



The Underground Economy in British Columbia's
Construction Industry: Assessing the Impact

2022 | **REPORT ON THE**
UNDERGROUND
ECONOMY

Authority

The BC Building Trades has commissioned Prism Economics and Analysis to provide this report to estimate the size of the underground economy in B.C.'s construction industry and provide recommendations.



The BC Building Trades provides coordination and support to affiliated construction unions. By working together, organized construction workers achieve a powerful voice in government, in bargaining, and in their communities.

Prism Economics and Analysis is a leading public policy firm with extensive experience providing analysis on labour markets, evaluating programs and policies.

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Photos on pages 2, 10, 15 & 30 by Josh Berson



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In the construction industry, the most common underground strategy is to deliberately misclassify workers as independent subcontractors to avoid the payroll costs that apply when workers are properly classified as employees.

Executive Summary

The annual revenue losses to governments from the misclassification of workers combined with the under-reporting of income by legitimate independent operators is approximately **\$308.2 million.**

In the construction industry, the most common underground strategy is to deliberately misclassify workers as independent subcontractors (“independent operators”) to avoid the payroll costs that apply when workers are properly classified as employees.

In 2019, the last full year prior to COVID-19, independent operators represented 19.3% of employed workers in B.C.’s construction industry. Of these, more than two-thirds were unincorporated.

Contractors that deliberately misclassify workers as independent operators enjoy an illegitimate and unfair labour cost savings of 20%. This is sufficient to skew many competitively bid jobs away from legitimate contractors in favour of cheaters.

Contributions and Obligations Avoided by Styling Workers as Independent Subcontractors rather than as Employees (based on 2021 rates)

Contribution or Obligation	Rate (2021)
EI Contributions (Employer Share)	2.21%
CPP Contributions (Employer Share)	5.45%
WorkSafeBC Premium (avg. estimate)	3.00%
Statutory Contributions Avoided	10.66%
Statutory Holidays (10 days)	3.85%
Statutory Vacation (2 weeks/10 days)	4.00%
Statutory Obligations Avoided	7.85%
Employer Health Tax Avoided (est. weighted avg.)	1.48%
Total Avoided Contributions and Obligations	19.99%
Rounded to	20.00%

In addition to the losses incurred by workers, there is also considerable leakage from the Income tax system owing to significant under-reporting of earned income.

WorkSafeBC loses in two ways. Firstly, the cheaters do not pay premiums. And secondly, many of the cheaters maintain a partial payroll, which enables them to claim an injured independent operator was an employee at the time of their injury. WorkSafeBC and the legitimate employers who finance it pick up the costs.

The shell game of misclassifying workers as independent operators rather than as employees creates winners and losers. The winners are the contractors that win construction jobs by using the shell game to achieve a cost advantage that enables them to under-bid legitimate contractors.

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¹This loss is stressed by Eric Hamilton-Smith in “Increasing Skilled Trades Employer Participation in Apprenticeship Training In British Columbia,” 2012, paper submitted to School of Public Policy, Simon Fraser University

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The losers in the shell game are many. They include the legitimate contractors and their employees who lose jobs to the underground contractors and every other contractor whose WorkSafeBC premiums are higher because the underground contractors have gamed the system to secure coverage without paying for it. The losers also include the general public whose taxes are necessarily higher to compensate for the leakage from the income tax system from underground workers who conceal some or all of their earnings. And lastly, many of the underground workers themselves are also losers. They do not get the employment standards or health and safety protections to which they are entitled. Those who are hired by an underground contractor who does not maintain a partial payroll will also lose out on the WorkSafeBC benefits to which they should be entitled if they are injured.



The annual revenue losses to governments and agencies from the misclassification of workers as independent operators is \$115.4 million. This increases to \$308.2 million if the under-reporting of income by legitimately classified independent operators is included.

Summary of Financial Losses to Government Agencies

Revenue Loss Type	Amount
Employer Health Tax	\$12,110,354
WorkSafeBC	\$24,531,406
Income Tax, CPP, EI (from under-reporting income)	
All Independent Operators	\$271,607,000
Misclassified Independent Operators Only	\$78,766,030
Total (with All Independent Operators)	\$308,248,761
Total (with Misclassified Independent Operators Only)	\$115,407,791

In addition to financial losses, the practice of misclassifying workers as independent operators also taints and distorts the competitive landscape in the construction industry, undermines investment in apprenticeship and fosters corner-cutting on health and safety.

Contractors that improperly style their workers as independent subcontractors are highly unlikely to invest in training those workers either in trade skills or in safety skills.¹

It is time for B.C. to put an end to this shell game. ↗

RECOMMENDATIONS

1. B.C. reconstitute the Joint Compliance Team with the Ministry of Labour, WorkSafeBC and the Canada Revenue Agency;
2. WorkSafeBC impose administrative penalties on contractors that misclassify workers as independent operators and also require those contractors to pay the premiums they should have paid in both the current and prior years; and
3. B.C.'s Employment Standards Act and Workers Compensation Act make prime contractors responsible for the compliance of their subcontractors and liable for their non-compliance.

Introduction

In 2001, B.C. showed leadership by being the first jurisdiction to systematically inspect construction sites to gauge the magnitude of the deliberate misclassification of workers

In the construction industry, the most common underground strategy is to deliberately misclassify workers as independent subcontractors (“independent operators”) to avoid the payroll costs that apply when workers are properly classified as employees. Those payroll costs include: EI, CPP, WorkSafeBC premiums and the Employer Health Tax, as well as employment standards obligations including vacation pay, statutory holiday pay, statutory overtime and now the new 5 days sick leave provision announced in B.C. in January 2022.

In addition to the losses incurred by workers, there is also considerable leakage from the Income Tax system owing to significant under-reporting of earned income. As well, WorkSafeBC premiums are higher for legitimate construction employers because many underground contractors maintain a partial payroll, which enables them to claim an injured independent operator was an employee at the time of their injury.

The winners in the independent operator shell game are easy to identify. They are the contractors that win construction jobs by using their cost advantage to under-bid legitimate contractors. The losers in the shell game are many. They include the legitimate contractors and their employees (union and non-union) who lose jobs to the underground contractors and every other contractor whose WorkSafeBC premiums are higher because the underground contractors have gamed the system to secure coverage without paying for it. The losers also include the general public whose taxes are necessarily higher because of the leakage from the Income Tax system from underground workers who conceal some or all of their earnings. And lastly, many of the underground workers themselves are also losers. They do not get the employment standards or health and safety protections to which they are entitled. Those who are hired by an underground contractor who does not maintain a partial payroll will also lose out on the WorkSafeBC benefits to which they should be entitled if they are injured. It is time for B.C. to put an end to this shell game.

All of the indicators point to a serious problem in B.C.'s construction industry with the illegal misclassification of workers as independent subcontractors rather than as employees.

