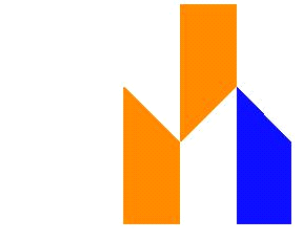


Submission by

MASTER BUILDERS AUSTRALIA

to the

Productivity Commission Inquiry

into

Workers' Compensation and Occupational Health and Safety – National Workers' Compensation and Occupational Health and Safety Frameworks Interim Report

January 2004

Master Builders Australia Inc ABN 701 3422 100

1.0 Introduction

1.1 This submission supplements the Master Builders Australia Inc (Master Builders) submission dated June 2003, submission number 79 on the Commission's website.

1.2 Master Builders is a member of the Australian Chamber of Commerce and Industry (ACCI) and supports the written submissions lodged by ACCI on the Interim Report and the oral representations made by Messrs Anderson and Shaw from ACCI on 8 December 2003. However, as detailed below, we seek one change to the Commission's recommendations not sought by ACCI.

2.0 Purpose of this Submission

2.1 This submission expands upon the arguments made in Master Builders' initial submission and, in particular, provides detailed comment on the Commission's recommendation set out on page 125 of the Interim Report. This recommendation deals with the principles to use when defining an employee with the objective of determining coverage under workers' compensation schemes.

2.2 For completeness, the recommendation is set out:

"*The Commission recommends the following as principles to use when defining an employee, to determine coverage under compulsory workers' compensation schemes:*

- *employer control, recognizing that the common law 'contract of service' provides a solid basis for defining an employee in most situations;*
- *certainty and clarity, as coverage under workers' compensation should be clear to both workers and employers at the commencement of the work relationship. For certain groups of workers and types of work relationships, deeming may be necessary;*

- *administrative simplicity, to reduce the costs of administration and enforcement;*
- *consistency with other legislation, to capture significant informational benefits and cost savings; and*
- *durability and flexibility, to deal with a wide variety of, and changing, work arrangements".*

2.3 This recommendation deals with issues of great importance for the building and construction industry. As expressed at page 124 of the Commission's Interim Report, the final report of the Royal Commission into the Building and Construction Industry (Cole Report) recommended (Recommendation 153) that the Commonwealth encourage the States and Territories to continue efforts to harmonise the key definitions of the various workers' compensation systems, particularly the definition of 'worker'.

2.4 We reiterate the comment made by ACCI in its submission on the Interim Report that industry does not support the third step set out in the Recommendation which appears at page 109 of the Interim Report. In other words, whilst Master Builders supports national consistency in workers' compensation, we do not support a national insurance scheme. This point was outlined in our initial submission. However, comment is provided on the issue of the definition of 'worker' as a means of defining access to the national system despite Master Builders' fundamental opposition to the Commission's approach.

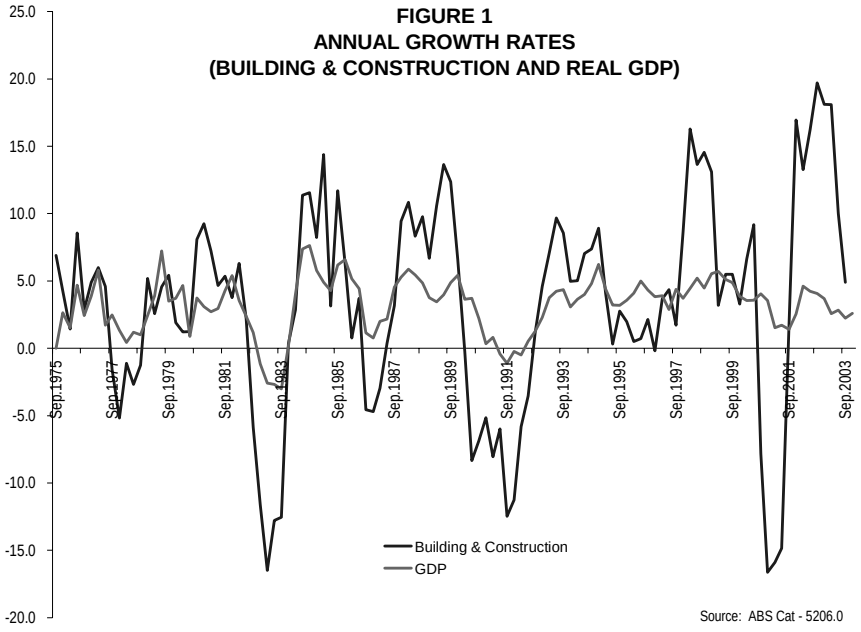
3.0 The Importance of the Subcontract System to the Industry

