. pg. 293

the same manner for income tax purposes as income actually derived by an employee;

- preclude such tax advantages arising from the splitting of payments in respect of personal services through the payment of trust distributions or dividends using the interposed entity, or the deferral of tax through the retention of profits in an interposed company; and
- prevent deductions being claimed which would not otherwise be allowable to an individual in their capacity as an employee of the service requirer (employer).

### ***New Business Tax System***

On 11 November 1999, the then Treasurer Peter Costello announced that the government would introduce measures to limit the avoidance of income tax that occurs through alienation of personal services income.<sup>25</sup> The proposed measures mirrored the recommendations of the Ralph Review in this regard. The then Treasurer said that the alienation of personal services income undermined the tax base and raised significant equity issues.<sup>26</sup>

However, the legislation to implement this announcement was very different from that recommended by the Ralph Review.

The *New Business Tax System (Alienation of Personal Services Income) Bill 2000* required that an individual include in his or her assessable income any income that another entity (the “personal services entity”) gains for the individual’s personal services unless:

- the other entity gains the income in the course of conducting a personal services business; or
- the income is promptly paid to the individual by the entity as salary or wages.

A personal services business exists if it:

- receives less than 80% of its personal services income in respect of an individual from one source and is able to satisfy one of the three personal service business tests; or
- receives 80% or more of its personal services income in respect of an individual from one source and is able to obtain a determination from the Commissioner that it gains personal services income in the course of conducting a personal services business.

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<sup>25</sup> Treasurer Peter Costello, Media Release – The New Business Tax System – Stage 2 Response, 11 November 1999

<sup>26</sup> Ibid,pg.1

The three personal service business tests can be summarised as follows:

- unrelated client test – this test is satisfied if during the year the personal services business gains income from two or more clients which are not associates of each other, the individual, or the personal services entity.
- employment test – this test is satisfied if one or more entities are engaged to perform work to the value of at least 20 percent of the business’ principal work, or an apprentice is employed for at least half a year;
- business premises test – this test is satisfied if the business uses or maintains business premises to conduct activities producing personal services income and the business has exclusive use of the premises. The premises must also be physically separate from any premises used for the private purposes of the individual, entity or any associate and the premises of the entity to which the personal services are provided.

If a determination must be obtained from the Tax Commissioner – that is, 80% or more personal services income is gained from one source – the Commissioner will determine that a personal services business is conducted if:

- either the employment test or business premises test are met;
- but for unusual circumstances, one of the three personal services business tests would be met; or
- the individual or entity is producing a result, supplies their tools of trade and is liable for the cost of rectifying defective work (the “results test”).

In relation to deductions, the *New Business Tax System (Alienation of Personal Services Income) Bill 2000* provides that an individual cannot deduct an amount that relates to his or her personal services income where:

- the income is payable to the individual, except as an employee; and
- the individual would not be able to deduct the amount if the income were payable to the individual as an employee.

### ***Australian Business Numbers***

On 13 August 1998, the then Treasurer Peter Costello announced the introduction of the Australian Business Number (ABN). This was implemented by the *New Tax System (Australian Business Tax Number) Act 1999*.

The ABN is an integrity measure to stamp out the cash economy and provides an audit trail. Quoting an ABN means that business related payments made to a person

do not have any tax deducted. Failure to quote an ABN means payers have an obligation to withhold PAYG amounts at the top marginal rate plus medicare levy. Consequently, ABNs are highly sought after and a critical ingredient for those seeking to avoid/evade tax.

Under the 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. “Enterprise” is defined in the Act as an activity, or series of activities, done in the form of a business. A “business” is any profession, trade, employment, vocation or calling, but does not include occupation as an employee.

