Master Builders Australia

SUBMISSION TO TREASURY

IMPROVING BLACK ECONOMY ENFORCEMENT AND OFFENCES (CONSULTATION PAPER)

21 December 2018

MASTER BUILDERS AUSTRALIA

Master Builders Australia Limited
ABN 68 137 130 182
Level 3, 44 Sydney Avenue, FORREST ACT 2603
T: +61 2 6202 8888, F: +61 2 6202 8877, enquiries@masterbuilders.com.au,
www.masterbuilders.com.au

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Introduction

1. This submission is made on behalf of Master Builders Australia Ltd.

2. Master Builders Australia (‘**Master Builders’**) is the nation’s peak building and construction industry association which was federated on a national basis in 1890. Master Builders’ members are the Master Builder State and Territory Associations. Over 127 years the movement has grown to over 32,000 businesses nationwide, including the top 100 construction companies. Master Builders is the only industry association that represents all three sectors, residential, commercial and engineering construction.

3. The building and construction industry (‘**BCI’**) is an extremely important part of, and contributor to, the Australian economy and community. It is the second largest industry in Australia, accounting for 8.1 per cent of gross domestic product, and over 9 per cent of employment in Australia. The cumulative building and construction task over the next decade will require work done to the value of $2.6 trillion and for the number of people employed in the industry to rise to 1.3 million.

4. The building and construction industry:

   - Consists of over 370,000 business entities, almost all of which (99%) employ fewer than 20 people and over half (59%) having no employees;
   - Employs over 1.1 million people (almost 1 in 10 workers) representing the third largest employing industry behind retail and health services, and the largest industry for full time employment;
   - Represents over 8% of GDP, contributing $142 billion Gross Value Added activity to the economy - the second largest sector in the economy;
   - Trains more than half of the total number of trades-based apprentices every year, being well over 50,000 apprentices; and
   - Performs construction work each year to a value of over $220 billion.

Summary of Submission

5. Master Builders opposes sham contracting. Sham contracting makes it more difficult for Master Builders’ members who comply with the law to compete. Those members are disadvantaged directly by having to compete against competitors whose costs are illegitimately reduced. In addition, they are adversely affected as taxpayers, where all taxpayers must pay increased taxes because of the “leakage” from the system via the black economy and mechanisms that are constructed to defeat the law.

6. This submission centres on questions 14 and 15 within the Consultation Paper that deal collectively with the issue of sham contracting. For reasons detailed below, we strongly recommend that:

   - **there is no change to the existing penalty levels**, as there is no evidence to confirm instances of sham contracting are increasing or that the existing penalties are ineffective;
   - that there must be **no change to the existing tests at s.357 of the FW Act**, as the existing tests are familiar and (on their proper construction) also involve consideration of 'reasonableness'; and
   - that Government first ensure it is making maximum effort to ensure the existing laws are properly enforced and that interagency communication and data sharing is utilised to its greatest potential.

7. We also respond to a number of specific questions that are relevant to Master Builders members.

Responses to Specific Questions

Are there any other key hallmarks you think should be considered when developing new, or amending existing black economy offences and penalties?

8. Master Builders believes there are a number of additional key hallmarks that not only should be considered, but must be considered, in order to increase the effectiveness of the proposed reforms and the overall integrity of the taxation system. These are set out below.

Re-evaluate utility of existing similar measures

9. Master Builders submits it is crucial to consider if there are current compliance and other integrity measures in place that seek to achieve the same policy outcome. Where this is the case, consideration should be given to removing existing obligations if they are deemed to be outmoded or ineffective, or the stated policy aim will be otherwise achieved by the new measures proposed.

10. While the concept of giving consideration to removing existing laws, regulations and compliance obligations may appear to some as a radical position to advance, we nonetheless believe it is a crucial one. This is because the BCI is one which already bears an extremely heavy compliance burden with a myriad of different reporting and record keeping obligations for every aspect of BCI business operations.

Ensure no duplication and overlap

11. Further, or in the alternative, we submit that any proposed changes should not duplicate or overlap with obligations that already exist. Where this is the case, satisfaction of one should automatically satisfy the other without creating any further compliance burden on business.

12. In addition, we submit greater attention should be given to existing non-Commonwealth legislative regimes that create obligations and frameworks that minimise the potential for engaging in black economy offences.

13. For example, within the BCI there are two broad types of existing non-Commonwealth legislative regimes with which compliance must be maintained. These are:

    - Security of Payment ('**SOP**') laws; and
    - Use of Project Bank Accounts/Retention Trusts ('**PBAs**') and ('**RTs**').