All of the indicators point to a serious problem in B.C.'s construction industry with the illegal misclassification of workers as independent subcontractors (“independent operators”) rather than as employees.

It is unrealistic to expect a precise and accurate measure of the size of the underground economy in construction and therefore of the magnitude of the losses to governments, WorkSafeBC and to workers. Non-compliant contractors and workers go to considerable lengths to conceal or disguise their non-compliance. For this reason, the most accurate way we can definitively track one measurement of underground economic activity is to use available data to formulate estimates of the approximate scale of the independent operator ruse in the construction industry.




29%

Percentage of inspected construction sites that were found by B.C.'s Joint Compliance Team in 2001 to be misclassifying workers

CONCLUSIONS

1. Contractors have improperly classified approximately 14,000 workers as independent subcontractors.
2. In 2019, these improperly classified workers represented around 5.6% of B.C.'s construction workforce.
3. The contractors that engage in the deliberate misclassification enjoy an unfair competitive advantage that is equal to around 20% of labour costs. In many trades, this is sufficient to skew competitive outcomes in favour of the non-compliant and to the disadvantage of the many hundreds of legitimate contractors.
4. The widespread use of misclassified independent operators weakens investment in the apprenticeship system and increases corner-cutting on occupational health and safety.
5. Losses to governments and government agencies from the misclassification of workers as independent operators are in the order of \$115.4 million annually. If tax losses from under-reporting of income by legitimately classified independent operators are added, this figure rises to \$308.2 million.



In 2001, B.C. showed leadership by being the first jurisdiction to systematically inspect construction sites to gauge the magnitude of the deliberate misclassification of workers. The Joint Compliance Team was a collaboration that involved the government of B.C, the federal government and the Canada Revenue Agency. The team found that misclassification was occurring on 29% of inspected construction sites. 

II What is the Underground Economy?

There are three definitions of the underground economy

1. The Unmeasured Economy

The “unmeasured economy” refers to economic activity that is not captured by Statistics Canada’s system of national accounts. This is the definition used by Statistics Canada. Most (but not all) of the unmeasured economy is illegal. It includes unlawful gambling, prostitution, the illicit drug trade, etc. A fraction of the construction industry may be unmeasured. This is chiefly revenue from small-scale repair and renovation work that is not reported by the worker or contractor. However, this is minor because Statistics Canada tracks the sale of building materials when verifying its estimates of the output of the construction industry.



2. The Cash Economy

The “cash economy” is the popular media portrayal of the underground economy. In the construction industry, the cash economy refers to work that is performed, in whole or in part, on a cash basis with no paper trail. The worker or contractor performing the work does not report the cash received to the CRA and, in turn, does not charge PST for the services remunerated in cash. Informal conversations with contractors suggest that the cash amount is essentially the normal transaction price minus the GST/PST that would otherwise be applicable. Data show that there was a ratcheting up of the use of cash after the GST was introduced in 1991. The cash economy is confined to small-scale repair and renovation where the customer is a homeowner. Corporations have no reason to evade paying GST or PST because it is deductible against owed GST or PST. Homeowners have no interest in omitting a paper trail on larger projects where liability issues could subsequently arise.

3. The Non-Compliant Economy

The “non-compliant economy” refers to construction work that is performed in a way that evades obligations for income tax, EI, CPP and workers compensation premiums as well as employment standards obligations such as statutory overtime, holidays, sick leave or vacation. The most common strategy is to style workers as “independent operators”, i.e., independent subcontractors, notwithstanding that these workers are, in the substantive sense, employees. The practice of styling workers as independent operators when they should be classified as employees is the dominant non-compliance strategy for evading tax and other obligations. For the construction industry, this is the most relevant definition.

Illegitimate Labour Cost Savings from Misclassifying Workers as ‘Independent Operators’

A contractor has no obligation to pay EI, CPP or to make WorkSafeBC contributions for independent operators. Similarly, workers who are engaged as independent operators have no entitlement to statutory holiday pay, sick leave or vacation. Additionally, they are not entitled to overtime, unless this is specified in their contract.

The table below sets out the 2021 employer contributions for EI and CPP that a contractor would avoid (i.e., evade) if styling their workers as independent subcontractors. WorkSafeBC premiums are determined by classification unit. For the trades in which workers are most frequently engaged as independent subcontractors, this ranges from 1.94% to 6.59%. An estimate of 3.0% has been used. Most, but not all, employees are entitled to pay on a statutory holiday and to a minimum of 4% vacation pay. (There are minimum service requirements for entitlement).

B.C. employers are also subject to the Employer Health Tax (EHT). The first \$500,000 of payroll is exempt. The tax rate is 2.925% for a payroll between \$0.5 million and \$1.5 million, and 1.95% for payroll over \$1.5 million. The estimated weighted average EHT is approximately 1.48% based on Statistics Canada data on employment in construction by enterprise size. The following table summarizes the illegitimate savings a contractor would realize by styling workers as independent subcontractors rather than as employees. All rates are based on 2021.

Contributions and Obligations Avoided by Styling Workers as Independent Subcontractors rather than as Employees (based on 2021 rates)

Contribution or Obligation	Rate (2021)
EI Contributions (Employer Share)	2.21%
CPP Contributions (Employer Share)	5.45%
WorkSafeBC Premium (avg. estimate)	3.00%
Statutory Contributions Avoided	10.66%
Statutory Holidays (10 days)	3.85%
Statutory Vacation (2 weeks/10 days)	4.00%
Statutory Obligations Avoided	7.85%
Employer Health Tax Avoided (est. weighted avg.)	1.48%
Total Avoided Contributions and Obligations	19.99%
Rounded to	20.00%

Figure No. 1

Misclassifying workers as independent subcontractors, when they should be classified as employees, generates illegitimate labour cost “savings” of approximately 20.0%. For some trades, with higher WorkSafeBC premiums, this “savings” would be higher.

Tax Evasion

Workers who are independent subcontractors do not have income tax, CPP and EI deducted from their regular pay. Nor do they receive a T4 slip indicating their earnings. Persons who are self-employed self-report their earnings in their income tax submission. Various researchers have found that under-reporting of earnings is widespread among the self-employed:

A study using data from the period 1969 to 1992 estimated that self-employed workers under-reported their actual income by 11% to 23%. For construction occupations, the estimate was 39% to 53%. (Schuetze, H. J. 2002. “Profiles of Tax Non-Compliance among the Self-Employed in Canada: 1969 to 1992,” Canadian Public Policy / Analyse de Politiques, Vol. 28, No. 2 (June, 2002), pp. 219-238, Table No. 4).

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A later study compared pre-GST under-reporting with the post-GST period. The study found that “the GST increased tax noncompliance by those with larger amounts of self-employment income.” The study estimated that on average, persons with self-employed income under-reported their gross income by approximately 34.9%. (Tedds, L. 2010. “Estimating the Income Reporting Function for the Self-Employed,” *Empirical Economics*. 38. 669-687. 10.1007/s00181-009-0284-8, Table No. 2).