## **Costs to Society**

As the previous sub-section indicated, the costs of dependent contractors and the alienation of personal services income have long been recognised by government. The Explanatory Memorandum to the *New Business Tax System (Alienation of Personal Services Income) Bill 2000* states that:

*“The alienation of personal services income poses a growing threat to the income tax base and raises issues of equity between those that can take advantage of these arrangements and other providers of personal services, including wage and salary earners, who cannot.”<sup>27</sup>*

This sub-section outlines the public cost of dependent contractors and the alienation of personal services income. These costs highlight why it is important that legislation aimed at dealing with dependent contractors and the alienation of personal services income must be comprehensive and rigorously enforced. The failure to do so significantly undermines the tax-transfer system.

## ***Lost Federal Tax Revenue***

Adopting the legal form of business (eg. a company, trust etc ) creates a prima facie assumption that a business is being conducted, even when this is not the case. The tax benefits of both avoidance and evasion are significant, and therefore attractive.

The use of interposed entities may allow individuals to:

- claim deductions that they would not be entitled to if they were employees;
- to split income by making distributions or dividend payments to other beneficiaries/shareholders of the interposed entity; and/or
- pay tax at the lower rate applicable to that entity and/or defer tax by retaining income in the interposed entity

The result is that the taxable income of the individual providing the personal services is understated and less tax is paid. Table 1 below shows how this may operate for a single worker.

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<sup>27</sup> Explanatory Memorandum to the *New Business Tax System (Alienation of Personal Services Income) Bill 2000*, pg.64

**Table 1 – Comparison of Taxes typically paid by PAYE and Contractors in the Construction Industry**

<b>Tax Return Profile of Joe Average – PAYG Worker</b>		<b>Tax Return Profile of Joe Average – Contract Worker - ABN</b>	
Wages as per PAYG Summary	\$75,150	Gross Income	\$75,150
<b>Less: Allowable Deductions</b>	\$1620	<b>Less: Allowable Deductions</b>	
		Materials & Job Costs	\$6,615
		Motor Vehicle Expenses	\$12,420
		Sundry Expenses	\$2,250
		Telephone	\$1,835
<b>Taxable Income</b>	\$73,530	<b>Taxable Income</b>	\$52,030
Income Tax Payable	\$16,659	Income Tax Payable	\$10,209
Medicare Levy	\$1,103	Medicare Levy	\$780
<b>Net Tax Payable</b>	\$17,762	<b>Net Tax Payable</b>	\$10,989
Employer Superannuation Contributions of \$5,200 <sup>28</sup> taxed at 15%	\$780	Employer Superannuation Contributions	-
<i>Government Revenue Summary</i>		<i>Government Revenue Summary</i>	
Net Income Tax Paid	\$17,762	Net Income Tax Paid	\$10,989
Tax on Superannuation Contributions	\$780	Tax on Superannuation Contributions	-
<b>Total Revenue</b>	\$18,542	<b>Total Revenue</b>	\$10,989
<b>Average Rate of Tax</b>	24.67%	<b>Average Rate of Tax</b>	14.62%

Note: This table was prepared by a senior accountant with experience in providing advice in the construction industry. The examples represent a typical situation gleaned from years of providing such advice and observing practice in the industry. 2007-2008 taxation rates have been applied.

<sup>28</sup> This amount is based on ordinary time earnings of \$57,800

### ***Other Budgetary Impacts***

Any understatement or deferral of income will also have other budgetary implications.

Three notable examples are:

- Medicare Levy: By understating income, people may qualify for a Medicare levy reduction or, if they do not have private health insurance, avoid the Medicare levy surcharge.
- Family Tax Benefits and other income - tested benefits: By understating income, individuals can become eligible for benefits which they would not otherwise be eligible for, or increase the payment they received under such benefits.
- Higher Education Contributions: By understating income, the obligation to repay Higher Education Contributions – which only occurs once a certain income level is reached – can be avoided.

Child support payments which are determined by reference to taxable income may also be effected.

The impact on income-test benefits also highlights the interaction between the tax system and the transfer system. If tax can be avoided, the transfer system is also abused. In other words, problems in the tax system will frustrate the effectiveness of the transfer system

### ***Lower Superannuation***

Employers must contribute 9% of an employee's salary to superannuation.

Generally<sup>29</sup>, by avoiding an employer-employee relationship, the employer can avoid that obligation.

