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MBAWA Submission to the Standing Committee on Employment, Workplace Relations and Workforce Participation Inquiry into Independent Contractors and Labour Hire Arrangements

The Master Builders Association of WA (MBAWA) welcomes the opportunity to present this submission to the Committee.

Our submission is in support of and endorses the submission of Master Builders Australia Inc on behalf of the Master Builders movement including MBAWA to the Committee in this Inquiry.

Our submission comprises two planks dealing with, firstly, independent contractors and secondly, labour hire arrangements with our submissions framed in the context of the building and construction industry in Western Australia.

1. Preamble

MBAWA is the oldest registered organisation of employers in the Registry of the Western Australian Industrial Relations Commission (WAIRC). We were formed in 1898 with our registration in the WAIRC Registry appearing as early as 1904, this being the earliest records of the Registry.

Today MBAWA represents over 1,000 members in the building and construction industry in Western Australia. Our members operate in:

- the industrial/commercial sector
- housing
- civil engineering
- government infrastructure projects
- resource projects

Given the broad scope of works undertaken by our membership we say the MBAWA can truly provide a voice for the building and construction industry in Western Australia.

Our commercial members include national and major state based builders, small to medium sized builders, commercial/housing sub-contractors, suppliers and kindred organisations.

Whilst the MBAWA provides the following comments in connection with the issues raised we point out that the limited time constraints involved only allow us to provide a concise response. Each of the matters raised are significant in their own right and can be discussed at much greater length, however, we recognise time is of the essence and appreciate succinct comments may need to suffice.

2. Independent Contractors

<u>Sub-contractor versus Employee</u>

In developing our submission MBAWA is mindful of the Construction, Forestry, Mining and Energy Union (CFMEU) being a longtime and vocal critic of the shift in the building and construction industry workforce from mostly direct day labour employees to a mix of sub-contractor, labour hire and direct day labour building workers. The CFMEU loudly proclaim the increasing reliance on independent contractors including those engaged by labour hire agencies as sub-contractors in the building industry has resulted in there being widespread use of illegitimate sub-contracting in the industry and as consequence there is widespread:

- tax evasion; and
- underpayment of award entitlements and other employee benefits such as workers' compensation.

MBAWA rejects these assertions by the CFMEU as an attempt by the union to deflect attention from its own agenda of wanting to reduce the level of sub-contracting in the industrial/commercial sector of the building and construction industry. The CFMEU is fundamentally opposed to the widespread utilisation of sub-contractors in the industry given the weakening of the union's control of labour on construction projects where sub-contractors have a significant presence.

In short, the experience of MBAWA has been that where there is a high level of sub-contracting on construction projects the industrial muscle of the CFMEU, and therefore its ability to apply pressure by industrial action, lawful or otherwise, has been proportionately weakened. Put another way, the CFMEU strongly opposes sub-contracting in the building and construction industry as sub-contractors prove to be more reluctant to take part in industrial action given they are not paid for work not performed.

MBAWA recognises the issue of sub-contractor versus employee is a long standing vexed question in the building and construction industry, as it is for many other industries. It is probably more so for the building industry given the relatively limited capital base required to set up as a sub-contractor in the industry.

MBAWA recommends a cautious approach on this matter as any attempt to introduce a "standard" definition of sub-contractor in the building and construction industry will have significant flow-on implications into the housing sector.

The housing sector's workforce in Australia is predominantly comprised of sub-contractors which is renowned for delivering a quality product at affordable prices. A key driver in delivering these outcomes is the efficiency of the sub-contract system in the housing sector. Absent the sub-contract system from the housing sector or reduce its efficiency by imposing cumbersome bureaucratic constraints will result in housing costs increasing and impacting on housing affordability.

Given the significant influence the housing sector has on the health of the national economy MBAWA contends any move to regulate the sub-contract system must deliver a consistent user friendly system which retains the status quo.

MBAWA does not suggest there does not need to be greater clarity on this issue, as there clearly does, however, whatever model might be recommended would have to be accommodated by many industries and require consistency in all appropriate state, territory and federal legislation. This is not a small ask given MBAWA understands a federal government task force in the late 1990s identified in excess of 300 differing versions of "employee" in various state and federal laws. As we recall there was no definition of "sub-contractor". In other words, whilst there are hundreds of differing definitions of who is an employee, there are no definitions for sub-contractor so, by default, those who do not meet these tests can arguably be considered to be sub-contractors.

For example, in Western Australia building industry employers are faced with a definition of employee for the purposes of the federal Superannuation Guarantee laws which is different to the Western Australian Workers' Compensation laws, which is different again to the state OH&S laws, which is different to the tests applied by the industrial relations courts. Each Act applies its own definition of employee and each Act stands alone from all others.

The Australia Taxation Office (ATO) rules as they apply to the alienation of personal service income also impact on this issue and shape many of the views of building workers as to whether they are sub-contractors or not.

