

False Economy

The Growth of 'Bogus Self-Employment'
in the Construction Industry

Winter 2015



CONGRESS
BRIEFING

Welcome to what is the first in an entirely new series of briefing and policy documents, from the Irish Congress of Trade Unions.

Over the coming months and years, Congress will utilise this platform to tackle some of the key issues facing our society and economy, north and south.

We hope to use this series to highlight issues that affect and concern working people and those without a voice in our society, highlighting critical deficits in social infrastructure and shining a light on areas of the economy where inequality persists and thrives.

In doing so, we aim to contribute to a very necessary and ongoing debate on the future shape of society on this island, particularly in the aftermath of crisis.

If we are to construct a more equitable and sustainable economic and social model, then it is vital that the concerns of working people are heard and understood.

That might be an ambition that lies beyond the scope of this series, but it is a conversation that we need to start.

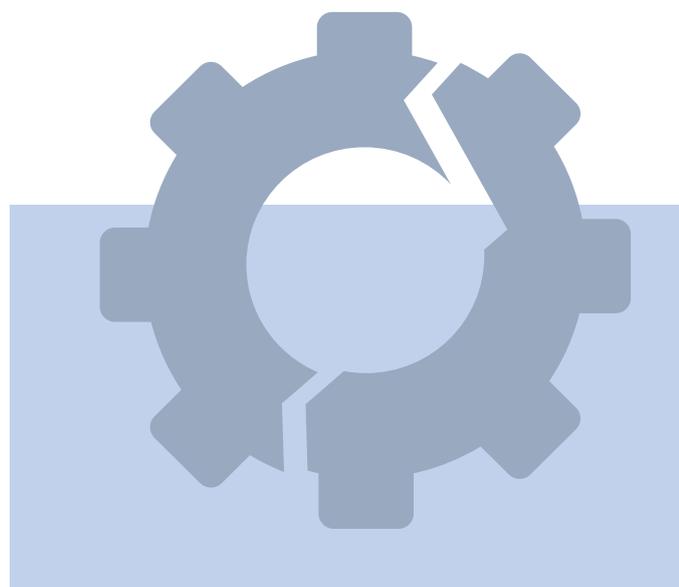


A handwritten signature in white ink, which appears to read 'Patricia King'. The signature is stylized and cursive.

Patricia King,
General Secretary

Contents

Executive Summary	4
What is a Principal Contractor?	6
Growth of Bogus Self-Employment	7
State and Taxpayer Shoulder Losses	9
Financial Advantages of Misclassifying Workers	10
A Problem in the United Kingdom	10
Feeble Risk Control	11
Flawed Systems	11
Congress Proposals for Risk Control	12
Appendix 1	13



Executive Summary

Bogus self-employment in the construction industry has increased at an alarming rate in the last decade. The practice involves workers being incorrectly designated as ‘self-employed’ in order to save money for major contractors, in terms of tax and social insurance. This has had a number of very negative consequences for the workers concerned, for the industry as a whole and for wider society, resulting in very substantial losses to the State. Workers suffer the loss of employment protections and social insurance cover, while the wider industry sees an erosion of standards that make it less sustainable into the future. Meanwhile, the State and citizens are deprived of substantial revenue in the form of lost PRSI contributions, taxes foregone and public money lost to unscrupulous contractors engaged in de facto fraud.

It is our view that a key contributory factor is the failure to adhere to a Code of Practice agreed by unions and construction employers, in a process hosted by Revenue. The revised *Code of Practice for Determining Employment or Self-employment Status* was agreed in 2007. The aim of the Code was to ensure that the Revenue systems designed to vet and assess applications for contractor status operated to the highest possible standard. However, bogus self-employment increased hugely in the years after 2007, strongly suggesting that the Code was not being adhered to. In 2012, Revenue discontinued the old paper-based system and moved the RCT1 (Relevant Contracts Tax) process online. The pre-2012 system had stiff controls for applicants seeking ‘contractor’ status and alerted them to the loss of benefits and protections that could apply. However, those controls disappeared with the move online.

Since then, the number of self-employed together with, bogus self-employed has further increased, in the construction sector. Given that the financial advantages of misclassifying workers as self-employed are immense, it is clear that some new form of control is required.