14. SOP laws exist to provide a low-cost, rapid and simple regime under which a BCI participant can seek to recover monies owed or seek a payment order through independent adjudication. While SOP laws vary from jurisdiction to jurisdiction, there are common elements including the need to be paid promptly, in full, on time, and without coercion or duress. Compliance with these laws necessarily involves the submission of a 'progress' or 'payment' claim that requires the issuance of an invoice and payment within a particular time period. Non-payment enables access to relief under the relevant legislation.

15. The relevance of SOP laws is that it obliges the industry to issue payment claims in the form of an invoice and demands payment of that invoice in the terms set to be compliant. Where this does not happen, parties may be ineligible to access relief under SOP regimes.

16. In other words, it is in the interests of BCI participants to avoid black economy behaviour as doing so risks rendering them ineligible to access relief in the event of non-payment.

17. Likewise, where PBAs or RTs are used (or mandated, such as in QLD and foreshadowed in other jurisdictions) it necessarily requires participants to place monies into a form of trust account from which payments to subcontractors are drawn. The existence of such arrangements again

discourages the use of black economy behaviour so as to ensure payment can be received through such a vehicle.

Communicate tangible outcomes to industry

18. The last hallmark we submit for consideration is one that requires Government to ensure new obligations can be measured and reports given to industry as to the effective or otherwise nature of the new obligations.

19. A very common criticism from BCI participants and Master Builders' members is that when new laws are put in place, they are rarely measured to determine if they are effective nor is industry provided with any plain English or simple report that explains improvements in terms of policy outcomes.

Which elements of serious black economy offences should reversing the onus of proof apply to?

Should the onus of proof for some elements of black economy offences be reversed and borne by the defendant instead of prosecution as recommended by the Taskforce?

What are the issues in reversing the onus of proof for some black economy offences?

20. Dealing with the above questions collectively, Master Builders submits that the reversal of onus should be avoided except where it involves black economy behaviour that incorporates a criminal element (such as where it is asserted that a matter involves proceeds of crime).

21. Master Builders submits that a fundamental principle of the western legal system is the presumption of innocence, or *ei incumbit probatio qui dicit, non qui negat*. It should be accepted that the burden of proof is on the one "*who declares*" and not on one "*who denies"* and matters involving black economy offences should, as a rule, have no exemption to this fundamental principle.

22. Other jurisdictions similar to Australia (such as the UK and Canada) maintain the presumption of innocence with respect to almost all legal matters, save for unexplained wealth (proceeds of crime) or defamation claims. While Australia has other exceptions, they are rare and where they exist, they are rarely used.

23. In the context of black economy offences, Master Builders has been unable to nominate a situation, circumstance or example in which a prosecution could not make out an offence that would warrant the reversal of the usual onus.

24. Often, Government cites cost of prosecution as the basis for such an approach and we do not consider this appropriate justification. In most cases, it is the failure of regulators or agencies to share information or cooperate thoroughly so as to obtain evidence to prove a black economy offence. Australia is a modern, technologically advanced country, and the ability for records to be obtained to prove an offence is extremely high and likely to deliver a favourable prosecution.

25. We strongly urge government to proceed cautiously in considering this issue and recommend against any onus reversal (save for unexplained wealth) as it would risk undermining fundamental principles of law and justice.

What non-financial penalties could be considered to enhance compliance with tax law?

Are there any limitations, risks or unintended consequences that may result from implementing non-financial penalties?

In what circumstances should a travel ban scheme apply to Australian taxpayers?

Would the introduction of arrangements in Australia to prevent travel by taxpayers with large tax debts improve compliance with Australia's tax law?

26. Again responding to these questions collectively, Master Builders notes that there are a range of existing non-financial penalties for participants in the BCI. These are of such significance that they already pose a compliance incentive and would discourage the consideration of additional measures.

27. For example, in the BCI, participants are required to provide evidence of compliance when:

    - Tendering for most types of public construction work and related services (for example, the 2016 Building Code, and the ACT 'Secure Local Jobs' Code);
    - Being engaged to perform any construction work that is directly, or indirectly funded by Government;
    - Being considered for Government procurement panels; and
    - Provide ongoing evidence of compliance on (usually) a quarterly basis.

