Submission by the

Housing Industry Association Ltd

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to

House of Representatives Standing Committee on Employment, Workplace Relations and Workforce Participation

INQUIRY INTO INDEPENDENT CONTRACTING AND LABOUR HIRE

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1 Executive Summary

Contractors are a growing form of self-employment, providing flexibility and choice in the labour market. Seven years ago, slightly more than 10 per cent of the workforce were contractors. The number of contractors, and their share of the total workforce, has almost certainly increased in the intervening years.

Contracting is the lifeblood of the housing industry. An estimated 80 per cent of the 394,000 people working in the industry are contractors, a far higher proportion of the workforce than in any other industry. More than any other sector of the economy, housing is an industry of independent family-operated small businesses.

Contractors ensure that the industry is efficient and capable of managing the volatile demand for housing. Contracting delivers much higher labour productivity than the use of unionised labour in the commercial sector.

Contracting is a legitimate choice for tradespersons, professionals and others in the housing industry. The decision to become a contractor is taken for positive rather than negative reasons. Contractors value their independence and the opportunity to build their own business. Contractors accept the risks of independence as inevitable if they are to reap the rewards.

Contracting has been criticised for allowing widespread tax evasion and economic exploitation. There is no credible evidence for these allegations; on the contrary, the evidence shows that contracting delivers substantial benefits to contractors and the community.

For many years, contractors have endured unnecessary business costs because of the uncertainty created by their ambiguous status under Commonwealth and State law. More recently, contractors have become the target for restrictive State legislation which has created commercial uncertainty and competitive handicaps for contractors. In many instances, the undeclared aim is to appease union demands for curbing what they see as undesirable competition for their members from contractors.

The pressures on contracting include deeming provisions used by State industrial relations tribunals to rope contractors into the industrial relations system, occupational health and safety regulation which adds to the cost of using contractors, payroll tax, workcover and superannuation.

HIA welcomes the Government's proposed *Independent Contractors Act* as an opportunity to clarify and protect the status of contractors. HIA trusts that the Commonwealth legislation will provide contractors with greater security than they have at the moment, and in particular does not simply restate the existing common law position. The legislation should recognise that contractors have chosen to operate in the commercial world, not the industrial relations system. This decision should be respected and supported.

HIA proposes that the Committee endorses contracting as a legitimate choice for small business people. A set of principles is proposed to guide the forthcoming *Independent Contractors Act*. To remove uncertainty, HIA recommends that all governments in Australia should adopt a common test or tests to identify contractors. The range of tests should include the Commonwealth's Alienation of Personal Services Income test as well as the common law. HIA also recommends that the Committee support the removal of contractors from the reach of all State legislation applying to the employment relationship (eg. workers compensation and payroll tax). Legislation which deems contractors to be employees should be repealed.

2 Introduction

2.1 The inquiry

The House of Representatives Standing Committee on Employment, Workplace Relations and Workforce Participation is asked to inquire into the use of independent contractors and labour hire arrangements, in particular:

- the status and range of independent contracting and labour hire arrangements;
- ways independent contracting can be pursued consistently across state and federal jurisdiction;
- the role of labour hire arrangements in the modern Australian economy; and
- strategies to ensure independent contract arrangements are legitimate.

2.2 The HIA

The Housing Industry Association Limited (HIA) is an association of 39,000 businesses. HIA is the peak industry association for businesses in the residential building, renovation and development industry in Australia.

HIA members include builders and building contractors (residential and commercial), consultants, developers, manufacturers and suppliers.

HIA is well placed to speak on behalf of contractors. Contracting is the primary business arrangement in the housing industry. HIA contractor members cover the full range of trade and professional services in the industry, including carpenters and joiners; tilers, plasterers and bricklayers; painters and decorators; architects and draftspersons; quantity surveyors; arbitrators and mediators; maintenance and service tradespersons; and landscapers.