Major public contracts – as in the school building programme – are procured on the basis that established rates of pay and pension contributions will apply. However, when workers are compelled to take on bogus self-employment status, those rates will often not apply and the ensuing differential is, we believe, retained by the contractors, while workers and taxpayers are short-changed. This practice reduces vulnerable workers to the status of ‘day labourers’ with no employment rights, while the State suffers substantial losses in PRSI contributions.

In this context, Congress believes it is a clear systematic error to allow ‘principal contractors’, who have a major vested interest, to retain the power of discretion in relation to employment status. The term ‘principal contractor’ is also misleading in that there can be any number of ‘principal contractors’ on a given project, often with no assets, no office and no employees. This lack of appropriate control and oversight effectively discriminates against good employers and facilitates those who want to substitute decent jobs with bogus self-employment, for short-term gain. Over the longer-term, only rogue employers benefit and everyone else loses out: Revenue, taxpayers, compliant contractors, the construction workforce and the wider industry.

It is ironic to note that employment agencies in the UK charge construction companies huge fees to facilitate their engagement in bogus self-employment. In this jurisdiction, systemic flaws and seeming political indifference means they get it for free. Unless there is urgent action, the Irish construction industry will cease to be a source of decent employment and become a haven for sweated labour, where workers have no rights or social insurance cover.

Ultimately, responsibility rests with policymakers who, to date, seem disinclined to ensure that labour standards are upheld, good jobs supported and public contracts are not a vehicle for fraud.



What is a Principal Contractor?

The generally accepted meaning of the term 'principal contractor' is the entity whose name appears on the project billboard. The term should usually comprehend a tax compliant entity with a set of accounts, a place of business, supplying materials and taking some of the financial risk in the project. However, many so called 'principal contractors' have no assets, no office and no employees. Under the system devised and administered by Revenue the term 'principal contractor' can apply to anyone who wants to appropriate it.

When a 'principal contractor' engages a sub-contractor through the online application system the 'principal' is expected to be satisfied that the contract is not a contract for employment. However, we believe, that granting this power of designation to the 'principal contractor' without restriction is to invite the possibility of wholesale abuse. In correspondence with Congress, Revenue provided the following definition of a principal contractor:

"A person who enters into a relevant contract in the construction.....sector and, makes payments under that contract and has an obligation to make deductions at source from any payments made. For example a State Body or a Board of Management of a school which awards a contract for a school is a principal contractor...."

This is misleading, whether by accident or design. When a State Body or a Board of Management acts as a 'principal contractor', the contract can be subdivided an infinite number of times so that a shadow employment agency can be a 'principal contractor' and offer contracts to individual workers who in turn can be a principal contractor for the purposes of engaging their 'mate' or 'helper.'

Congress raised directly with Revenue the case of one so-called 'principal contractor' who functioned without any employees, yet had engaged several persons on a self-employed basis on a number of publicly-funded projects in the Dublin area. The business address was a funeral parlour in Belfast. The Revenue response declared that:

"There are EU Treaty of principles of non-discrimination, transparency, freedom of movement and the freedom to provide goods and services to be borne in mind."

Congress believes proper and effective controls should apply, regardless of the domicile of the 'principal contractor'.



Growth of Bogus Self-Employment

Bogus self-employment has been a problem in the construction industry for many years. The first serious attempt to examine the issue took place under the auspices of the **Hidden Economy Group (HEG)** in 2007. The HEG was hosted by Revenue and involved Congress, employer groups, the National Employment Rights Authority (NERA) and the Department of Social Protection (DSP). The group exists to combat tax and PRSI evasion and to promote a level playing field on which companies can compete fairly and do business. Within the HEG a strong consensus emerged that self-employed status was appropriate only to those with contracts that met the criteria of genuine self-employment.

That in turn resulted in one of the key achievements of HEG – the agreement of a *Code of Practice for Determining Employment or Self-employment Status*. The aim of the Code was to establish objective criteria capable of determining whether a given contract was either *for service* (employee), or *of service* (a sub-contractor). The criteria derived from a large body of Common Law on what constitutes legitimate self-employment. To that end, the Code merely reflected the law as decided by the courts. The HEG emphasised the need for clarity, transparency and effective control in the systems deployed to establish employment status. It was our belief that this agreed Code of Practice would serve as the basis of official policy and practice and would be fully utilised when assessing how employees and contractors were to be classified.