A study published by the Bank of Canada estimates that 30% to 50% of self-employed workers under-report their income. (Dunbar, G. R. and Fu, C., “Sheltered Income: Estimating Income Under-Reporting in Canada, 1998 and 2004,” Bank of Canada, Working Paper 2015-22)

Similar findings are reported by U.S. researchers. A study for the U. S. Federal Reserve System estimated that the self-employed under-report their income by approximately 30%. (Hurst, E., Li, G, and Pugsley, B. 2010. “Are Household Surveys Like Tax Forms: Evidence from Income Underreporting of the Self-Employed.”

In 2019, the average earnings of a construction worker in B.C., assuming full-time employment for 47 weeks, was approximately \$58,500. In the absence of RRSP or other deductions, this would result in a tax obligation of around \$14,455 (including CPP). If income is under-reported by 30%, the tax obligation falls to around \$8,820. This represents an illegitimate savings on income tax, CPP and EI of around \$5,635—equal to approximately \$3 per hour.

In 2019, a construction worker in B.C. earned an average of \$58,500, representing a tax obligation of around \$14,455. If income is under-reported by 30%, the tax obligation falls to around \$8,820, representing an illegitimate savings on income tax, CPP and EI of around \$5,635—equal to approximately \$3 per hour.

Terminology

Common Law: Employee or Contractor

The common law distinguishes between an employee and a contractor. An employee is an individual who is subject to a “contract of service” while a contractor is an individual or corporate entity that is subject to a “contract for service.”

In Canada, the first and still cited case setting out the tests for employee status is Montreal Locomotive Works Ltd.³ In Montreal Locomotive, the Supreme Court set out a fourfold test for employee status: (1) control, (2) ownership of tools, (3) chance of profit and (4) risk of loss.

Dependent Contractors

In 1965, Harry Arthurs introduced the concept of a “dependent contractor” to describe individuals who are “dependent economically, although legally contractors.”⁴ The dependent contractor concept was subsequently incorporated into both labour standards legislation and labour relations legislation, but is not used in workers’ compensation legislation.

Substance not Appearance

In 1986, the courts explicitly established the principle that employee status was determined by the

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substance of the relationship, not the styling of the relationship.⁵ That is to say, a document purporting to establish contractor status would not prevail if the actual relationship was substantively an employer-employee relationship.

The 'Organization Test' of Employee Status

In 2000, the Supreme Court introduced an additional test of employee status, known as the "organization test."⁶ The organization test takes into account the degree to which an individual is integrated into an organization and the degree to which they work exclusively for that organization.

Employee or Contractor – Summary

When determining whether a worker is an employee or independent contractor for purposes of income tax source deductions and EI entitlement, the federal government suggests the following summary of factors:

Factors in Determining Employee or Contractors Status	
Employee	Independent Contractor
Characteristics	Characteristics
• Works exclusively for the payer	• May work for other payers
• Payer provides tools	• Provides own tools
• Payer controls duties	• Decides how task is completed
• Payer sets working hours	• Sets own working hours
• Worker must perform services	• May hire someone to complete the job
• Provision of pension, group benefits	• Unable to participate in payer's benefit plans
• Paid vacation pay	• No vac. pay, no restrictions on hrs of work or time off
• Payer pays expenses	• Pays own expenses
• Paid salary or hourly wage	• Paid by the job on predetermined basis
• Regularly reports to payer's workplace	• Submits invoice to payer for payment
	• May accept or reject work

Figure No. 2
Factors in Determining Employee or Contractors Status
Government of Canada
<https://www.canada.ca/en/employment-social-development/programs/laws-regulations/labour/interpretations-policies/employer-employee.html#appb>

Independent Operators

"Independent operator" is a term found in workers' compensation legislations in all or most Canadian jurisdictions. The term is not used in labour standards or labour relations legislation. Nor is the term used in the common law.

The application of workers' compensation legislation revolves around the term "worker," which is defined in the statute. In all provinces, including B.C., the definition of "worker" includes persons under a contract of service, i.e., employees, as well as apprentices, learners, volunteer firefighters and others who might not be considered employees under the common law tests. In addition to persons who are explicitly included in the definition of "worker," workers' compensation legislation also recognizes "independent operators." These are persons who are self-employed and who do not employ other workers. In the B.C. legislation, an "independent operator" is someone who is "neither an employer nor a worker." An independent operator, therefore, is a person who is engaged under a contract for service (not of service) and who does not employ other persons. B.C.'s legislation empowers the Workers' Compensation Board to extend coverage and contribution requirements to independent operators. ↗

²Statistics Canada: "The underground economy can be defined as consisting of market-based economic activities, whether legal or illegal, that escape measurement because of their hidden, illegal or informal nature." <https://www150.statcan.gc.ca/n1/daily-quotidien/181012/dq181012a-eng.htm>

³Montreal Locomotive Works Ltd. [1947] 1 D.L.R. 161

⁴Arthurs, H. 1965. "The Dependent Contractor: A Study of the Legal Problems of Countervailing Power" The University of Toronto Law Journal Vol. 16, No. 1.

⁵Wiebe Door Services Ltd. v. Canada (Minister of National Revenue) [1986] 3 F.C. 553.

⁶Sagaz Industries Canada Inc. [2001] 2 S.C.R. 983 (2001)

III Measuring Independent Operators

Estimating the number of independent operators

Statistics Canada's Labour Force Survey classifies workers as either employees or self-employed. Self-employed workers may be incorporated or unincorporated. Self-employed workers may also employ or not employ other workers. Using these descriptors, independent operators would include any self-employed person who does not employ other persons, regardless of whether the person is incorporated or not. When considering the underground economy, our primary focus is on persons who have been improperly styled as independent operators, i.e., they are employees in the substantive sense.

As the Supreme Court said in *Sagaz*, "the central question is whether the person who has been engaged to perform the services is performing them as a person in business on his own account [emphasis added]." Incorporation does not determine whether a person is a contractor or an employee. However, incorporation does, in the normal course, express an intent to operate as a person in business. Therefore, we are more likely to find persons who are misclassified as independent operators when we focus on individuals who are self-employed, who do not employ other persons and who are not incorporated.

Independent Operator Trend

Figure No. 3 shows that from 1988 to 2009, there was a marked upward trend in the number of independent operators who were unincorporated.

Three distinct periods are evident in Figure No. 3:

1. In the first period – 1988 to the summer of 2009 – the number of unincorporated independent operators almost quadrupled from around 10,600 persons to 40,200.
2. In the second period – from the summer of 2009 to 2013 – the number of unincorporated independent operators declined.
3. Since 2014, the number has ranged between 26,000 and 33,000.