28. These requirements flow down to all those within the BCI contracting chain if they become part of, or are engaged on, the relevant work, and those who supply goods or services related to the work. Non-compliance with these terms conventionally involve sanctions of a type that creates an effective deterrent against such conduct, including termination of contract, sanctions, and bans on tendering for or being engaged in relation to future government work. In addition, it is common to demonstrate compliance broadly when:

    - Seeking a trade licence or registration;
    - Entering, servicing, or delivering to, particular work sites where compliance is a condition of access;
    - Obtaining various types of insurances relating to companies and directors;
    - Seeking to obtain the proposed Director Identifier Number ('**DIN**') and be placed on the associated Director Register;
    - Working for various not-for-profit groups, such as religious, community and education organisations; and
    - Becoming registered as an entity eligible (pursuant to terms of a relevant Trustee Deed) to make contributions on behalf of employees to approved superannuation, redundancy or other worker entitlement funds.

    Other examples are available.

29. Master Builders would oppose the use of any travel ban scheme. This is simply because such a ban may actually cement the policy mischief the taskforce is charged to address and, potentially, worsen it. This is particularly so for the BCI where the overwhelming majority of products are sourced overseas and, through mechanisms like Modern Slavery and Building Product laws, participants are obliged to satisfy themselves about particular standards and therefore are required to travel overseas regularly.

What level of increase to the civil penalties would serve as an appropriate deterrent to stop employers from engaging in sham contracting arrangements?

30. Master Builders submits that there is no level of increase necessary, and indeed any increase would be entirely misguided and made without sound basis. In considering that position, it is important to note a number of factors which underpin it.

Master Builders Policy Position – Independent Contracting

31. It is a core policy position of Master Builders that we support the use of independent contracting as a legitimate and legal method of engagement and oppose measures that seek to undermine or erode its standing as a lawful and acceptable practice.

32. The entire BCI is underpinned by a comprehensive system of relationships between contractors that is necessary in terms of both conventional industry structure and inherent in performing the tasks associated with construction work. This ensures:

    - the labour force experiences high levels of utilisation;
    - construction costs are not inflated due to delay or damages claims;
    - delivery of much needed personal and public infrastructure (and the entire every day-built environment) is achieved in a productive way; and
    - boosts in levels of employment, innovation and entrepreneurship that flow from a high concentration of SMEs and family businesses.

33. There are currently over 300,000 independent contractors engaged in the BCI alone[1], representing around one-third of the total number within all sectors of the economy. It is clear that this form of engagement is vital to the ongoing and future successes and economic output of the BCI.

34. There are a number of identified[2] reasons for the prevalence of independent contracting in the building and construction industry as follows:

    - the production process on construction projects comprises a diverse range of tasks. Many workers are only required at one point on a project. Production therefore tends to be carried out by a collection of subcontractors working under the supervision of a head contractor;
    - demand for housing and commercial buildings is sensitive to the economic cycle. As demand is uncertain, the environment encourages the use of contract labour; and
    - fluctuations in employment mean workers enter from other industries during periods of high labour demand.[3]

35. The BCI is cyclical and demand for both employees and contractors varies.

Master Builders Policy Position – Sham Contracting

36. As previously stated herein, Master Builders has long sought the full effects of the law to be visited on those who operate illegitimately and has, on many occasions, assisted the Australian Taxation Office ('**ATO**') with policies which assist with the process of strengthening the taxation system to stifle the activities of those who deliberately misrepresent the nature of the employment relationship, as proscribed by the FW Act.

37. Having regard to the above policy position, we note the following additional reasons as to why Government should not make any changes to penalty levels.

No evidence

38. Master Builders has yet to sight any solid qualitative evidence that instances of sham contracting have increased or decreased such that it warrants a revision of related penalties. Without any evidence, Government should simply not increase penalty levels to tackle a problem about which it freely admits there is no evidence as to scale.

39. Indeed, the Consultation Paper itself notes [at p.15] that *"it is difficult to estimate the size of the issue around sham contracting"* and refers back to the Taskforce Final Report suggesting it contains "*evidence*". However, the Taskforce Final Report [at page 231] actually states "*we do not have specific estimates on the size of the sham contracting problem"* and found that while *"it may be growing"* it was *"an area which requires further examination"*.

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[1] *ABS Dataset 6.333.0 – Characteristics of Employment.*
[2] *Sham Contracting Inquiry Report 2011 Office of the Australian Building and Construction Commission: http://www.fwbc.gov.au/sites/default/files/ShamContractingInquiryReport-1.pdf*
[3] *Id at para 4.23*

40. The Final Report also cites ABS data which notes there is a growing level of contractors who report they have no control over their own work and infers this represents a rise in sham contracting. Unfortunately, self-reported ABS data relating to an independent contractor 'authority over their own work' cannot be relied on as an accurate reflection of 'instances of sham contracting'.