3.1 A considerable amount of work in the building and construction industry is performed by persons other than in the capacity of employee. It is essential that this subcontracting system is not undermined by unclear provisions concerning the responsibility for workers' compensation insurance where the dividing line between an employee and a subcontractor is blurred. In relation to this concern, two issues are addressed in this submission: Master Builders'

opposition to the notion of extending compulsory workers' compensation insurance to so-called dependent contractors and, in establishing the definition of 'worker', the need to supplement the control test with a test that aligns with the test used in income tax law. As will become evident from the argument that follows, these two issues merge in the outcome proposed. For the purpose of this submission, we have used the term 'contractor' to describe any person who performs work other than as an employee, whether they do that as a sole trader, through a company, partnership, trust or other arrangement or in some other capacity.

3.2 The volatility and fluctuating nature of the industry (see Figure 1) means that there is limited scope for any degree of permanent employer/employee relationships. This has been recognised over the years, both by the industry and legislatures, through the establishment of industry-based benefit schemes such as portable long service leave funds, centralised redundancy funds, portable superannuation and, most recently, in some areas, portable sick leave. Other factors contributing to the movement towards the subcontract system include increased labour costs and technological changes which encourage participants in the industry to specialise in a specific aspect of the building and construction process.

FIGURE 1
ANNUAL GROWTH RATES
(BUILDING & CONSTRUCTION AND REAL GDP)



3.3 These factors, coupled with the fluctuating and uncertain nature of building operations, have contributed to the growth of the contract system. This growth reflects a general acceptance in the industry of the competitive advantage of such a system, a matter explained in more detail in paragraph 3.5 below. The Cole Report recognised that contracting is a legitimate, important form of business activity and working arrangement. The Cole Report did, however, explore allegations of sham contracting.

3.4 The Cole Report extensively analysed the subcontracting system following the earlier release in September 2002 of Discussion Paper No. 11, *Working Arrangements – Their Effects on Workers' Entitlements and Public Revenue*. The Royal Commission's conclusions about sham subcontracting were largely inconclusive. At paragraph 276 of Chapter 23, Volume 9 of the Cole Report, the following is said:

"*The indications of high levels of incorporation and possession of ABNs by contractors in the building and construction industry support the view that there may well be significant illegitimate subcontracting. However, there are no reliable statistics providing a basis to estimate the extent of the problem with any precision."*

Further, the notion of "illegitimate subcontracting" is ill-defined but the activity complained of appears to Master Builders to be in breach of current laws e.g. through outright evasion of obligations.[1]

[1] This belief accords with the one of the main conclusions of the ILO International Labour Conference in June 2003 concerning the assessment of the scope of the unemployment relationship. Master Builders believes that in a very small proportion of cases disguised employment occurs. At paragraph 7 of the conclusions concerning the employment relationship, the following is noted:
"Disguised employment occurs when the employer treats a person who is an employee as other than an employee so as to hide his or her true legal status. This can occur through the inappropriate use of civil or commercial arrangements. It is detrimental to the interests of workers and employers and an abuse that is inimical to decent work and should not be tolerated. False self-employment, false subcontracting, the establishment of pseudo cooperatives, false provision of services and false company restructuring are amongst the most frequent means that are used to disguise the employment relationship. The effect of such practices can be to deny labour protection to the worker and to avoid costs that may include taxes and social security contributions. There is evidence that it is more common in certain areas of economic activity but governments, employers and workers should take active steps to guard against such practices anywhere they occur".