MBAWA contends that if the legislature cannot provide consistent direction on this vexed question how can employers and building workers be expected to do so?

In addition, it has been MBAWA's experience that many building workers, and especially those more skilled workers, have a reluctance to work as employees. A major motivation is the sub-contract system, as it currently operates, which allows building workers to earn more based on their skill level, performance and earning capacity.

A further exacerbation is the current skills shortage being experienced in the building industry as in many other industries with employers having limited choice about their labour force. MBAWA is hearing reports from builder members that if they do not agree to engage building workers as sub-contractors and pay the going rates which are more generous than award rates they cannot attract building workers on their site(s).

For these builders there is little choice in the matter.

Further, many building workers who class themselves as sub-contractors do so as they see themselves as working for themselves or their own small business. Rightly or wrongly many are reluctant to consider themselves being an employee and under the ATO rules they are taxed as sub-contractors.

Whilst this may not be best practice in a technical sense MBAWA argues that until such time as payment models in the building and construction industry have the flexibility to reward building workers on the basis of "reward for effort", not "reward for mediocrity", then the sub-contract system offers a better financial incentive and outcome for all parties. Further comment on this issue follows in this submission.

Equally we say the same philosophy applies to many other industries.

This is not to say the award/enterprise bargaining agreement/workplace agreement safety net system needs to be done away with, rather there must be genuine choice for workers. Those who want to stay on the weekly wage system can do so, whilst those who have a capacity or wish to operate as sub-contractors (either as a small or big business) can do so.

MBAWA supports a simple across the board definition of sub-contractor which retains the current benefits of the present model, however, we recognise a major stumbling block to this approach is how can a simple criteria be translated into the various state and federal legislation that applies across the country.

We also add that Australia is not alone in this debate given reports out of the United States in 1998 which indicated the US Senate was attempting to grapple with the very same issue. We are, however, unaware of the outcome of that debate.

<u>Productivity</u>

MBAWA urges the Committee to be mindful about how the use of sub-contractors in the building and construction industry in general and in Western Australia including the housing sector provides significant productivity.

Reports to the MBAWA indicate that where major commercial supplier/fixing contractors have employee teams only, productivity is at the lower level, whereas, fixing teams with a mix of direct day labour employees and sub-contract teams enjoy higher productivity output as a result of the sub-contract teams whilst only sub-contract teams deliver the best performance. That is, where greater reward for effort is recognised greater productivity and efficiency exists.

Sub-contract only fixing teams have the greatest productivity as these teams work more as they earn more. Day labour employees have no incentive to work harder as most do not receive increased pay at the end of the week for increased productivity.

An example of this gulf between the efficiencies of the sub-contract system and the wages system was evident in Western Australia in the mid to late 1980s and early 1990s.

The then Building Management Authority (BMA) was a state government agency with responsibility for the construction of the state's schools, police stations and other minor public works projects. It had a direct day labour construction workforce which had been cut back from about 800 in the early 1980s to about 350 in the late1980s.

A major difficulty identified by various reviews of the BMA day labour construction workforce during the 1980s was its poor work output compared to the private sector. One review showed that for every two schools built by the BMA day labour construction workforce private sector builders could deliver 3 schools of equivalent size for the same total cost.

Whilst the BMA contended its quality of work was higher, which was arguable, the fact remained its cost to the public could not be sustained. Various attempts to lift the productivity of the BMA construction sector workforce were attempted throughout the 1980s and early 1990s but all failed.

The underlying barrier was that the BMA construction sector workforce was locked in to an award wage which did not provide reward for greater effort. That is, irrespective of how poor their work output was or how good it was they were paid the same weekly award wage. Comparisons with what the private sector building industry workforce was being paid demonstrated a gulf in the level of remuneration but there was a strong reluctance by the BMA workforce to move onto a reward for effort payment basis given increased pay rates were based on increased productivity output.

Ultimately, the BMA was wound up by the state government with all construction work allocated to the private sector.

In MBAWA's view there needs to be a payment structure in the building industry which provides reward for effort. The sub-contract system currently does that and is therefore extremely attractive to principal contractors, clients and the sub-contractors themselves.

If one across the board model for sub-contractors might be suggested it is that the ATO's current framework covering payment for performance test be adopted. This model appears to work well across all industries and is well understood.

In proposing this course MBAWA points out in the housing sector it is not uncommon for legitimate sub-contractors to work for only one builder over many years. This arises due to a combination of several factors including loyalty to the builder where the sub-contractor receives work in the buoyant times in the housing sector as well as the less buoyant times.

Whilst the flow of work to the sub-contractor may be continuous year in year out the fact is work on each new house is a new stand alone contract. The ATO "pay for performance" based model addresses this situation well.