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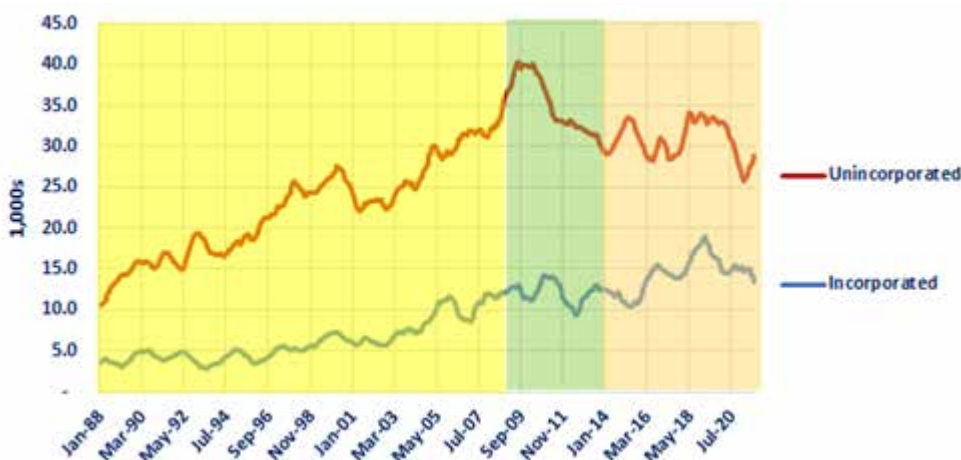


Figure No. 3
Number of Incorporated and
Unincorporated Independent Operators
in the B.C. Construction Industry
12 Month Moving Average
Statistics Canada,
Table No. 14-10-0026-01



19.3%

Percentage of employed workers who were independent operators in 2019, the last full year of data collection prior to COVID-19

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In 2019, the last full year prior to COVID-19, independent operators represented 19.3% of employed workers in B.C.'s construction industry. Of these, more than two-thirds were unincorporated. It is highly likely that a great many of these workers—especially those who are unincorporated—are being styled by the contractors that hire them as “self-employed” for the purpose of evading payroll and employment standards obligations. In reality, they are employees. Figure No. 4 shows the trend in unincorporated independent operators and compares it to the unemployment rate.

Figures No. 3 and 4 (next page) show that there are push-and-pull factors explaining changes in the number and share of unincorporated independent operators. The GST was introduced in 1991. The opportunity for tax evasion through cash payments likely encouraged other forms of tax evasion, including styling workers as independent operators. This “pull” factor was augmented by unemployment. Unemployment was a “push” factor that compelled workers to take jobs offered on the condition that they agree to be classified as self-employed. Although unemployment in B.C.'s construction industry fell in the 1990s, it was still over 10% during most of the decade.

The importance of the push factor is evident after 2000 when the unemployment rate fell from around 10% in the prior decade to under 5%. This was coincident with a decline in the share of unincorporated independent operators from a peak of 24.0% in the summer of 2000 to around 16% in 2008 before the onset of the financial crisis. As traditional jobs became available, workers who had been forced by circumstances

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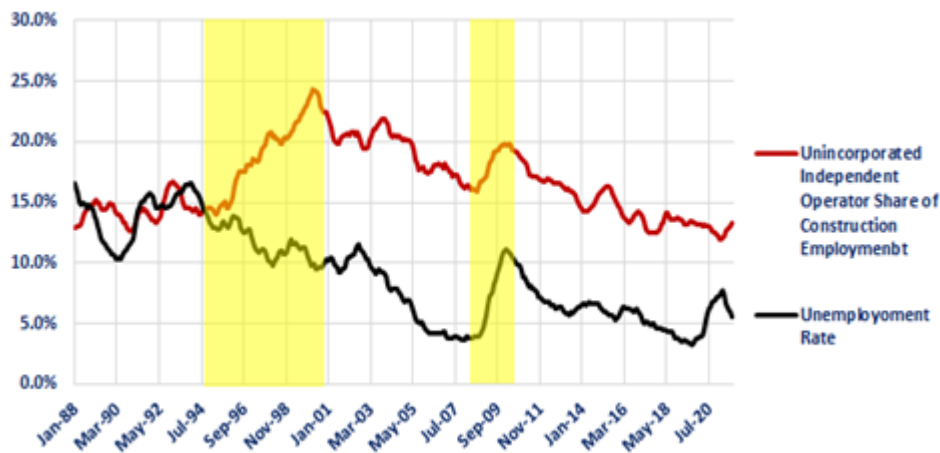


Figure No. 4
Share of Incorporated Independent Operators in the B.C. Construction Industry Employment
12 Month Moving Average
Statistics Canada, Table No. 14-10-0026-01

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to work as independent operators abandoned those contractors for legitimate employment where they were covered by WorkSafeBC, EI and CPP and where they had the protection of the Employment Standards Act. This reversed after 2008. As the financial crisis took hold, both unemployment and the share of unincorporated independent operators increased. Both measures trended downwards as the construction economy recovered after 2009.

The distinction between push and pull factors is important from a policy perspective. It is undoubtedly true that some workers are drawn to unincorporated independent operator status for the independence it offers. This is legitimate. Others are drawn to unincorporated independent operator status because it enables them to evade taxes. However, a large number of workers become unincorporated independent operators because that is the only work that is available and they need the job to support their families.

It is also important to note that the denominator in the percentages depicted in Figure No. 4 is “all construction employees.” This includes salaried staff. The use of unincorporated independent operators, however, is largely confined to tradespersons who are typically paid on an hourly or piece-rate basis. Over the past 10 years (2011 to 2020), approximately 15.1% of the employed construction labour force in B.C. were salaried employees. If these employees are excluded, then the share of unincorporated independent operators in the non-salaried construction employment in 2019 increases to 14.8%

Structure of B.C.’s Construction Workforce in 2019

Figure No. 5 shows that in 2019 (the last full year before COVID-19), almost one worker in five (19.3%) in B.C.’s construction industry was nominally classified as an independent operator. This is double the number of workers who are self-employed and, at the same time, also employ other workers.



Figure No. 5
Approximate Composition of Workforce in B.C. Construction Industry, 2019 Average,
Statistics Canada, Table No. 14-10-0026-01

Independent Operators Compared to Self-Employed Workers

As noted earlier, there are four types of self-employed workers. Figure No. 6 summarizes data for 2019.

Both the incorporated and the unincorporated who employ no paid help are considered to be independent operators by WorkSafeBC. However, the likelihood is that a large majority of the independent operators who are incorporated are legitimately self-employed. From the perspective of reining in underground practices, the focus should be on the unincorporated independent operators. In 2019, these workers comprised 44.9% of the self-employed workforce in B.C.'s construction industry.