If there is no obligation to pay superannuation, whether superannuation contributions are then made will depend on the structure used by the individual who provides the personal services. For example, if the interposed entity pays salary or wages to the individual, an obligation to pay superannuation would still exist. However, for other structures there will be no obligation to make superannuation contributions.

While individuals could voluntarily choose to make contributions to a superannuation fund, the absence of any obligation must diminish the extent of superannuation contributions. This acts as a structural weakness to superannuation adequacy and increases the risk that recourse will be necessary to the government provided pension.

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<sup>29</sup> There will still be an obligation to contribute to superannuation if the person is engaged under a contract that is wholly or principally for the person's labour.

### ***Workers Compensation***

The engagement of dependent contractors, rather than employees, may also have different consequences for access to workers compensation.

In some jurisdictions, labour only subcontractors are not covered for workers compensation purposes. In other jurisdictions, the uncertainty as to whether contracting arrangements are covered can be exploited by employers to minimise their premiums. In those circumstances, dependent contractors may need to pursue legal action before they claim compensation for any injury.

The use of these contractual arrangements frequently results in additional costs (for example, medical and rehabilitation costs) being imposed on government and/or society, when such costs should properly be incurred, or managed, by the employer. Ensuring compliance with proper workers compensation arrangements is also essential in order that employers act to reduce the risk of workplace injuries.

### ***Other Employment Conditions***

Arrangements whereby employees are put on “sham” contracts also deny workers the rights that they would otherwise have under various awards, industrial instruments and legislation. Such rights include protection against unfair dismissal, leave arrangements, and redundancy payments. The erosion of these entitlements without proper compensation will similarly shift costs on to society.

The following extract from a Productivity Commission Staff Research Paper indicates that proper compensation for the lost entitlements is not occurring.

*“From a worker welfare perspective, while workers may gain through reduced tax liabilities and greater autonomy when they work as contractors, it is possible, as Creighton and Stewart (2000, p. 712–3) suggest, that some workers do not know the true value of the employment benefits foregone, and that only employers therefore gain from the contracting arrangements. The concern has also been raised that, in an environment of relatively high unemployment, workers offered contractual employment cannot negotiate more attractive terms and conditions (Collins 1990).”<sup>30</sup>*

There is also the risk of “wages” not being paid and contractors being treated like any other creditor in the event of insolvency, rather than obtaining the preference that employees have in the *Corporations Act*.

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<sup>30</sup> Waite, M. and Will, L. 2001, Self-employed contractors in Australia: incidence and characteristics, Productivity Commission Staff Research Paper, AusInfo, Canberra, pg.8

### ***Lost State Tax Revenues***

The prevalence of dependent sub-contractors may also affect the revenue of state governments under payroll legislation. While the definition of “employee” in such legislation may capture people who would be regarded as contractors under federal law, the prevalence of “sham” contractual arrangements and the culture that creates also poses a risk to the revenue of state governments

### ***Inequitable***

The alienation of personal services income is inequitable. As stated in the report of the Ralph Review:

*“The use of such arrangements to reduce the tax liabilities of individuals means that people in substantially the same financial and work situation would be paying significantly different levels of taxation. It is clearly inequitable that some taxpayers should be reducing their tax liability by using interposed entities to alienate income while other taxpayers also deriving personal services income, including ordinary wage and salary earners, pay the correct amount of tax.”<sup>31</sup>*

The tax system should be designed so that economic transactions having the same economic substance are taxed similarly, irrespective of legal form.

### ***Inefficient Resource Allocation***

As indicated above, the shifting of costs from the employer to society (such as costs for rehabilitation of injured workers) can lead to inefficient resource allocation in the economy.

Also, the prevalence of ‘sham’ contractual arrangements creates an unfair competitive advantage for companies using such techniques. By making employees dependent contractors who are not properly compensated for the entitlements lost, an “employer” can lower their costs and undercut the honest competitors who engage employees and meet their lawful entitlements. This distorts competition and means that the most efficient provider of services is not necessarily engaged. This could lead to a misallocation of resources in the economy and should not be facilitated by lax taxation laws and inadequate compliance activity.