3.5 Master Builders submits that the growth of the subcontracting system is overwhelmingly a function of market forces rather than a device to avoid the payment of worker entitlements or for any other of the largely spurious reasons proposed by some industry participants. The specialist contract system has consistently been found to be the most efficient and productive method of building. There are a number of reasons for this, including:

- contractors can enter the industry with very little capital outlay resulting in a very competitive environment i.e. barriers to entry are low;
- the system provides an important opportunity for a skilled tradesperson with the necessary motivation to significantly increase their earnings with their income directly related to their efficiency in the actual time they work;
- the system is administratively simple and reduces supervision costs considerably as the principal contractor does not incur the administrative overheads of employing staff;
- as contractors do not get paid for delays, there is an incentive to solve problems which develop on site quickly and effectively. Employees, on the other hand, have little incentive to solve such problems;
- a contractor quotes a price for a job which reflects the situation in regard to work on hand. The market price reflects the level of demand;
- results based contracts are generally more efficient than time costed labour working towards the same ends;
- regional variations in prices paid to contractors encourages mobility of those contractors which helps to achieve and improve balance within regional markets; and
- the housing sector, which predominately uses contractors, has, unlike all other sectors in the construction industry, not faced any major stoppages or strikes as a contractor is bound by the contract he enters into in respect of the work to be performed and has an incentive to get on with the job.

The Cole Report also found that "the trend to contracting has been accepted by significant numbers of workers" – paragraph 277, Chapter 23, Volume 9.

3.6 It can be discerned, therefore, that the building and construction industry operates on a subcontract basis for two principal reasons. First, while the nature of construction work is relatively labour intensive, it is also highly specialised. Many of the industry's contractors are sole traders with highly specialised skills focussed on one particular aspect of the construction process. Secondly, competing specialist skills in an environment where work is project based naturally create efficiencies through competition. The subcontracting system, by its very nature, is highly price competitive. The move to contracting does not auger any groundswell of 'sham' arrangements designed to exploit workers or avoid workplace obligations. The subcontracting system exists and operates efficiently for the two principal reasons outlined in this paragraph and as set out in more detail in paragraph 3.5.

3.7 The unions have long, wrongly, contended that these 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 unions seek the right to challenge the bona fide legal status of subcontractors. Most complaints emanate from unions as the 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. Individuals are legitimately entitled to structure their business affairs as independent contractors. Unions and others have a vested interest in preventing them from so doing in order to increase the size of the labour pool from which the unions can recruit members. The tests that are adopted in a compulsory workers' compensation scheme should recognise the legitimate right of workers to act as contractors.

3.8 At page 121 of the Interim Report the Commission states that:

"There is a substantial proportion of contractors whose relationship with their client is not one of genuine independence, but is more like that of an employer-employee."

The discussion that then follows identifies the type of contractor as a "dependent contractor." The issue is not debated in the text. The second dot point of the recommendation reproduced at paragraph 2.2 above appears to have been partly crafted with the issue of dependent contractors in mind because it states that "for certain groups of workers and types of work relationships, deeming may be necessary." We disagree that any deeming should extend to so-called dependent contractors. This point is taken up in part 4 of this submission.

3.9 We also disagree with the contention that the employer control test should be the only test for inclusion in compulsory workers' compensation insurance arrangements. Nevertheless, we agree that the control test provides a solid basis for defining an employee in most situations. For the purposes of defining a worker in a compulsory workers' compensation scheme, however, we would strongly argue for alignment with the income tax definition (as suggested on page 120 of the Interim Report) via the adoption of the same terms as are used in the alienation of personal services provisions of the *Income Tax Assessment Act* 1997 (Cth) (ITAA 97).

3.10 We now deal with the two issues raised in paragraphs 3.8 and 3.9 in more detail.

4.0 Dependent Contractors

4.1 Initially, we note that amongst commentators and academics, there is confusion about the definition of a dependent contractor, which emphasises the conceptual shortcomings of this notion. For example, the definition used in the Waite and Will[2] work referred to at page 121 of the Interim Report is labeled (at page 35 of the paper) as "very different" from the definition used by VandenHeuvel and Wooden in

[2] Waite M and Will L 2001 Self Employed Contractors in Australia: Incidence and Characteristics. Productivity Commission Staff Research Paper, Ausinfo, Canberra.

their 1995 study.[3] That latter study adopted the definition of dependence based on the provision of services to only, or predominantly, one organisation. This definition is unsatisfactory, to say the least, as a means of categorising a relationship of economic dependency or as a trigger where the normal market mechanisms need to be set aside. The fundamentally flawed assumption is that the so-called dependent contractor is the subject of exploitation. Indeed, the flaw in the assumption is underlined where a so-called dependent contractor may legitimately employ its own workforce.