Types of Self-Employed Workers		
	Number	Percent of Self-Employed
Self Employed - Incorporated - with Paid Help	18,600	25.3%
Self-Employed - Unincorporated - with Paid Help	6,700	9.1%
Independent Operators		
Self-Employed - Incorporated - No Paid Help	15,200	20.7%
Self-Employed - Unincorporated - No Paid Help	33,000	44.9%
Total Self-Employed	73,500	100%

Figure No. 6
Composition of Self-Employed Workforce in B.C. Construction Industry, 2019 Average,
Statistics Canada, Table No. 14-10-0026-01

From the perspective of reining in underground practices, the focus should be on the unincorporated independent operators.



Incidence of Nominal Self-Employment Across Different Sectors & Trades

Census data provide insight into which sectors and trades are most likely to use self-employed workers. Unfortunately, these data do not distinguish between those who are incorporated and those who are not. Nor do the Census data distinguish between self-employed workers who employ other workers and those who do not. Consequently, we can use Census data only as an approximate guide to which sectors and which trades most commonly use unincorporated independent operators.

Most construction workers (67.4%) are employed by trade contractors. However, some construction workers are directly employed by developers, general contractors, contractors in the residential and industrial-commercial-institutional (ICI) sectors or by specialized civil and heavy construction contractors. Figure No. 7 summarizes data from the 2016 Census on the distribution of overall employment in the construction industry and the distribution of self-employed workers.

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Workers that are Nominally Self-Employed and Share of Sectors and Contracting Trades in Total Construction Employment in B.C.

	Percent of Workers in Sector who are Nominally Self-Employed	Sectoral Share of Total Construction Employment
ICI Builders (Directly employed by Developers, General Contractors)	7.3%	5%
Residential Builders (Directly employed by Developers, General Contractors)	31.2%	19.8%
Heavy & Civil Construction Contractors (Directly employed by heavy & civil contractors)	6.2%	7.9%
Employed by Trade Contractors		
Foundation, structure, and building exterior contractors:		
<ul style="list-style-type: none"> Poured concrete foundation & structure contractors Structural steel & precast concrete contractors Framing contractors Masonry contractors Glass & glazing contractors Roofing contractors Siding contractors Other foundation, structure & building exterior contractors 	25.1%	11.5%
Building Equipment Contractors:		
<ul style="list-style-type: none"> Electrical contractors & other wiring installation contractors Plumbing, heating & air-conditioning contractors Other building equipment contractors 	17.8%	25.1%
Building Finishing Contractors:		
<ul style="list-style-type: none"> Drywall & insulation contractors Painting & wall covering contractors Flooring contractors Tile & terrazzo contractors Finish carpentry contractors Other building finishing contractors 	44.8%	23%
Other Specialty Trade Contractors:		
<ul style="list-style-type: none"> Site preparation contractors All other specialty trade contractors 	20.5%	7.8%

Figure No. 7

Percent of Workers in Sectors and Contracting Trades that are Nominally Self-Employed and Share of Sectors and Contracting Trades in Total Construction Employment in B.C., Statistics Canada, Census 2016

Figure No. 7 supports a number of conclusions:

- ✓✓ **Self-employment occurs in all construction sectors and in all, or virtually all, construction trades.**
- ✓✓ **In the residential sector, almost a third (31.2%) of the workers who are directly hired by developers, general contractors or builders are nominally self-employed. This is in sharp contrast with the ICI sector, where only 7.3% of the workers hired directly by developers or general contractors are nominally self-employed.**
- ✓✓ **While a significant proportion of the workforce hired by trade contractors is nominally self-employed, there are marked differences across the trades. For building equipment contractors (chiefly electrical, plumbing and HVAC contractors), the incidence of nominal self-employment is only 17.8%.**
- ✓✓ **By contrast, for building finishing contractors (whose work is more easily priced by units such as square feet) the nominal incidence of self-employment is 44.8%. This is exceptionally high. It seems implausible that almost half (44.8%) of the total workforce in these trades (e.g., drywallers, painters, flooring installers, tile installers, etc.) is self-employed. It seems much more likely that contractors in these trades style a large portion of their workforce as self-employed to avoid payroll costs associated with conventional employment.**
- ✓✓ **It is sometimes suggested that self-employment is not a material factor in the ICI sector. Based on the data in Figure No. 6, this seems unlikely. With 44.8% of workers hired by building finishing contractors reporting that they are nominally self-employed, it is difficult to believe that the practice of styling workers as self-employed subcontractors has not permeated into the ICI sector to at least some degree.**

“

Workers benefited greatly from the work of the Joint Compliance Teams in terms of wages recovered but also in terms of working conditions and safety.

*-Dave Ages,
Ministry of Labour (1985-2002)*

”



Figure No. 8 shows that there are also marked differences in the incidence of nominal self-employment across the various trades, leading to a number of observations.

Share of Workers in Specific Trades that are
Nominally Self-Employed in the B.C. Construction Industry

Trade (NOC Code)	Percent of Workers in Trade who are Nominally Self-Employed
7247 Cable television service and maintenance technicians	100.0%
7283 Tilesetters	62.9%
7295 Floor covering installers	61.2%
7294 Painters and decorators (except interior decorators)	42.2%
7281 Bricklayers	41.4%
7272 Cabinetmakers	32.1%
7441 Residential and commercial installers and servicers	34.9%
7271 Carpenters	32.1%
7284 Plasterers, drywall installers and finishers and lathers	29.3%
7253 Gas fitters	28.9%
7291 Roofers and shinglers	25.1%
7282 Concrete finishers	21.4%
7251 Plumbers	20.7%
7611 Construction and trades helpers and labourers	17.0%
7521 Heavy equipment operators (except crane)	16.3%
7292 Glaziers	16.2%
7293 Insulators	16.0%
7241 Electricians (except industrial and power system)	15.2%
7237 Welders and related machine operators	13.2%
7246 Telecommunications installation and repair workers	10.1%
7243 Power system electricians	10.0%
7252 Steamfitters, pipefitters and sprinkler system installers	9.1%
7235 Structural metal and platework fabricators and fitters	9.1%
7371 Crane operators	9.0%
7233 Sheet metal workers	7.7%
7236 Ironworkers	7.00%
7245 Telecommunications line and cable workers	4.2%
7318 Elevator constructors and mechanics	1.2%
7244 Electrical power line and cable workers	1.0%
7234 Boilermakers	0.0%

Figure No. 8
Share of Workers in Specific
Trades that are Nominally
Self-Employed in the B.C.
Construction Industry,
Statistics Canada, Census
2016

Trades in which output is easily measured in standard units (e.g., square feet) are much more likely to have a high proportion of nominally self-employed workers. This includes: tilesetters (62.9%), floor covering installers (61.2%), painters (42.2%), cabinet makers (40.3%), installers and servicers (34.9%) and drywallers (29.3%). This suggests that there is more than a casual relationship between the prevalence of piece-rate remuneration (which is compatible with an employment relationship) and the styling of workers as nominal subcontractors. Piece-work remuneration may migrate to styling of workers as subcontractors.