41. Authority over how work is carried out is only one element of understanding this relationship, and, especially in the BCI, is by no means a determinant of the head and subcontractor relationship.

42. For example, an independent contractor engaged to carry out the brickwork at a new residential property on behalf of a builder may subjectively report no control or 'authority' of how they work. This contractor may very well be required to follow specified plans, use specified materials, follow a specified method to achieve a specified finish - and do so on a specified timeframe. This contractor may consider they have no authority over the way they carry out this role – but this is simply because the terms of the head contract (and their subsequent engagement) dictate specifications. However, nothing stops this contractor determining their hourly rate, method of invoicing or choice of branding - and ultimately deciding whether they chose to work with that same builder into the future.

43. The ACTU has created a Report[4] that purports to examine and quantify the extent of sham contracting and asserts it is evidence that it is a growing problem and improved laws are needed. Master Builders has examined this report and submit it is clearly both (a) a clear misrepresentation of ABS data[5], and (b) makes a claim that, even if the data relied on was a true reflection of ABS statistics, fails to support their claim.

44. As noted earlier above, self-reported ABS data relating to an independent contractor 'authority over their own work' cannot be relied on as an accurate reflection of 'instances of sham contracting'. The flaw in the ACTU's logic, and the logic of relying on this statistic as a measure of 'sham contracting' is apparent.

45. The ACTU report follows an earlier CFMEU report that also sought to misrepresent the size of sham contracting and contained similarly flawed conclusions. Both the ACTU and CFMEU reports endeavour to paint sham contracting as something different to the deliberate manipulation of the law. This is done, we say, to promote a range of other agendas.

46. Firstly, it assumes that sham contracting is an endemic problem in the building and construction industry or other industries. This is not the case. Secondly, it enables unions where members are employees rather than a contractor to discourage the formation of independent businesses as a means to boost membership.

47. Relatedly it appears that some of the fallacious assumptions about this subject arise from the CFMEU's "*Race to the Bottom: Sham Contracting in the Australian construction industry*".[6] This report contains completely unreliable statistics. It is inaccurate and falsely damning of the industry.

48. The above CFMEU statistics were dealt with by the ABCC who, after commissioning independent research, found that "*without further explanation by the CFMEU it is difficult to find other than the conclusions reached by the CFMEU are not reliable*".

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[4] *See https://www.actu.org.au/media/1385230/d182-the-rise-of-sham-contracting-and-abuse-of-the-abn-system-14-september-2018.pdf*

[5] *See the ACTU Report into Sham Contracting, which states at page 4 that only 1/3 of contractors reported to 'have authority' over their own work, relying on ABS Dataset 6.333.0 – Characteristics of Employment. In actual fact, this data set shows the inverse of the ACTUs claim, in that 2/3 of contractors reported to 'have authority' over their own work (see table 11).*

[6] *http://www.cfmeu.asn.au/downloads/nat/reports/race-to-the-bottom-sham-contracting-in-australias-construction-industry Accessed 12 February 2015*

49. We can be more direct. The CFMEU report is wrong and misconstrues the issues. The research released by the Fair Work Building Construction agency on 21 December 2012 about sham contracting[7] falls into error as well. The estimate of 50,000 people being potentially "on a sham contract" may indicate possible misclassification. But it does not represent a proper indication of sham arrangements – the deliberate misuse of the law. This is especially the case with the report's reliance on self-assessment combined with the finding that 54% of workers have never heard of the term "sham contracting".

50. Much of the agenda of those who seek to oppose the current law is based upon making misclassification akin to sham contracting. This is lamentable given the state of the complex law which distinguishes between whether a worker is an employee or a contractor. Employers can already suffer very problematic financial burdens following misclassification if they are then asked to reverse the status of a contractor. Adverse cost consequence should not be added to by labelling misclassification an offence. The current provisions in the law should not be changed and the penalties should remain at their current level.

51. Master Builders also notes that available data produced by the FWO and ABCC is actual evidence that the extent of sham contracting is contextually minor and does not represent any basis on which the level of penalty should be changed.