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<sup>31</sup> Review of Business Taxation (July 1999) op.cit., pg. 287

### **Inadequacies of the Current Legislation**

Due to the significant costs to society that can arise from dependent contractors not being treated as employees for taxation purposes, it is essential that the tax regime is rigorous, comprehensive and properly enforced.

It was the finding of the Ralph Review that the use of interposed entities and dependent contractors were driven by tax considerations. The report stated that:

*“The use of interposed entities to alienate payments in respect of personal services is increasing along with the tendency to engage dependent contractors rather than employees. These practices are generally, though not necessarily, driven by and lead to taxation consequences.”<sup>32</sup>*

The CFMEU has serious concerns with the legislative tests set out for determining whether an entity is a personal services business and with the easy access to ABNs. The ease with which ABNs can be obtained, combined with the inadequacies of the *New Business Tax System (Alienation of Personal Services Income) Act 2000*, make the risk of continued tax avoidance too great.

### ***Inadequacies of Legislative Tests***

As indicated earlier, the test for determining whether income is to be treated as personal service income for income tax purposes differs from that proposed by the Ralph Review. The CFMEU pointed out at the time the Senate Standing Economics Committee inquired into the *New Business Tax System (Alienation of Personal Services Income) Bill 2000* that:

*“[t]he Ralph Report was concerned to ascertain whether the supposed contractor was operating in an employee-like manner. This legislation applies the opposite test: whether the contractors are acting in a business-like manner.*  
..<sup>33</sup>

The CFMEU still believes that testing whether contractors are operating in an employee-like manner would be more consistent with the aim of taxing such contractors in the same manner as employees. In this regard, the criteria suggested in the Ralph Review are more appropriate and more comprehensive than the distinct, separate and inappropriate tests now enshrined in legislation.

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<sup>32</sup> Review of Business Taxation (July 1999), *A Tax System Redesigned – More certain, equitable and durable*, pg. 288

<sup>33</sup> Senate Economics Legislation Committee Hansard, Reference: *New Business Tax System (Alienation of Personal Services Income) Bill 2000* and two related bills, 23 May 2000, pg. E40

In relation to the tests set out in the legislation, the CFMEU has also long held the view that the need to satisfy just one of the multiple tests is not sufficiently demanding. Further, the tests suffer from a number of significant flaws:

- the unrelated clients test fails to catch the high proportion of building industry contractors who change employers at least once a year and having more than one employer per year does not change the nature of employee-like work;
- the employment test does not exclude associates (thus, allowing income splitting); and
- the business premises test is so open-ended as to allow contractors to erect artificial “premises” which would satisfy the test.

These flaws seriously undermine the ability of the legislation to curtail the significant tax avoidance that the Ralph Review and the earlier Labor government warned of.

### ***Ease of Access to ABNs***

The major problem leading to tax avoidance/evasion is the ease of access to ABNs. Put simply, it is too easy to obtain an ABN. The test of being in an “enterprise” can be easily satisfied and the process for getting an ABN requires no substantiation. A few clicks on the ATO website will generate an ABN.

The purpose of ABNs has also encouraged their misuse. According to the Explanatory Memorandum, one of the purposes of ABNs is to:

*“...reduce the need for difficult judgements by businesses about whether the service providers they engage are employees or contractors. (If a business receives an invoice without an ABN, they are required to withhold tax from that payment just as they do for payments to their workers.)”<sup>34</sup>*

This would also suggest to the contractors – who are frequently unsophisticated and inexperienced - that if they can obtain an ABN they are legitimately contractors and not employees. This was the also the finding of the Cole Commission, which stated:

*“A major area of concern is the number of ABNs issued in the industry. Industry evidence does suggest that there is an erroneous understanding that the possession of an ABN enables the holder to be treated as a contractor.”<sup>35</sup>*

The lack of rigour in the requirements that need to be satisfied to obtain an ABN is clearly facilitating arrangements which are more akin to an employer-employee relationship being structured as a contractual arrangement.