Conversely, self-employment is somewhat less common in more complex mechanical and electrical trades. In trades with a high incidence of nominal self-employment, it seems improbable that the practice of styling workers as nominal subcontractors has not seeped into the ICI sector.

Self-Employed vs. Employees: Hours Worked

While only one-third (33.0%) of employees in construction worked fewer than 35 hours per week in 2019, the proportion of part-time work among the self-employed is significantly higher: 44.6%. However, a much higher share of self-employed workers (17.7%) worked 50 hours or more compared to employees (11.4%). (Figure No. 9). An additional advantage from styling workers as nominally self-employed, therefore, may be to avoid overtime obligations.

	Employees		Self-Employed	
	Number	Percent of	Number	Percent of
0 hours	11,500	6.5%	8,300	11.3%
1 to 14 hours	4,500	2.6%	6,300	8.6%
15 to 29 hours	16,300	9.3%	9,100	12.4%
30 to 34 hours	25,800	14.65%	9,100	12.3%
Subtotal: Part-Time	58,200	33.0%	32,800	44.6%
35 to 39 hours	12,700	7.2%	5,700	7.8%
40 hours	64,100	36.4%	16,800	22.9%
41 to 49 hours	22,100	12.0%	5,200	7.1%
50 hours or more	20,100	11.4%	13,000	17.7%
Subtotal: Full-Time	118,000	67.0%	40,700	55.4%
Total	176,200	100.0%	73,500	100.0%

Figure No. 9
Comparison of Average Weekly Hours, Self-Employed vs. Employees - B.C.'s Construction Industry,
Statistics Canada Table No. 14-10-0037-01

The share of self-employed workers in construction employment tends to be somewhat higher than their share of construction hours worked. Over the past decade, the self employed accounted for an average of 32% of construction employment in B.C., but 29.7% of hours worked in construction. (Figure No. 10). One explanation for this divergence is that some construction workers who work full-time as employees may also work part-time as self-employed workers.

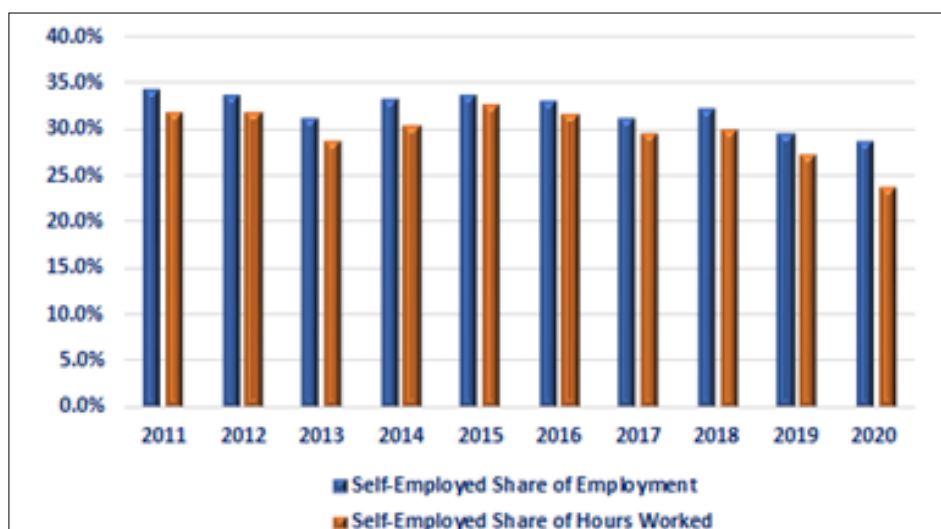


Figure No. 10
Comparison of Share of Employment and Hours Worked, Self-Employed vs. Employees -
B.C.'s Construction Industry, Statistics Canada Table No. 14-10-0037-01 and 14-10-0026-01

WorkSafeBC Personal Optional Protection Coverage

WorkSafeBC offers income replacement and medical benefits coverage, known as Personal Optional Protection (POP), to unincorporated independent operators. POP coverage is not available to independent operators that become incorporated. Nor is POP coverage available to self-employed workers who also employ other workers. Self-employed workers who employ other workers are expected to register with WorkSafeBC as employers.

The usual practice is for an incorporated independent operator to make themselves an employee of the company. The reason for this is that only earned income is counted when determining eligibility for RRSP contributions (and the related deductions from income). Dividend income, which is the other way an individual can withdraw income from a private company, does not count toward determining eligibility for RRSP contributions. Consequently, most incorporated independent operators in the construction industry are expected to register with WorkSafeBC as employers.

Figure No. 11 compares the estimated number of unincorporated independent operators in B.C.'s construction industry, based on the Labour Force Survey, with the number of unincorporated proprietorships and partnerships that have registered with WorkSafeBC for Personal Optional Protection.

Comparison of POP Coverage Among Employers
and Unincorporated Independent Operators

Year	No. of Unincorporated, Self-Employed Workers, without Paid Help (Unincorporated Independent Operators)	No. of Employers Registered for Personal Optional Protection (POP)	No. of Unincorporated Independent Operators without POP Coverage	Percent of Unincorporated Independent Operators without POP Coverage
2011	32,800	11,755	21,045	64.2%
2012	31,900	11,873	20,027	62.8%
2013	29,400	11,609	17,791	60.5%
2014	23,300	11,387	11,913	51.1%
2015	30,100	11,239	18,861	62.7%
2016	30,900	11,633	19,267	62.4%
2017	30,200	11,897	18,303	60.6%
2018	34,000	12,056	21,944	64.5%
2019	33,000	12,164	20,836	63.1%
2020	37,200	12,171	15,029	55.3%
Avg.	30,280	11,778	18,502	60.7%

Figure No. 11
No. of Unincorporated Proprietorships and Partnerships in the Construction Industry (Rate Group 72), Registered with WorkSafeBC for Personal Optional Protection and Number of Unincorporated Self-Employed Workers without Paid Help in the Construction Industry estimated by the Labour Force Survey (Table No. 14-10-0026-01)

It is notable that, on average, 60.7% of unincorporated independent operators do not have Personal Optional Protection.

Potential Implications of Low Rate of POP Coverage

Figure No. 10 shows that the majority of unincorporated independent operators in the construction industry do not take out POP coverage. In some cases, these workers may prefer to work without coverage to avoid the cost of POP premiums. However, a ruse that should be of particular concern to WorkSafeBC is the practice of some contractors to employ a mixed workforce composed of both employees and independent operators.