52. The below table contains data collated from ABCC/FWBC[8] reporting, from which a number of conclusions can be drawn. These are:

    - Less than half of the number of inquiries received alleging instances of sham contracting were identified at early stages as being without basis and did not proceed to investigation;
    - Where investigations were conducted, they almost always found no basis to the alleged complaint and did not result in the commencement of proceedings;
    - There were only a handful of prosecutions in which an instance of sham contracting was found.

PERIOD	INQUIRIES	INVESTIGATIONS	COURT PENALTY
2011-12	189	63	1
2012-13	379	107	3
2013-14	*Unreported*	47	*Unreported*
2014-15	*Unreported*	6	*Unreported*
2015-16	*Unreported*	0	0
2016-17	28	16	*Unreported*
2017-18	53	47	0

53. Similarly, the below table contains data collated from FWO annual reports[9] and demonstrates that the level of instances in which a sham contract was found is incredibly low.

PERIOD	INSTANCES FOUND	IN CONSTRUCTION

[7] http://www.fwbc.gov.au/sham-contracting-research-released-0.
[8] https://www.abcc.gov.au/about/plans-and-reports/annual-reports
[9] https://www.fairwork.gov.au/about-us/our-role/enforcing-the-legislation/litigation

2009-10	1	0
2010-11	2	0
2011-12	2	0
2012-13	2	0
2013-14	2	0
2014-15	2	0
2015-16	2	0
2016-17	6	0
2017-18	7	0

54. The above evidence is backed by a BCI specific compliance audit undertaken by the FWO in July 2015.[10] At page 16 of the FWO audit report the following is said:

> *"Given the historically high reliance on contracting arrangements and concerns of sham-contracting and misclassification within the industry, the contracting arrangements for 90 businesses within the sample of 700 employers were assessed. Of the 90 contracting arrangements assessed, no prima-facie evidence of sham-contracting arrangements was found. Rather it was found that:*
>
> - *Genuine invoices were being issued from one company to another (not from a company to an individual) and were usually based upon a quote to complete a job/task, with no reference to hours or days of work; and*
> - *Where invoices were issued, they were for tasks outside the scope of the principal contractors skill-set (i.e. a builder invoices an electrical company to complete electrical work)."*

55. On any reasonable assessment of the qualitative data that exists, it cannot be said that instances of sham contracting are such that would justify any alteration to existing penalty levels.

Existing Compliance Obligations abound

56. Master Builders also submit that BCI participants frequently must also demonstrate compliance with existing contractor laws and have not entered into or encouraged a sham contract arrangement. These include:

- The 2016 Code: The *Building and* Construction *Industry (Improving Productivity) Act 2016* (Cth) (‘**the BCIIP Act’**), and the associated *National Code for Tendering and Performance of Building Work 2016* (‘**The 2016 Building Code’**) – which include obligations to:
  a. Mandate subcontractor compliance with the BCIIP Act and 2016 Building Code;
  b. Provide detailed industrial relations management plans with respect to direct employees and engaged subcontractors;

[10] *National Building and Construction Industry Campaign 2014/15 Fair Work Ombudsman July 2015*

c. Undertake to comply with all Commonwealth Laws and industrial instruments, which includes (specifically mentioned) laws relating to the payment of employees and subcontractors and remittance of tax, work health and safety, and contracting arrangements

d. Avoid 'sham contracting' arrangements;

e. Meet all state based Security of Payment requirements, including by contracting into compliant dispute resolution procedures with subcontractors; and

f. Report on all aspects of the proposed work to be undertaken relating to sourcing and compliance of materials, projected whole of life costs of the project, the impact the project will have on jobs and the development of a skilled workforce.

- State based Security of Payment Laws – many of which require head contractors to provide monthly (or more regular) statutory declarations that they have met all payment obligations to subcontractors before their rights to enforce payment become enforceable at law;
- Federal obligations to undertake quarterly taxation remittance, TFN and ABN assessments; and
- Other general compliance checks, including single touch payroll, superannuation and associated reporting obligations - including remittance of payments to worker entitlement and redundancy funds.

57. In short, the vast number of compliance obligations that exist in the BCI make it virtually impossible to engage in sham contracting. This is supported by the data noted above.

Regulators abound

58. Master Builders notes that there are many government agencies, departments and regulators which exist and have power to investigate and prosecute instances of sham contracting. This prolific number, combined with the data noted above, suggests that sham contracting is not a significant problem despite their powers to investigate. Agencies and regulators with such powers include, for example -

- Fair Work Ombudsman;
- Australian Building and Construction Commission;
- Safety Regulators – including state WorkSafe inspectorates, and the Office of the Federal Safety Commissioner;
- The Australian Taxation Office;
- The Australian Securities and Investment Commission;
- State Industrial Relations Authorities; and
- State Offices of Fair Trading.