HIA has extensive experience in providing legal advice and support to contractor members. Consequently, HIA is familiar with the range of compliance and other business issues stemming from the treatment of contractors under Commonwealth and State legislation.

2.3 The Housing Industry

The housing industry is a vital part of the Australian economy, generating 4.4 per cent of gross domestic product (an estimated $45 billion in 2004-05) and providing work for 394,000 Australians. The overwhelming majority of people working in the industry are contractors (an estimated 315,000).

As these figures suggest, residential building is an industry characterised by independent small businesses. In fact, there are more small firms in the building and construction sector than any other industry sector (19 per cent of all small businesses in Australia operate in building and construction). In residential construction, an average of 2.3 people are employed per firm.[1]

Nearly two-thirds of these businesses are suppliers of specialist trade services – plumbers, electricians, carpenters, bricklayers, concreters, tilers, and plasterers. Of the remaining firms, more than 40,000 were residential builders. Unlike commercial construction, smaller firms command

[1] Productivity Commission. Reform of Building Regulation. Canberra, Productivity Commission, 2004, p.412.

most of the market. The largest 100 housing firms hold some 40 per cent of the market (the equivalent figure for commercial construction is more than 90 per cent).

2.4 Contracting as an industry solution

The prevalence of small businesses in the housing industry is no accident.

In some industries, where human capital is specific to the firm, work is ongoing and outcomes are difficult to measure, firms will tend to use employees rather than contractors. In other industries, where the opposite circumstances apply, contractors will be preferred.

Many of the critics of contracting fail to grasp this point. It is simply assumed that there is an optimum solution for all industries, usually the traditional model of full-time employment under awards. HIA rejects this 'one size fits all' approach. Some industries, such as residential building, have inherent characteristics which create a strong preference for contractors rather than employees.

The building and construction industry relies on contracting for a range of reasons:

- The project based nature of the industry, with workforces in flux and workplaces constantly opening and closing, dispersed across the country;
- The boom and bust economic cycle, which affects all sectors but especially housing;
- The need for specialised but often scarce skills;
- The high earnings and lack of junior rates, which makes the industry attractive when work is available; and
- The ability of workers to easily start small businesses, with modest capital.

The use of contractors in the housing industry is NOT a new or emerging relationship. Substitution by employees operating under the more rigid and inefficient practices of the award system, as applies in the commercial sector, would make houses less affordable.

Independent research has shown that the housing industry is significantly more efficient than commercial construction. The Productivity Commission first analysed the effects of restrictive work practices in the commercial sector in 1999.[2]

In 2003, Econtech conducted a thorough analysis of the different cost structures applying in the housing and commercial construction sectors.[3] Econtech found that the same tasks cost an average of 10 per cent more in the commercial sector than in the residential sector. Labour costs were on average 19 per cent higher in the commercial sector. This analysis understated the actual cost differential by excluding site allowances which are a considerable additional cost for commercial projects. Industry estimates suggest that the impact of site allowances for large projects in Victoria, for example, is an additional 3 to 4 per cent of total project costs.

In those jurisdictions most affected by restrictive work practices, namely Victoria and Western Australia, the cost difference between the sectors is even greater. In Victoria, standard tasks such as laying a concrete slab cost 19 per cent more in the commercial sector than in the residential sector; in Western Australia, the difference is 14 per cent. These states also have much higher rates of industrial disputation, with an annual average of more than 500 working days lost per thousand employees.

[2] Productivity Commission. Work Arrangements on Large Capital City Building Projects. Canberra, AusInfo, 1999.
[3] Econtech. Economic Analysis of the Building and Construction Sector. Canberra, Econtech 2003.

Closing the productivity gap would deliver huge benefits to the economy. Econotech estimates that raising productivity in commercial construction to the level of the housing industry would generate an extra $2.3 billion a year in economic benefits, permanently raise gross domestic product by 1.1 per cent and reduce the consumer price index by 1 per cent. Demand for construction, residential and commercial, would benefit from a permanent boost of 2.2 per cent. Consumers would benefit from a 2 per cent fall in the price of housing.