Continued next page



60.7%

**Average percentage of
unincorporated independent
operators who do not have
Personal Optional Protection
from WorkSafeBC**

Continued from previous page

In some cases, workers may be treated as employees during the regular week, but as independent operators for weekend work. WorkSafeBC premiums are paid on behalf of the employees, but not the independent operators. The independent operators may be told that if they are injured, they should apply for WorkSafeBC benefits and that the contractor will not dispute their claim. To the degree that this occurs, legitimate contractors are covering WorkSafeBC's claims costs through higher premiums.

The large number of unincorporated independent operators that do not have POP coverage poses two policy challenges. The first of these pertains to the "level playing field" principle, which holds that no contractor should enjoy a subsidy (lawful or unlawful) when competing for work. Given that a large majority of workers who are unincorporated independent operators do not take out POP coverage, it would appear that medical benefits for work-related injuries suffered by these workers are being borne by B.C.'s Medical Services Plan. Effectively, the Medical Services Plan is subsidizing the employment costs of the unincorporated independent operators and therefore the labour costs of the contractors that engage these workers. This is to the competitive detriment of contractors that employ conventional employees and pay for WorkSafeBC coverage. This goes against the grain of the level playing field principle.

The second policy issue pertains to the motivation for working in the construction industry, which is inherently dangerous, without taking out POP coverage. As noted, some workers may take on this risk willingly. However, a potentially stronger motivation is that unincorporated independent operators may believe that registering with WorkSafeBC will increase their risk of being audited by Canada Revenue Agency. This obviously applies if the work is remunerated in cash, but also applies if income is underreported on the scale suggested by the studies cited earlier. ↗

IV Lessons from B.C.'s Joint Compliance Pilot

2001 team made 400 visits to construction sites across province

Estimating the Incidence of Non-Compliance

It is impossible to estimate non-compliance with precision. Non-compliant contractors and workers do not want to be observed and measured. They utilize various ruses to conceal or disguise their non-compliance, including the creation of false paper trails such as invoices and status declarations.

Formulating an estimate of the incidence of misclassification of workers as independent operators is also challenging because the common law requires that each case be assessed on the basis of its individual circumstances.

There has been only one systematic review of the construction industry that examined the classification of workers on a case-by-case basis.



In 2001, a pilot project known as the Joint Compliance Team was established by the B.C. Ministry of Skills Development and Labour, the federal Department of Human Resources Development and the Canada Customs and Revenue Agency. The Joint Compliance Team made 400 visits to construction projects across B.C. and across a range of sectors and contract trades. There appeared to be irregularities in classifying workers as subcontractors rather than employees on 29% of these sites. Considering the number of non-compliant sites indicative of the incidence of non-compliance, then, applied to the 2019 complement of independent operators (48,200), there are approximately 14,000 workers improperly classified as independent subcontractors. In 2019, these workers constituted 5.6% of the construction workforce—a sufficient proportion to have an adverse and damaging impact on competitive conditions.

As noted earlier, the labour cost savings to the contractors that operate by styling workers as independent operators rather than employees is around 20.0%. This runs strongly counter to the declared public policy goal of maintaining a level playing field for competition in the construction industry. By effectively turning a blind eye to the cheater, government penalizes all legitimate, compliant contractors.

Approximately 5.6% of independent subcontractors in construction are improperly classified.

Estimating the Financial Losses from Non-Compliance

Figure No. 12 summarizes the estimated Employer Health Tax revenue loss from the deliberate misclassification of workers:

- In 2019, based on the Labour Force Survey, there were 48,200 independent operators working in B.C.'s construction industry.

- The average weekly earnings for workers in B.C.'s construction industry was \$1,245. We estimate 47 weeks of work and therefore annual earnings of \$58,500.


- The estimated misclassification rate is 29% based on the 2001 Joint Compliance Team finding.

- The EHT rate is zero for payrolls under \$500,000, 2.925% for payrolls between \$500,000 and \$1,500,000, and 1.95% for payrolls over \$1,500,000. In construction, this corresponds approximately to 0 to 9 workers, 10 to 19 workers and 20 or more workers.

- The number of construction workers in each payroll category is based on estimates using Statistics Canada Table No. 14-10-0215-01. This table reports employment by employer size. The size categories do not correspond precisely with the EHT payroll categories. However, an estimate has been made that is consistent with Table No. 14-10-0215-01.

- The estimated weighted average of the EHT in construction is 1.48%.

- The estimated notional payroll of the misclassified independent operators is \$817.7 million.

- The annual estimated loss to the B.C. treasury from misclassifying construction workers as independent operators is \$12.1 million. 

Estimate of Lost Employer Health Tax Revenues from Misclassification of Workers as Independent Operators (IOs) rather than Employees

No. of Independent Operators 2019				
Incorporated	15,200			
Unincorporated	33,000			
Total	48,200			
Earnings/Payroll				
Avg. Weekly Wages & Earnings	\$1,245			
Estimated Annual (47 weeks)	\$58,500			
Gross National Payroll	\$2,819,701,848			
Misclassification				
Joint Compliance Team Estimate	29%			
Estimated No. of Misclassified IOs	13,978			
BC Employer Health Tax (EHT) Rate				
<\$500,000 Payroll	0.00%			
\$500,000 to \$1.5M Payroll	2.925%			
>\$1.5M Payroll	1.950%			
Distribution of Misclassified IOs and Avoided EHT				
Estimated No. of Workers by Payroll Category (All Workers)*	Employer Size (# of workers)	No. of Workers	Percent	No. of Misclassified IOs
<\$500,000 Payroll	9 or fewer	54,002	32%	4,536
\$500,000 to \$1.5M Payroll	10 to 25	27,949	17%	2,347
>\$1.5M Payroll	>25	88,476	51%	7,095
Total		166,427	100%	13,978
Distribution of Misclassified IOs and Avoided EHT				
	Tax Rate	No. of Misclassified IOs	National Payroll	Avoided EHT
<\$500,000 Payroll	0.00%	4,536	\$265,330,543	\$0
\$500,000 to \$1.5M Payroll	2.925%	2,347	\$137,321,650	\$4,016,658
>\$1.5M Payroll	1.950%	7,095	\$415,061,342	\$8,093,696
Total		13,978	\$817,713,536	\$12,110,354
Weighted Average of Payroll				1.481%
Based on estimates drawn from StatsCan Table No 14-10-0215-01				

V Consequences of Non-Compliance

Consequences of non-compliance include WorkSafeBC premiums, and unpaid income tax, CPP and EI contributions

WorkSafeBC Premiums

Figure No. 13 shows the estimated loss in WorkSafeBC premium income from misclassifying workers as independent operators. WorkSafeBC premiums are applied to covered payroll. The notional payroll of the misclassified workers is the same as in the EHT analysis, namely \$817,713,536. The average WorkSafeBC premium for construction rate groups is estimated at 3.0%. On this basis, the lost premium income is estimated at \$24.5 million, which is conservative. In an earlier study, Hammerer estimates losses from worker misclassification for 2006-07 to be \$24.6 million.⁷ Updated to 2019, the Hammerer estimate would be approximately \$34.4 million. The Joint Compliance Team described earlier estimated losses to WorkSafeBC in 2001 at \$40 million.⁸