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<sup>34</sup> Explanatory Memorandum to the New Tax System (Australian Business Tax Number) Bill 1999, pg.8

<sup>35</sup> Final Report of the Royal Commission into the Building & Construction Commission, pg 89

Applicants for an ABN should be required to produce tangible evidence that they are operating a business before an ABN is issued. There should also be significant penalties for making false declarations in order to obtain an ABN. Similarly, there should also be significant penalties introduced for professional advisers or employers who facilitate the obtaining of “bogus” ABNs.

### **Tax avoidance still a problem**

In the 1995-1996 Budget it was estimated that measures to prevent the alienation of personal services income could be in the order of several hundred million dollars per annum.<sup>36</sup>

Buchanan & Allen (2000) estimated that just under \$2.2 billion was lost in 1996/97 when the level of tax paid by contractors is compared to the level of tax they would have paid if they had been treated as PAYE taxpayers.<sup>37</sup>

In 1999, the then Treasurer's press release in relation to measures to prevent the alienation of personal services income estimated that measures would recoup \$2.4 billion over five years, as set out in the table below.

**Table 2: Fiscal Impact of Restricting Alienation of Personal Services Income<sup>38</sup>**

<b>2000-2001</b>	<b>2001-2002</b>	<b>2002-2003</b>	<b>2003-2004</b>	<b>2004-20005</b>
\$380m	\$480m	\$495m	\$515m	\$530m

Unfortunately, it is not known if the projected revenue gains have ever eventuated. However, given the potential revenue to be recouped, it is critical that the Australian Taxation Office undertakes and publishes analysis to confirm if the changes introduced as part of the New Business Tax System have raised the projected revenue and is more effective than the system it replaced.

In any event, anecdotal evidence shows that there is a substantial problem to be addressed.

### ***Evidence of Poor Compliance***

It was a conclusion of the Cole Commission that:

*“There appear to be justified concerns about the use of Australian Business Numbers in the building and construction industry. There are suggestions that Australian Business Numbers are misused to justify the treatment of persons, who hold Australian Business Numbers but who are employees, as contractors.”<sup>39</sup>*

The CFMEU is aware of numerous examples of builders' labourers and apprentices purportedly working as independent contractors. It would be extraordinary if the vast majority of these workers were in anything other than an employment relationship.

<sup>36</sup> Budget Statements, 1995-1996, Budget Paper No. 1, pg.4-8.

<sup>37</sup> Buchanan J. and Allen, C., "The Growth of Contractors in the Construction Industry: Implications for Tax Revenue", The Economic & Labour Relations Review, Vol. 11, No. 1 June 2000, pp.60-65

<sup>38</sup> Treasurer Peter Costello, Media Release – The New Business Tax System – Stage 2 Response, 11 November 1999, Attachment O

<sup>39</sup> Final Report of the Royal Commission into the Building & Construction Commission, pg 91

Indeed, the very essence of an apprenticeship is constant supervision, guidance and control by an employer.

Employment sections of newspaper also contain advertisements stating that applicants for building construction jobs must have their own ABN.

The CFMEU is also becoming aware of subclass 457 visa holders being required to obtain an ABN. This is inconsistent with the migration program which requires the sponsor to be the visa holder's direct employer.

The abuse of ABNs is also occurring among working-holiday maker visa holders ("backpackers"). This large and growing proportion of the workforce is using ABNs in their employment arrangements. According to the Minister for Immigration and Citizenship:

*"[t]he number of working holiday makers has more than doubled in the past 10 years, with 155 000 visas likely to be granted in 2007-08 compared to 134 612 in 2006-07. The Department of Immigration and Citizenship estimates that up to 180 000 visas may be granted in 2008-09."*<sup>40</sup>

Given the nature of the jobs performed by backpackers (eg. bar work, labouring, hospitality, etc.), they should be ineligible to use an ABN in their employment. In addition, the likelihood of effective compliance activity among this transitory group after the employment is completed is extremely low.