Existing law is comprehensive

59. Master Builders submits that the framework to prevent sham contracting is already extensive and appropriate. This framework includes, for example -

- Independent Contractors Act 2006 (Cth);
- Fair Work Act 2009 (Cth);
- Corporations Act 2001 (Cth);
- Treasury Laws Amendment (Registries Modernisation and Other Measures) Bill 2018;
- Competition and Consumer Act 2010 (Cth); and
- Australian Consumer Law

60. Given the coverage and regulator capacity to enforce compliance, any increase to penalty levels on the FW Act is unnecessary and misguided.

Disregards employee behaviour

61. The provisions of the Fair Work Act regarding sham contracting, while appropriate, do exist on the assumption that only employers seek to engage in or encourage sham arrangements. This clearly disregards employee behaviour and forgets the very real circumstance that employees may consider there to be an advantage to being a contractor and seek to be engaged as such.

62. The above contention was supported by the Taskforce Report which found [at page 13] that:

> *"Employees may sometimes propose or support sham contracting arrangements to avoid or lower their tax and other obligations."*

63. Later [at page 232] the Taskforce report observes:

> *"Sham contracting can occur as a result of employer and employee collusion"*

64. And later

> *"Businesses and workers together, sometimes with professional advice, contrive arrangements to exploit the tax differential, avoid the obligations associated with an employment contract, and take advantage of the perceived benefits associated with independent contracting."*

65. Within the BCI, Master Builders' members report a high level of circumstances in which 'workers' demand to be engaged as a contractor and refuse offers of engagement on any other basis. This is more common in specialised trades, or where a 'worker' is already engaged as a contractor elsewhere.

66. It is often the case that BCI participants are faced with the choice between entering into an arrangement that may represent a sham contract or being able to perform basic construction work. Labour market and economic conditions are obviously linked to this. For example:

- current data confirms that an average employee tradesperson in the BCI earns $150,000 - $180,000 per annum;
- construction has experienced strong employment growth[11], with employment in the industry increasing by 221,400 (or 26.6 per cent) over the 10 years to February 2015, making it the third largest growth industry in Australia over this period. This represents a growth rate of 2.4 per cent per annum, compared with 1.8 per cent per annum recorded across all industries; and
- workforce size is predicted to increase by over 120,000 people over the next 5 years in addition to replacement of loss due to ordinary turnover.

67. When regard is had to the above data, the conclusion to be drawn is that 'workers' in the BCI have a significantly better bargaining position than employers and that they can maximise earnings by seeking engagement as a contractor rather than an employee.

68. This demonstrates our contention that it is not only employers who should be the focus of penalties under the FW Act. We recommend that anyone should be exposed to penalty.

Preferences one relationship over another

69. The focus on employers assumes that an employment relationship is more beneficial to one party than a contractor relationship, or that taxation levels for individual employees would be higher than as a contractor. This is simply not the case.

[11] *Australian Government – Department of Employment Construction Outlook 2015*

Is the existing 'reckless' threshold for prosecuting employers involved in sham contracting appropriate? Should this legal threshold be lowered to 'reasonableness' test?

70. The existing threshold is entirely appropriate and should not be altered. Master Builders would oppose any change that weakens the existing tests for the reasons already stated above and those additional reasons set out below.

71. Prior to doing so, Master Builders notes that sham contracting is directly related to the matters proscribed by the FW Act in sections 357 to 359. Hence, a sham contract arrangement arises where an employer deliberately treats an employee as an independent contractor or coerces employees into signing contracts that represent them as being contractors rather than employees. This is different to misclassification which may arise from having a poor understanding of the law or through inadvertence.

72. Master Builders stresses that a sham arrangement is a deliberate act by those who seek to act illegitimately. This is accepted by the Productivity Commission (which the Taskforce Final Report cites as justification for its recommending a test alteration) who adopted the following definition in its public infrastructure report:

> *"Sham contracting 'involves misrepresenting or disguising an employment relationship as one involving a principal and contractor under a contract for services', which is unlawful under the Fair Work Act 2009 (Cth)"*

73. Employers should not suffer from the difficulties in certain circumstances of making the relevant distinction between employee and independent contractor. They should, however, suffer harsh consequences when they deliberately flout the law.