Estimate of Lost WorkSafeBC Premium Income from Misclassification of Workers as Independent Operators rather than Employees, 2019

No. of Independent Operators 2019	
Incorporated	15,200
Unincorporated	33,000
Total	48,200
Misclassification	
Compliance Team Estimate	29%
Estimated No. of Misclassified Independent Operators	13,978
Earnings/Payroll	
Average Weekly Wages and Earnings	\$1,245
Estimated Annual (47 weeks)	\$58,500
Gross National Payroll	\$817,713,536
WorkSafeBC Premium - Average Estimate	
Avoided Premiums	\$24,531,406

⁷Tiffinie Hammerer, "Measuring the Underground Construction Economy in Relation to WorkSafeBC," January 6, 2010, paper submitted BCIT Forensic Crime Program

⁸Cited by Eric Hamilton-Smith, "Deterring the Underground Economy in B.C.'s Residential Construction Sector," December 10, 2010, paper submitted to School of Public Policy, Simon Fraser University.

⁹This loss is stressed by Eric Hamilton-Smith in "Increasing Skilled Trades Employer Participation in Apprenticeship Training In British Columbia," 2012, paper submitted to School of Public Policy, Simon Fraser University

Income Tax, CPP and EI

As noted earlier, independent research indicates a high rate of under-reporting income by self-employed workers. This report uses a 30% estimate, which is consistent with the research. Figure No. 14 shows the impact of a 30% under-reporting of income by all independent operators: \$271.6 million. If the estimate were confined to improperly classified independent operators, the corresponding number would be approximately \$78.8 million. In other words, correcting the misclassification ruse would generate an additional \$78.8 million income tax, EI and CPP revenues.

Estimate of Lost Income Tax, EI and CPP from Under-Reporting of Income by Independent Operators in Construction

No. of Independent Operators 2019	
Incorporated	15,200
Unincorporated	33,000
Total	48,200
Earnings/Payroll	
Average Weekly Wages and Earnings	\$1,245
Estimated Annual (47 weeks)	\$58,500
Income Tax	
Income Tax, EI, CPP payable (no deductions)	\$14,455
Income Tax, EI, CPP payable (no deductions) 70% income reported	\$8,820
Tax Loss from reporting only 70% of income	\$5,635
Total Income Tax, EI and CPP Loss	\$271,607,000
Misclassified Independent Operator Share (29%)	\$78,766,030

Figure No. 15 summarizes the financial losses from the above analysis.

Summary of Financial Losses to Governments and Agencies

Revenue Loss Type	Amount
Employer Health Tax	\$12,110,354
WorkSafeBC	\$24,531,406
Income Tax, CPP, EI (from under-reporting income)	
All Independent Operators	\$271,607,000
Misclassified Independent Operators Only	\$78,766,030
Total (with All Independent Operators)	\$308,248,761
Total (with only Misclassified Independent Operators)	\$115,407,791



Other Consequences of Non-Compliance

Turning a blind eye to the widespread misclassification of workers as independent operators taints and distorts the competitive landscape in the construction industry to favour the cheaters and penalize those workers and contractors that meet their obligations.

Contractors that misclassify workers as independent operators enjoy an illegitimate labour cost advantage of 20%. This can be sufficient to win a competitively tendered project at the expense of legitimate contractors and legitimate workers.

Workers that become independent operators and under-report their earnings are more competitive than legitimately employed workers. By under-reporting their earnings, these independent operators enjoy an illegitimate cost advantage of around 9.6%.

Independent operators that avoid registering with WorkSafeBC or who do not take out Personal Optional Protection (POP) effectively transfer the costs for their work-related medical benefits to the B.C. Health Services Plan. This contrasts with legitimately employed workers whose employers must pay the appropriate premium for WorkSafeBC coverage.

Contractors that improperly style their workers as independent subcontractors are highly unlikely to invest in training those workers either in trade skills or in safety skills. They may also view themselves (incorrectly) as having a lesser responsibility for maintaining safe working conditions than if their workers were hired as employees.

Non-compliance is not stable. If governments turn a blind eye to non-compliance, it will expand, especially in periods when there is an economic downturn in construction. Once established, non-compliant behaviour tends to become embedded.

Non-compliance is not stable and if governments turn a blind eye to it, the underground economy will expand, especially in an economic downturn.

There are of course legitimate self-employed workers in the construction industry. But whether they could plausibly constitute almost 20% of the industry's total workforce, let alone more than 30% in some trades, is suspect. ↗

Contractors that improperly style their workers as independent subcontractors are highly unlikely to invest in training those workers either in trade skills or in safety skills.



Recommendations

In the recommendations that follow, a key role is played by the recommendation that B.C. reconstitute the Joint Compliance Team that had brought together enforcement and inspection resources from the Ministry of Labour, WorkSafeBC and CRA. In preparing this report, we had the opportunity to interview a Ministry official who had oversight of the Joint Compliance Team. In a statement provided, he stressed the value and impact of that initiative:

I was employed by the Ministry of Labour for 17 years. I began as an Industrial Relations Officer and, as such, at times participated in the work of the Joint Compliance Team. At the time of my resignation, I was a Regional Manager. The JCT had been my responsibility.

The JCT operated for a number of years and worked effectively, combining the authorities of a large number of government agencies (both provincial and federal). It was a great example of proactive enforcement in various fields, including agriculture and construction. Many employers were brought into compliance through the educational and outreach functions of the JCT.

Workers benefited greatly from the work of the JCT in terms of wages recovered but also in terms of working conditions and safety.

Responsible employers also benefited by not having to compete against “bad actors” who ignored their legal responsibilities. And governments benefited substantially as well—through recovered taxes but also through the savings generated by safe and well-run workplaces.

Dave Ages
Ministry of Labour, 1985 to 2002

Recommendation 1

B.C. reconstitute the Joint Compliance Team with the Ministry of Labour, WorkSafeBC and the CRA. The 2001 pilot project demonstrated the prevalence of non-compliance and provided a strong evidentiary basis for corrective policies.

Recommendation 2

WorkSafeBC should impose administrative penalties on contractors that misclassify workers as independent operators. WorkSafeBC should also require those contractors to pay the premiums they should have paid in both the current and prior years. The standard CRA assessment period is three years when there is no wilful evasion, but assessments can be extended further if there is evidence of deliberate evasion. Businesses, including unincorporated entities, are required to maintain their records for six years.

Recommendation 3

B.C.’s Employment Standards Act and Workers Compensation Act should make prime contractors responsible for the compliance of their subcontractors and liable for their non-compliance. ↗





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