For avoidance of doubt, we suggest a specific amendment to clarify that these classes of employees, namely:

- apprentices,
- backpackers,
- 457 visa holders, and
- workers doing general labouring

can never obtain an ABN. Adopting this simple suggestion would be a good start to addressing this significant problem.

The CFMEU also remains concerned about tax avoidance through the alienation of income in the construction industry. The Cole Commission found that:

*"Evidence and submissions provided from industry participants, employer and employee representatives, the ATO and academics establishes that tax avoidance in the building and construction industry is a significant issue. .... The industry requires ongoing attention from the ATO because of the level of*

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<sup>40</sup> Senator The Hon. Chris Evans, Minister for Immigration and Citizenship, Media Release – Working Holiday Extension a Boom for Backpackers and Employers, 1 July 2008

*non-compliance. .... the ATO must continue to focus specific attention on the industry and endeavour, through increased interaction with industry participants and through educative processes, to attempt to drive cultural change. The evidence suggests that ATO resources devoted to compliance activity within the industry produce a very favourable return on revenue outlaid. The Commonwealth should consider increasing the resources able to be directed to the Australian Taxation Office for compliance activity in the building and construction industry”<sup>41</sup>*

The attention of the Review Panel is also drawn to the comments made by Justice Spender of the Federal Court on 8 October 2008, as extracted below from a transcript of proceedings:

*“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 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*

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<sup>41</sup> Final Report of the Royal Commission into the Building & Construction Commission, pg.89

*pay into the superannuation funds of the employees the 9 per cent that is mandated by Commonwealth legislation.”<sup>42</sup>*

### ***Number of Contractors Growing***

Direct data is not available on the number of dependent contractors in the economy due to dependent contractors needing to hide their true legal form. However, several authors have looked at proxies from which inferences about the number of dependent contractors can be made. These studies confirm that dependent contractors clearly exist and the number is growing, most particularly in the construction industry<sup>43</sup>.

A Productivity Commission Staff Research Paper, in particular, has examined the number of dependent contractors using the Forms of Employment Survey produced by the Australian Bureau of Statistics (ABS). This survey was first published by the ABS in 1998 and using that data it was conservatively estimated that there were 215,200 dependent contractors in the economy, or 26% of all self-employed contractors.<sup>44</sup> An upper-bound estimate was that 41.4% of self-employed contractors were dependent contractors<sup>45</sup>. A subsequent study by the Productivity Commission found that by 2001 the conservative estimate had increased to almost a third of all self-employed contractors.<sup>46</sup>

This finding of about one third of all self-employed being dependent contractors is also consistent with the results of audits conducted by the ATO. During 2002 and 2005, the ATO conducted just over 2000 personal services income audits and found that an adjustment had to be made in approximately one-third of the cases because people had incorrectly assessed themselves as being engaged in a personal services business<sup>47</sup>. This also supports the conclusion that tax avoidance is still prevalent and compliance is poor.

The likelihood that the number of dependent contractors is still growing requires that the government ensure appropriate resources are devoted to this issue.

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<sup>42</sup> Transcript of Proceedings, Steven Lovewell v Bradley O'Carroll and Others, No.QUD 427 of 2007, Federal Court of Australia, 8 October 2008, pg. 89

<sup>43</sup> See for example, Buchanan and Allen (2000), op.cit., pp53-56.

<sup>44</sup> Waite, M. and Will, L. (2001), op.cit., pp.36-37

<sup>45</sup> Ibid.