4.2 This conceptual confusion is able to be demonstrated from the discussion in the Victorian Industrial Relations Taskforce report where the following is said about dependent contractors:

"*There is also a view that somewhere between genuine employees and genuine independent contractors, that a third category of contractors is starting to emerge. This category is defined as those workers who are self-employed, but at the same time are dependent on the hiring organization to whom they provide their services. They are basically dependent on a regular employer for work, much like an employee is dependent on an employer for a wage. While workers in this third category may not yet account for a substantial share of the workforce, their numbers look set to grow."*[4]

4.3 This passage begs the question of how the notion of dependency is characterised, how it is correlated with a relationship of exploitation for which protection needs to be afforded and whether it is a dynamic or a static concept. If dynamic, why enclose the contractor within a static legal framework such as imposed by s.275 *Industrial Relations Act*, 1999 (Qld) or proposed by Clause 7 of the exposure draft of the *Industrial Law Reform (Fair Work) Bill 2004 (SA)*?[5] This is particularly the case for building workers who are often itinerant or who may choose, between different projects or over different time spans, from one week to a year, to act as employees or to act as contractors. In addition, there does not appear to be evidence that people are being forced into contractor positions.

[3] VandenHeuvel, A and Wooden, M – Self Employed Contractors in Australia: How many and who are they? Journal of Industrial Relations (1995) Vol 37, No. 2, P.263.
[4] The State of Victoria, Independent Report of the Victorian Industrial Relations Taskforce *Part 1: Report and Recommendations,* August 2000, p.146.
[5] For a discussion of the Queensland provision see Queensland Government Department of Industrial Relations 'The Operation of the Industrial Relations Act 1999 – The First 2 Years', esp at p. 21 - http://www.ir.qld.gov.au/reports&submissions/iract-first2yrs.pdf

4.4 It is against this difficulty that the current Australian laws regulating dependent contractors and the rationale for their introduction need to be examined, although that task is not attempted in this submission. It is also in this context that the utility of deeming dependent contractors to be workers for the purposes of workers' compensation legislation needs to be examined. Whilst we disagree with their ultimate solution to the issue of the definition of worker, we agree with the summary of the law relating to deemed inclusions in the definition as expressed by Clayton, Johnstone and Sceats[6] as follows:

"The deemed inclusion of a diverse range of workers represents a potpourri of examples without any single defining principle, apart from some inchoate notion that they represent socially desirable areas of coverage."[7]

4.5 What is the mischief against which legislation deeming so-called dependent contractors as employees is alleged to address? The words of one commentator assist:

"The archetypical dependent contractor…typically relies on work from one source only. The dependent contractor differs from the employee only in that the dependent contractor brings to the exchange financial capital as well as his or her own labour effort."[8]

This definition brings with it the assumption that one contractual source, with a clear economic dependency on that source, is inherently exploitative. But is that an inviolable proposition and does it embrace the very unclear boundaries of who is and who is not a dependent contractor? Both questions should be answered in the negative. It cannot be the case that, say, one small independent software company would cavil at, for example, a five year Commonwealth Government contract. In some senses, that would be one of the most desirable outcomes for any small business – a long term, secure contract with a responsible principal. The same applies in the building and construction industry. The point is that dependent contractors, even when they rely on one main source, are not

[6] A Clayton, R Johnstone and S Sceats 'The Legal Concept of Work-Related Injury and Disease in Australian OH&S and Workers' Compensation Systems' April 2003, ANU National Research Centre for OHS Regulation.
[7] Id at p.19.
[8] A Commons 'Dependent Contractors: In from the Cold' Auckland University Law Review, Vol. 8 No. 1 (1996) p.103.

necessarily in a position where they have been or are open to exploitation or where they merely bring financial capital to the relationship. For example, their intellectual capital is often equally, if not more, important. The basic assumption that they have, as a matter of fact, relatively less bargaining power than employers is flawed. The fact that having one client at a particular point in time means that the business, in whatever form, is similarly illegitimate is also not logically sustainable. It is for these reasons that the deeming of so-called dependent contractors as employees will not assist in bringing clarity to the divide between employees and contractors.