74. An employer can be liable for a breach of the terms of the modern award or other provisions which would attract substantial civil liability. There are a range of other serious consequences that can flow from a breach of a number of statutes including taxation laws, superannuation, long service leave and workers compensation laws. The current law is adequate to deal with those who take deliberate action and enter into a sham arrangement, with the knowledge of doing so.

75. In this context we note that, as discussed earlier in this submission in the context of sham contracting, the CFMEU has, for a long time, incorrectly contended that many bona fide contractual arrangements are artificial and that many subcontractors are, in fact, employees. The contention manifests itself in disruptive tactics against contractors and subcontractors from time to time as the CFMEU, amongst other things, seeks the right to challenge the bona fide legal status of subcontractors. Most complaints emanate from the union because unions have a direct interest in reducing the number and minimising the growth of independent contractors - because that activity decreases the pool of potential members and hence the flow of funds to the unions.

76. Both the Consultation Paper and Taskforce Final report outline several basis that purport to justify the recommendation to amend the existing test. These include difficulties for regulators and others in establishing the proof required to satisfy the existing recklessness test and the associated recommendation of the Productivity Commission, expressed [at page 237] as follows:

> *"The Productivity Commission reviewed these provisions in 2015 and found that the 'recklessness' test was generally too high a bar for regulators and others to prove, and should be lowered to a test of 'reasonableness'."*

77. The Consultation Paper references *Fair Work Ombudsman v Ecosway Pty Ltd [2016] FCA 296* (**'the Ecosway Case'**) as guiding how a potential altered 'reasonableness' test might be applied.

78. Master Builders submits there are two major flaws that underpin both the PC and Taskforce recommendation.

'Recklessness' is a ground for defence, not a ground for prosecution

79. First, the 'recklessness' test is not one that a prosecutor must satisfy. A demonstration that the conduct was 'not reckless' is an available defence and not a barrier to be satisfied in bringing a prosecution. The burden of proving that conduct was not reckless is the responsibility of the defendant.

80. The concerns from regulators, therefore, that 'recklessness' is difficult to establish and therefore is a deterrent to bringing prosecutions is clearly misguided. If there are difficulties in terms of establishing 'recklessness', those difficulties are experienced by employers and not prosecutors.

Ecosway confirmed 'reasonableness' is necessary to determine 'recklessness'

81. Secondly, the *Ecosway* case is one that actually confirmed that in order to demonstrate the absence of recklessness, the employer must also demonstrate that they could not be expected to have known that the contract was a contract for employment rather than a contract for services.

82. At para 199 of *Ecosway,* White J said:

> *"Accordingly, I consider that employers seeking to discharge the s 357(2) onus must prove that they did not know that the contract was a contract of employment rather than a contract for services and further that, in the circumstances known to them at the time they made the misrepresentation, they could not reasonably be expected to have known that the contract may be a contract of employment. That is the approach which I will apply in this case."*

83. In reaching the above conclusion, White J noted earlier cases which considered similar discussions. One of these was *Fair Work Ombudsman v Metro Northern Enterprises Pty Ltd* [2013] FCCA 216 in which Judge Barnes noted that different considerations may apply when the absence of recklessness is a criterion of a defence as opposed to its presence being a necessary element of liability. At para 184, White J noted that:

> *"Her Honour considered that recklessness in s 357 relates to the respondent's state of mind as to whether the contract was one of employment, at [387], but did not elaborate on the state of mind it required. However, it is evident that Judge Barnes considered that recklessness involves an element of objectivity:*
>
> > *[403] On all the evidence it is apparent that, notwithstanding this advice and knowledge, Metro acted in a manner that was careless or incautious as to whether the contracts with the complainants were in fact contracts of employment. ...*
> >
> > *[405] Mr Bizimovski was or should have been aware that there was a real risk that the contracts with the complainants were contracts of employment, notwithstanding the statement in the Independent Agent Agreement that they were not employees. He was aware of the possibility of ramifications if a complainant was wrongly categorised. "*

84. It was also noted that in Director of the *Fair Work Building Industry Inspectorate v Bavco Pty Ltd (No 2)* [2014] FCCA 2712; (2014) 291 FLR 380, Judge Manousaridis considered that the approach of the plurality should be applied in relation to s 357(2) so that it should not be understood as including any element of objectivity. Essentially, this was because both provisions used the term "reckless as to whether" and because if the legislature had intended that recklessness should be determined objectively, terminology indicating that that was so had been readily available to it.