<u>Evasion of Taxation by Illegitimate Use of Sub-Contracting</u>

Widespread taxation evasion by sub-contractors in the building industry is regularly raised by the CFMEU as a major drawback which MBAWA rejects.

We reviewed a report produced by the ATO dated June 2002 put before the Cole Royal Commission which asserts the national building and construction industry is somehow

riddled with builders and sub-contractors who promote and apply tax evasion schemes. MBAWA strongly objected to the assertions as they relate to Western Australia.

We did so and do so for the following reasons. In the late 1990s the ATO conducted a review of cash payments into the building industry on a national basis. Those inquiries included Western Australia.

In discussions between the MBAWA and the ATO officers in charge of the Perth investigation it was put to us that there was *little evidence of systemic or widespread cash payments* in the building industry or of tax evasion in Western Australia. This was due to the high level of record keeping in this state under the then PPS tax system operating in the building industry in Western Australia.

The upshot was builders and sub-contractors had high levels of record keeping which did not allow for cash payments to be made and not shown to avoid tax.

The investigation team leaders indicated there was some evidence of cash payments in the housing sector as a means to avoid tax but this was generally confined to work performed on the weekend by sub-contractors for householders. They suggested It would be difficult to stamp out entirely given the nature of work performed and small amounts of money involved.

Whilst some parties will criticise the former PPS system as allowing or promoting tax evasion by building workers the MBAWA points out that the PPS system resulted in the ATO collecting tax which was a major deficiency in pre-PPS times. Further, the tax deductions made by building workers for business expenses under the former PPS tax system were generally deductions an employer would make against an employee. In other words, much of the tax burden was only shifted from the former employer to the PPS sub-contractor.

That was the experience in WA, at least.

MBAWA was also advised by the ATO investigators that the investigations in NSW and Victoria into the cash economy had identified tax evasion in the commercial sector in conjunction with the use of phoenix companies. These investigations showed some practices were somewhat sophisticated.

MBAWA takes some comfort from the ATO report of June 2002 noting at pages 5, 8, 9, 10 & 16 reference was made to the intelligence gathering by the ATO on tax evasion being mainly limited to NSW.

Simply put, the ATO report validates MBAWA's assertion that there is no widespread systemic tax evasion in the building industry in WA and supports what we were advised by the ATO in the late 1990s.

Having put this, MBAWA does not say there are no sham sub-contractor arrangements in the building industry in Western Australia as there are, however these have not come about through some concerted promotion or endorsed by employer groups which includes the MBAWA. Where these sham arrangements exist they are generally limited to the sole trader type sub-contractor. MBAWA believes the ATO has the resources and responsibility to scrutinise and deal with these breaches and ought do so.

MBAWA supports the concept of freedom of choice in the building industry and that includes the ability of a building worker to choose to work as an employee or as a sub-contractor, so long as the contracting arrangements are legitimately structured and freely entered into. A major issue for the sole trader sub-contractor is how do they structure themselves legitimately? This vexed question applies across all industries.

The many and varied federal and state criteria on this matter is a confusing maze for the sole trader sub-contractor, most of whom are unsophisticated and often rely upon only one test, that being the ATO criteria.

This has some obvious risks associated with it and leads many employers and building workers, who say they are a sub-contractor, into a false understanding that they have entered into a legitimate sub-contracting arrangement when they have not.

Clarification of this uncertainty is urgently required.

Business Tax Changes

With the full extent of the Alienation of Personal Services Income Taxation rules applying from 1/7/2002, these provide a significant tightening up of the taxation laws as they apply to sub-contractors and in our view limit tax evasion by sub-contractors.

This occurs by the ATO reducing or denying certain business expense claims and placing those sub-contractors who are attempting to evade paying the appropriate tax on a more "like with like" basis to employee/employer taxation arrangements. Having put this, MBAWA understands the ATO does not intend to force a change in the nature of the working arrangement, rather closer scrutiny will be placed on the legitimacy of claimed business expense tax deductions by sub-contractors.

We say sole trader sub-contractors will still be able to claim legitimate work expenses, as employees do, but income splitting with the spouse and payments to the spouse where the spouse does not play a major part or any part in the running of the business will receive greater scrutiny. As the MBAWA understands, the ATO is targeting the latter under the business taxation rules with an emphasis placed on the professional and semi-professional vocations which have taken significant advantage of this tax minimisation practice over the years.

In short, the more sophisticated the worker the more sophisticated the tax minimisation scheme!

Non-Payment of Workers' Compensation Premiums

This is also a constant allegation raised by the CFMEU in that it asserts sub-contractors do not pay their appropriate workers' compensation premiums or avoid paying their premiums.

The MBAWA is not aware of concerns being raised by WorkCover WA which is the state government agency charged with administering the state workers' compensation system in connection with the non-payment of workers' compensation premiums in this state or of a problem arising in connection with evasion of workers' compensation premiums in the building industry in general.