4.6 Having made these arguments, it is acknowledged that the alienation of personal services income provisions of the income tax law (Divisions 84 to 87 *ITAA* 97 introduced into the ITAA 97 by the *New Business Tax System (Alienation of Personal Services Income) Act* 2000 (Cth) for the 2000-2001 income year), encapsulates an unrelated clients' test (in Section 87-20) which carries with it inter alia an assumption that the provision of services during a tax year to two or more entities that are not associated with each other shows evidence that a personal services business is not within the personal income tax regime.[9] This is where Master Builders' arguments about not deeming dependent contractors to be employees for the purposes of workers' compensation legislation and the argument about introducing tests from the income tax law as adjuncts to the control test converge. We believe that the manner in which the definition of 'worker' should be addressed should follow and incorporate a relevant provision from Schedule 2 of the *Workplace Compensation and Rehabilitation Act,* 2003 (Qld) (WCRA), introduced from 1 July 2003 that adds a further test to the traditional common law test.

5.0 Alignment with Income Tax Definition

5.1 The WCRA contains Schedule 2 which deals with the definition of a worker. From 1 July 2003 it contains a new provision specifying that

[9] This is one of the 4 personal services business tests identified in subsection 87-15(2) ITAA 97

any person who works for another person under a contract (regardless of whether the contract is a contract of service) is a 'worker' unless the person can satisfy all three elements of a results test, similar to that which appears in Section 87-18 ITAA 97, or it can be shown that a personal services business determination is in effect for the person.

5.2 As stated, despite the outcome of the results test, a person will not be considered to be a worker if they have a personal services business determination under the ITAA 97, section 87-60. This section specifies the matters about which the Commissioner of Taxation must be satisfied in order to make a determination that a person is performing work and receiving income via a personal services business.

5.3 Under the WCRA, in the event of an application for compensation being lodged, all of the information available at the time of the claim about the individual's status may be considered. This is in keeping with the current common law per *Stevens v. Brodribb Sawmilling Co. Pty Ltd*[10] and *Hollis v. Vabu Pty Ltd*[11] that there is no single objective test for deciding who is an 'employee' or 'worker' and that all of the circumstances of a case must be considered, on an individual case-by-case basis. The WCRA does not therefore seek to replace or codify the common law meaning of 'employee' or 'worker'. However, the Commission is urged to take that step by recommending that the provisions of Clause 2 of Part 1 of Schedule 2 of the WCRA become an integral part of the definition of 'worker' in a model workers' compensation scheme. That clause defines a worker to cover the following:

"*A person who works for another person under a contract (regardless of whether the contract is a contract of service) unless –*

(a) the person performing the work –

(i) is paid to achieve a specified result or outcome; and

(ii) has to supply the plant and equipment or tools of trade needed to perform the work; and

(iii) is, or would be, liable for the cost of rectifying any defect in the work performed; or

[10] (1986) 160 CLR 16
[11] (2001) HCA 44

(b) a personal services business determination is in effect for the person performing the work under the Income Tax Assessment Act 1997 (Cth), section 87-60".

5.4 Accordingly, we recommend that the principles encapsulated in the terms of Clause 2 be added to the list of principles devised in the relevant interim recommendation and that the definition of worker connects with the notion of an employee at common law in any national scheme but supplemented by, at the least, a provision similar to clause 2(b) as set out in paragraph 5.3.

6.0 Conclusion

6.1 Once a building contractor has obtained a personal services business determination, he or she can be assured of exclusion as a worker under the model workers' compensation regime. This is a desirable, practical outcome in any national system of workers' compensation and one that is very important to the building and construction industry.

6.2 Each of the current workers' compensation statutes establishes a definition of 'worker' that relies upon the general law distinction between an employee and an independent contractor. Master Builders' recommendation does not cut across this basic principle; it merely seeks to add a further consideration which will assist to make the distinction between the two categories clearer and do so in a practical manner.

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