<sup>46</sup> Productivity Commission 2006, The Role of Non-Traditional Work in the Australian Labour Market, Commission Research Paper, Melbourne, pg.20

<sup>47</sup> Evidence of Mr Mark Konza, Deputy Commissioner of Small Business, Australian Taxation Office, to the inquiry of the House of Representatives Standing Committee on Employment, Workplace Relations and Workforce Participation on Independent Contracting and Labour Hire Contractors, Committee Hansard, 16 June 2005, pp. EWRWP 3-4

### ***Initiative to Combat Tax Avoidance - Building and Construction Industry Forum***

The Cole Commission recognised that unions could assist the ATO with the identification of tax avoidance in the building and construction industry and appropriate measures to reduce it. The Cole Commission recommended that

- “(a) The Australian Taxation Office establish a Building and Construction Industry Forum:
- (i) to examine taxation issues of significance to the building and construction industry including phoenix company activity; and
  - (ii) to develop workable solutions to the issues and problems identified, including where necessary proposals for taxation policy changes and legislative amendments.
- (b) Membership of the Building and Construction Industry Forum should include representatives of all major industry participants including unions and employer organisations.”<sup>48</sup>

Pursuant to this recommendation, the ATO established the Building and Construction Industry Forum. It has the following terms of reference:

#### *Terms of reference*

The Tax Office seeks to involve the Building and Construction Industry Forum in both existing programs and new initiatives.

The meetings provide opportunities for all parties to:

- **consult** on proposed changes to the administration of the tax system, services, and products
- **advise** on small business perceptions, interests, concerns and areas of difficulty
- **identify** and **discuss** tax administration issues impacting on small businesses
- **suggest** improvements to products and services
- **provide** feedback on new business products and the interpretation of government policy, to enable it to be better understood by the wider small business community

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<sup>48</sup> Final Report of the Royal Commission into the Building & Construction Commission, pg.94

- **inform** the Tax Office where a review of products, services or processes may be required to help small businesses attend to their tax affairs
- **test** ideas, products and administrative arrangements, and
- **encourage** greater use of technology.

In relation to the sector, the partnership aims to:

- address issues concerning administration of the tax system
- identify ways to minimise the cost of compliance
- develop strategies to address compliance risks
- understand the communication and education needs of the sector
- increase awareness of tax issues within the sector
- seek feedback on the Tax Office's service delivery and performance, and
- understand broad trends in the sector and implications for the tax system.<sup>49</sup>

The CFMEU is happy to participate in the activities of the Building and Construction Industry Forum. However, the effectiveness of the forum would be enhanced by the participation of a senior ATO officer to chair and lead the forum. The information brought to the Forum is important and needs to be integrated effectively into the whole of the ATO's operations.

As currently drafted, the terms of reference for the Forum are also very broad. The effectiveness of the Forum would be enhanced by placing greater and more particular focus on the issue of dependent contractors and on improving tax compliance. This is one of the most significant issues for the industry and for taxpayers, and needs to be a specific focus of the Forum and recognised as such in the terms of reference.

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<sup>49</sup>ATO website, at the following page :  
<http://www.ato.gov.au/businesses/content.asp?doc=/content/00139956.htm&pc=001/003/014/001/010&mnu=35837&mfp=001/003&st=&cy=1>

## **Conclusion and Recommendations**

The CFMEU is aware that both the avoidance and evasion of tax - in particular through the misuse of ABNs and the alienation of personal services income – remains a significant issue in the construction industry.

The cost of such activities – and, in particular the damage done to the tax-transfer system which relies so heavily on the integrity of the tax system – requires that action be taken.

The CFMEU recommends that:

- the issuing of ABN's be constrained and that successful applicants be required to demonstrate through tangible evidence that they are operating a business. It should not be possible for apprentices, backpackers, 457 visa workers and workers doing general labouring to obtain an ABN;
- the penalties for making false declarations in order to obtain an ABN be substantially increased for both individuals and their advisers;
- the ATO be directed to undertake and publish analysis investigating whether the legislation in relation to the alienation of personal services income introduced as part of the New Business Tax System has raised the revenue estimated at the time and is more effective than the system it replaced;
- the Government amend the existing legislation with respect to the alienation of personal services income to strengthen the provisions in line with that recommended in the Ralph Review;
- the terms of reference for the Building and Construction Industry Forum be amended to increase the focus on dependent contracting arrangements and on improving tax compliance; and
- the Building and Construction Industry Forum be chaired and led by a senior member of the Australian Taxation Office.