Since the Code of Practice was agreed we have witnessed exponential growth in self-employment in the sector (see Figure 1 below). In 2012, Revenue's system for the registration of building contractors – the Relevant Contracts Tax (RCT1) – moved from a paper-based system to an online system. The paper-based system

had the advantage of requiring a worker to consider the nature of the (self-employed) contract they were being offered and to sign a form stating they were genuinely self-employed. It also clearly spelt out the right and entitlements the worker would sign away by opting for self-employment: in terms of pay, pension, sick pay, holidays, social insurance etc. As an additional disincentive to bogus self-employment, Revenue also imposed a special retention tax/levy of 35% of the value of the contract they were to be engaged on. However, that 'test' and the system of controls it embraced was lost in the transition online.

Congress believes that since then all semblance of effective monitoring and control has disappeared. Thus, the retention tax/levy was significantly reduced and now applies at rates between 0% to 20%. In our view this weakens what was a powerful disincentive to fraud.

Under the new system anyone can go online and designate any number of employees as self-employed, without challenge. In short, a 'principal contractor' can propel a job candidate out of the PAYE system at the click of a mouse.

There appears to have been no risk analysis carried out in advance of this systemic change to assess the obvious dangers of leaving such power of designation solely in the hands of those with a commercial and vested interest. For some unscrupulous employers, this amounts to an invitation to replace decent employment with bogus self-employment, thereby putting pressure on good employers. Contractors can now use the system to avoid paying decent wages, evade PRSI and divest themselves of employment rights obligations. The chart below provides a graphic illustration of the scale and exponential growth of the problem, over the last two decades.

Ireland's Self Employment as a % of Total Employment in Construction: 1995 - 2014



Figure 1: Exponential Growth in Self-Employment
(Source: Unite)

From a low of 24% in 2005 (near the EU-15 average) self-employment has accelerated by over 50%. It is our view that if the 2007 Code of Practice had been applied as intended, the general level of self-employment would have reduced or stabilised close to comparable levels elsewhere. However, if current trends continue it is reasonable to assume the construction industry will be populated overwhelmingly by bogus self-employed workers in the near future.

The huge growth of bogus self-employment in construction has produced big winners and losers. The primary winners are the construction employers who have driven wages down to

a record low and now have a workforce with few employment rights of any kind. The other winners are the so called 'principal contractors' who employ no-one but can have the work done for a fraction of the true cost.

The State and the taxpayers are the losers, forgoing PRSI of 10.75% for every misclassified worker. However, the real losers are the workers forced into bogus self-employment, along with unemployed workers and apprentices who are unlikely to find decent work in the Irish construction industry as long as the current system facilitates such abuse.

State & Taxpayer Shoulder Losses

For some time now campaign groups within construction have sought to uncover the true scale of the losses accumulating to the State and taxpayer as a result of this bogus employment activity. With the assistance of elected representatives and the use of Parliamentary Questions (PQs) they have succeeded in establishing a clearer picture.

The response to PQ 312 (submitted 04/11/2014) revealed that in 2013 there were 62,443 active RCT1 registrations and 263,994 contract notifications. The supplementary answer to question PQ 55 (submitted 16/07/2013) suggested that the number of active RCT1's specifically in construction in 2013 was 44,674.

Furthermore, in correspondence with an elected representative (July 2015), Revenue stated that *"there are 34,000 subcontractors in the construction sector that are active in the RCT1 system."* The correspondence goes on to say that about "81% (of these are) operating as sole traders or self-employed."

This equates to about 27,600 individual workers. Anyone with knowledge of the sector will instantly recognise what looks like an abnormal trend.

The modern construction industry is a managed hierarchy, not a free for all of sole traders. Traditionally if 30 bricklayers were needed for a project such as a school, they would be employed and directed for the duration of the project. However, the RCT1 system allows the principal contractor to inform Revenue that he has made a contract with 30 sole traders. The 30 bricklayers must accept this designation or

seek work elsewhere. It would be an interesting exercise to compare the tax take from this cohort of 30 'sole traders' with the take from a similar number of tradespeople, employed on the same rates, in the PAYE sector. Congress has no doubt that it would highlight the massive loss of tax and PRSI to the state and a consequential loss of social insurance cover for workers.