85. On the above basis, Judge Manousaridis concluded at [65] that an employer seeking to establish that it had not been reckless within the meaning of s 357(2)(b) had to prove one of two things: first, that it did not know there was a possibility that the employee might be an employee; alternatively, if the employer was aware that there was a possibility that the employee was an employee, that it had not been indifferent about whether the employee was in fact an employee.

86. In addition, White J in *Ecosway* had regard to the legislative history behind s 357(2)(b) and observed at [190-191]:

> *[190]…….Section 357 had predecessors in ss 900 and 901 of the Workplace Relations Act 1996 (Cth). The former proscribed a representation that a current contract was a contract for services when it was in fact a contract of employment. The latter proscribed a representation by a person offering to enter into a contract that the contract was one for the provision of services when it would in fact be a contract of service. Each of s 900 and s 901 provided for a defence which, while not identically expressed, had the same effect as s 357(2). In the case of s 900, subs (2) provided for a defence if misrepresentors proved that at the time the representation was made, they did not know that, and were not reckless as to whether, the contract was a contract of employment rather than a contract for services.*
>
> *[191] In relation to this provision, the Minister gave the following explanation in the Explanatory Memorandum accompanying the Second Reading Speech:*
>
> > *Subsection 900(2) would provide a defence to the civil penalty in subs 900(1). Subsection 900(2) would provide that a person would not contravene the civil penalty if, when they made the representation that there was an independent contracting relationship, they believed the contract was for independent contracting and could not have reasonably been expected to know that the contract was one of employment. The onus to prove the defence in subs 900(2) would rest with the person who made the representation. This is a reversal of the burden of proof; the burden of proof normally rest with the person making the civil remedy application. The reason for this reversal is that the matter in subs 900(2) would be peculiarly within the knowledge of the defendant and would be significantly easier for the defendant to disprove and for the person making the application to prove.*
> >
> > *(Emphasis added)*

87. White J then found:

> *"The emphasised portion is a clear indication of an understanding that the term "reckless" in s 900(2) was to have an objective element. It is reasonable to suppose that the term has the same meaning in s 357(2), the successor provisions."*

88. And went on to observe:

> *"It is also appropriate to have regard to the mischief to which s 357 is directed. North and Bromberg JJ referred to this in Quest South Perth at [95] as "the attempted avoidance of legal entitlements due to an employee through arrangements which falsely disguise the employee as an independent contractor". Their Honours went to describe ss 900 and 901 as "remedial and beneficial despite their penal nature". The same can be said of s 357.*
>
> *In my opinion, construing the word "reckless" in s 357(2) as including an objective element is consistent with the purpose for which the provision was enacted."*

89. When regard is had to the above decisions, it is clearly evident that a determination of 'reasonableness' is a necessary precursor to the establishment of 'recklessness'. As such, any change to the existing tests is unnecessary.

Benefits of retaining existing test

90. Master Builders submits that, in addition to there being no identified basis or need to change the existing tests, there are benefits associated with the current test. These must be considered as part of any objective assessment of the merit of altering current provisions. In our submission, the benefits of the existing arrangements are many as we now detail.

Delivers fairness and objectivity

91. Master Builders believes the existing threshold tests bring with them an inherent capacity to be applied in such a way as to deliver an outcome that best services the intended policy outcome and delivers justice to all parties involved. They are applied appropriately and in a manner which encourages objectivity and with regard to evidence and fact.

Reasonableness is a subjective, and therefore unclear test

92. The application of the 'reasonableness', or 'reasonable person' test is one of the most oversimplified, and paradoxically confused legal concepts within our common law system. Fundamentally the fact that the test exists, and requires judges to consider its application, highlights the apparent paradox that innately exists within its application. The need for judges, barristers, solicitors, and formal reams of evidence is indicative that the test often cannot be applied simply, particularly where circumstances are fluid, and the application of facts and circumstances to law changes over time. Fundamentally, where this test can be avoided by the application of an objective or qualitative test in its favour, it should be; and this is one of those cases.

Existing tests are familiar

93. There is a plethora of existing case law which assists in understanding the current test and related obligations. As such, the existing obligations are well known and understood. Making any change to legal test will likely spur no change from industry, but instead drive confusion and angst off the back of uncertainty in obligations.

Conclusion

94. Master Builders appreciates the opportunity to make a submission to the Department with respect to the Taskforce Report.

95. Any further information relevant to this submission can be obtained by contacting Mr Shaun Schmitke, Deputy CEO, on 02 6202 8888 or shaun.schmitke@masterbuilders.com.au.

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