The state workers' compensation laws contain a very broad definition of "worker" which includes a worker principally or wholly engaged for labour. As such, many legitimate sub-contractors are captured by this definition. This includes sole traders, partnerships and working directors.

This is one example of where legitimate sub-contractors are subject to a state law which overrides their working status.

In our view the basis of workers' compensation legislation is more at home in the 1940s and 1950s when the great majority of workers were employees. With the increasing move to specialisation of contracting in the building industry, as with many other industries, the workers' compensation laws have failed to keep pace with this change.

MBAWA repeatedly pressed the state governments during the 1990s to amend the legislation to recognise what is the reality in the workplace in the 21st century, without success.

In addition, the courts have taken a broad view in WA that it is the party with the deepest pockets that ultimately has the burden to pay for a work related injury. In the building industry this is the builder in most cases which requires the builder to not only cover his site workers but also have sufficient cover for sub-contractors and their employees as the case may apply on their projects(s).

MBAWA believes there is a desperate need for consistency between state and federal legislation on the question of employee versus sub-contractor and that the definition allows freedom of choice about which system a building worker can operate in.

This in itself would be a major step forward for the building industry and provide greater certainty for principal contractors, sub-contractors and the industry parties. Reduced levels of bureaucracy would lessen the cost burden on the industry and contribute to lower costs.

Non-payment of Employee Entitlements

We limit our submission to two employee benefit schemes, being superannuation and redundancy and comment as follows:

Superannuation

As MBAWA understands the federal superannuation laws contain a wider definition of employee than usually applies.

Whilst sub-contractors who have structured their respective business arrangements as either Pty Ltd companies or partnerships are exempted from having superannuation obligations payable for them by the principal contractor, some unique circumstances apply to sole traders. These are that where the sole trader is required to provide more than 50% of the contract as labour costs and/or the sole trader is required to provide “personal” performance of the work, they are deemed to be an employee for the purposes of the SGC laws.

This very broad definition can and does in MBAWA’s view capture many legitimate sub-contractors given many will not have material costs exceeding 50% of their contract rate for the job. For example, sole trader sub-contractors such as painters, electricians, bricklayers, and ceramic tilers spring to mind readily as legitimate contractors who would be captured by this broad definition given many work as sole traders.

They should either have a superannuation contribution paid by their principal contractor to a recognised superannuation fund or have a component built into their sub-contract price. In most cases neither usually happens.

However, many of these sub-contractors will have their own superannuation fund. The question is who pays for the superannuation contribution? Is it the principal contractor or the sub-contractor?

MBAWA is unable to comment on how widespread the non-payment of superannuation contributions in the commercial sector in WA is, however we are not aware of the matter being raised by any industry party or statutory government agency as one of some significance or concern in Western Australia over the past years. That is, in the absence of any validation about underpayment/non-payment of superannuation being a major problem in the building industry in Western Australia the MBAWA can rightfully conclude the question is not a major problem in general on the evidence before us.

Redundancy

Similarly, MBAWA is unaware of any major concerns dealing with under/non-payment of redundancy in the building industry in Western Australia.

We are buttressed in our views about superannuation and redundancy given a submission to the 2002 Cole Royal Commission by the state Department of Consumer & Employment Protection (DOCEP) in which DOCEP submitted that it had few complaints made to it concerning underpayment of award entitlements in the building industry. Given DOCEP is charged under the state Industrial Relations Act 1979 with policing compliance of state awards and registered state agreements this is a telling admission.

3. Labour Hire Arrangements

The experience of MBAWA regarding the utilisation of labour hire in the local building and construction industry in Western Australia has been that it has grown over the last decade but has not made inroads across the entire building industry. We do, however, understand other industries in Western Australia have chosen to use labour hire workers in recent years following the scrapping of the state workplace agreement model by the Gallop government.

There are two types of labour hire workers in the building industry in Western Australia, being the independent contractor model in line with the Odco Case and more recently the Tri-Cord case in the Western Australian Industrial Appeal Court or the employee labour hire model such as Skill Hire for example.

Labour hire has proven useful in some niches in the building industry such as labourers performing site cleaning duties, temporary or short term site tasks or meeting temporary peak work loads but in general the great majority of building work is carried out by a mix of day labour and/or sub-contract workers.

There is a role for labour hire workers in the building industry and MBAWA sees no reason for the status quo to be changed regarding their working status. Contracting parties should clearly have the right to choose whatever arrangement best suits their needs.

MBAWA supports the submission of Master Builders Australia Inc in relation to labour hire arrangements.

4. Concluding Comments

MBAWA does not support any move to overturn the current arrangements as they apply to sub-contractors or labour hire companies but strongly supports the need for clarity regarding a simple user friendly definition of sub-contractor that applies across the state and federal jurisdictions unlike the current confused state.