For every single bogus self-employed worker engaged for a year there is a loss to the State of €2,886 in PRSI payments. For every thousand workers the loss is €2,886,432. It seems to us that there are no controls in place to ensure that all 27,600 sole trader contracts are wholly legitimate. If all are bogus self-employed – which is entirely possible – then the State is losing close to €80 million in PRSI payments per annum. This amounts to a loss of almost €640 million, since the Code of Practice was agreed in 2007.¹

In addition, the State will also become liable for another heavy, but as yet unquantifiable burden when these workers become unemployed or are unable to work through illness or old age. This should be a matter of pressing concern for, amongst others, the Department of Social Protection (DSP).

¹ See appendix 1

Financial Advantages of Misclassifying Workers

There are significant financial advantages for employers in misclassifying potential employees. The 'principal contractor' can evade substantial amounts of PRSI, while the unequal nature of the relationship between employer and the bogus self-employed worker can lead to situations such as in the recent dispute at JJ Rhatigan's, where the workers were being paid well below the going rate of €17.21 per hour. In December 2014, a number of JJ Rhatigan workers requested the 'Scope' section of the DSP to declare that they were actually employees, based on the nature of their contracts. They were successful, although the process took 10 months.

At the time they submitted their request to the DSP's Scope section these workers were involved in a bitter and long running dispute seeking direct employment, rather than the bogus self-employed status, under which they had been originally engaged. Yet, the 'principal contractor' was free to hire strike breakers and other workers on a self-employed basis to complete the project. All of this unfolded on a public project funded by the taxpayer.

A Problem in the United Kingdom

Bogus self-employment is not confined to this jurisdiction and is also a major problem in the UK, as the following excerpt from a UCATT report highlights:²

"An employment scandal costing hundreds of millions in lost tax revenue, and depriving hundreds of thousands of construction workers of their employment rights, is taking place across the UK.

".....The scandal involves payroll companies who help construction firms switch their staff from the status of employee to self-employed subcontractor, even though many of these individuals are not genuinely self-employed..... Big profits are to be had,

employers benefit from switching their staff to self-employed status because they no longer have to pay Employers' National Insurance, holiday pay or other benefits.

"They can also hire and fire their former employees at will. But the real winners are the payroll companies. They are making millions by levying fees for their services."

In the UK payroll companies charge hefty fees for this illicit service. In this jurisdiction, they face no such obstacle, official or otherwise.

Feeble Risk Control

Revenue has argued that they write to workers informing them of how the 'principal contractor', has classified them and that a misclassified worker "is perfectly entitled to bring to Revenue's attention any concerns."

This is an ill-conceived risk control mechanism for several reasons:

- If one worker in every hundred complains, then they will not get the job and the contract will be confirmed by the ninety nine who accept the principal contractor's fictional description of the nature of the contract.
- Bogus self-employment is being offered to vulnerable workers, many of whom have been long-term unemployed and some of whom may arrive here from abroad with no knowledge of their employment rights, no understanding of our social insurance system and are therefore, unlikely to fully understand the difference between legitimate employment and bogus self-employment.
- The JJ Rhatigan dispute highlights the perils for workers who raise concerns about their status.
- Bogus self-employment can also be the result of collusion between a worker and an employer to evade PRSI liabilities.
- The current Revenue system demands that a worker opt out of bogus self-employment. The consequences of opting out will inevitably be the withdrawal of the job offer. However, the earlier paper based system obliged them to opt into self-employment, in the full knowledge of the adverse consequences of doing so.
- If a worker does not contest bogus self-employed status and is adjudged low risk, then 0% of earnings will be withheld. A worker who opts out of bogus self-employment will pay standard tax rates of: 20% of taxable earnings, plus PRSI at 3.5%, plus USC at 7%. That is a deduction of 30.5%, as opposed to 0%. This we believe could be described as 'moral hazard' and also penalises the compliant.

Flawed Systems

Bogus self-employment is, we believe, being used to drive wages down and deprive workers of their pay, pension and other rights. It also distorts the labour market in construction and acts as a barrier to recruitment of skilled craftspeople and apprentices. Congress has had many discussions with the Department of Education & Skills and has been assured that contracts on the school building and other public projects were awarded on the basis of

construction companies paying the agreed rates and including them in the pension scheme. In reality such assurances cannot be substantiated. There is no certainty that the agreed pay rates included in the pricing for such publicly funded projects are applied to the workforce. In such circumstances this would leave the taxpayer and worker short-changed to the benefit of the contractor. The bogus self-employment system reinforces this possibility.

Congress Proposals for Risk Control

Bogus self-employment could be easily eradicated but it requires political will and commitment from the public administration. We believe that Revenue's technical systems are advanced and capable of closing off the loopholes which are currently facilitating wholesale use of bogus self-employment. In order to assist with the introduction of adequate risk controls into the system, Congress proposed the following measures to Revenue:

- The criteria for a 'principal contractor' should be redefined by Revenue and require having assets, a business address within the State and a taxation record. (Congress was referring here to Revenue's own definition relating to RTC1s).
- Only one 'principal contractor' should be recognised per project. All others should be either a sub-contractor or an employee.
- No worker without a taxation record should be automatically registered as self-employed unless they satisfy the criteria laid down in the Agreed Code of Practice.

- As the bricklaying and plastering trades are very vulnerable to abuse, Revenue should run an anti-abuse pilot project targeting these trades.

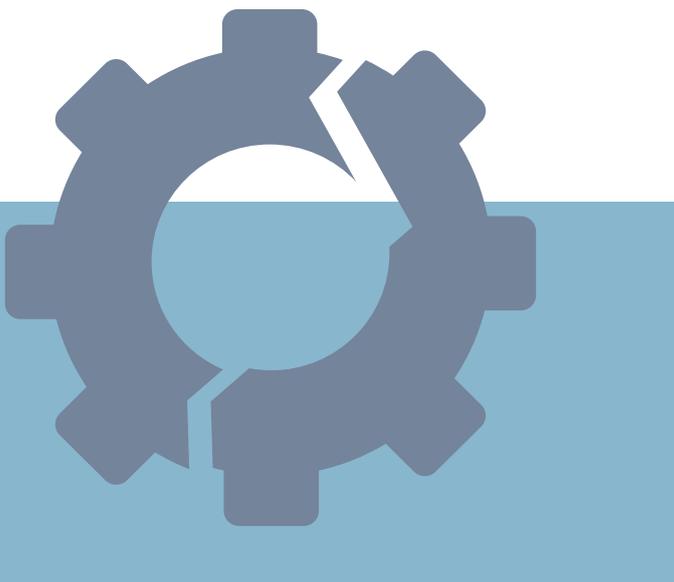
Revenue responded to our suggestions in a manner that we believe is inappropriate given the gravity of the situation in hand, observing that:

"... it appears to us that Congress is not prepared to consider the explanations provided by Revenue and is assigning roles to Revenue that are not within our remit."

"Questions as to entitlements under employment legislation regarding payment of wages and rates of pay are more appropriate to DJEI."

"Loss of PRSI and social insurance cover arising.....from bogus self-employment is a matter for DSP."

Congress made its submission in order to encourage a tightening of risk controls. Our submission raised no questions relating to employment law, payment of wages or other matters. If our suggestions are not to be countenanced, we believe it behoves those at a most senior level in Revenue to overhaul their own procedures, and considering their expertise in fraud detection and abuse control, we are confident they have all the necessary powers and information to do so. Unless action is taken, we can only conclude that the exponential growth in bogus self-employment is more than just the unintended consequence of an ill-thought out system.



Appendix 1

Calculations lost Employers PRSI revenue - bogus self-employment		
Assume:		
	calculating per 1,000 workers in such a position	
	full-time workers (39 hours per week)	
	Tradesmen/craft workers paid at €17.21 per hour	
	Working a total of 45 weeks a year (i.e. taking account of some down time between jobs, winter etc.)	
Employers PRSI structure:		
	using 2015 rates - Class A	
	8.5% on first €356	
	10.75% on all above €356 calculated per week	
	Calculation (2015 basis):	
	Hourly rate	€17.21
	Hours per week	39
	Weekly gross pay	€671.19
	PRSI @ 8.5%	€30.26
	PRSI @ 10.75%	€33.88
	Total PRSI per week	€64.14
	Per year (45 weeks)	€2,886
	Per 1,000 employees	€2,886,432
	For 27,600 employees	€79,665,513
	Over 7 years	€557,658,590
	Over 8 years	€637,324,103

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