The Royal Commission into the Building and Construction Industry has confirmed that restrictive work practices imposed by unions have stunted productivity growth in the commercial sector.

The key to the greater productivity in the housing sector is, quite simply, the use of contractors. Residential housing benefits from the efficiency and flexibility of independent contracting. Contracting provides substantial benefits to contractors, head contractors, consumers and the economy generally. These benefits include:

- Higher levels of productivity;
- Guaranteed higher quality of work;
- Payment by results which leads to stable costs; and
- Capacity to organise work to suit themselves.

Contractors have made Australia's housing industry among the most successful, cost effective and innovative in the world. The industry has low operating costs, slender profit margins and high consumer satisfaction.

Over the last ten years, employment in building and construction has risen by 41 per cent or 210,000 jobs. An estimated two-thirds of this growth (c.140,000) has been in the residential sector. It seems unlikely that this growth would have occurred if conditions in the sector were unattractive.

3 Legal Position of Contractors.

There is an urgent need for clarity about the legal status of contractors. Uncertainty about the status of contractors, particularly under State industrial legislation, imposes considerable costs (see section 4.2). A clear definition of contractor would provide certainty to businesses, eliminate unnecessary costs and allow people to choose their preferred method of business. Governments would benefit from simpler administration of otherwise complicated schemes such as workers compensation.

Unfortunately, there are many different legal definitions of who is a contractor, under the common law and State and Commonwealth legislation. At the Commonwealth level, much but not all of this uncertainty has been addressed by the Alienation of Personal Services Income (APSI) legislation.

For its part, HIA considers that contractors are persons who, at common law, contract for the performance of a particular service. Contractors earn income via a commercial contract which specifies the work to be done. Contractors are also liable for rectification in the event of faulty work. By contrast, employees earn income via employment, which is a contract to perform whatever services the employer lawfully requires of them from time to time. Their employer is liable for rectification.

3.1 Common law

The common law has clear, well settled tests for determining independent contractor status, such as control over the conduct of the work, the sources of income for the contractor and whether the contractor uses his or her own equipment.

The weight any particular test has depends on the circumstances. No single test is decisive.

Thus the common law falls short of providing a simple, reliable test for contractor status. When applying the common law tests to individual circumstances, differences in interpretation inevitably occur. The same circumstances put to different decision-makers will not necessarily produce the same ruling. The result is damaging uncertainty for all concerned.

The common law poses another problem. A contract meeting the common law test of employment will not be treated as independent contracting, *whatever the intention of the parties*. HIA considers that the wishes of the parties should be respected as far as possible. Third parties should refrain from rewriting an open commercial transaction which was fairly and freely negotiated.

3.2 Legislative definitions

Besides the common law, there is a plethora of legislation, State and Commonwealth, using conflicting statutory definitions of employees and contractors. Once again, tests are often subjective, uncertain and for practical purposes unreliable.

In the Commonwealth's jurisdiction, for example, different definitions are used for the purposes of the Superannuation Guarantee legislation, ordinary PAYG income tax, Alienation of Personal Services Income (APSI – see Div 84 of the *Income Tax Assessment Act 1997),* and the Australian Business Number (ABN).

The *Superannuation Guarantee (Administration) Act 1992* defines employee broadly, including in s.12 (3):

> (3) If a person works under a contract that is wholly or principally for the labour of the person, the person is an employee of the other party to the

contract.

Judicial interpretation of the phrase "a contract that is wholly or principally for the labour of the person" has held that this sub-section does not include a contract for the production of a result or which allows the contractor to sub-contract or employ others to carry out the work.[4] Most industry subcontracts contain an express term to that effect, ensuring the Act has no application.

Income Tax law obliges employees and contractors to pay tax through the PAYG system and requires businesses to withhold tax on payments to both employees and contractors. However, withholding obligations do not apply when the taxpayer is a contractor who quotes an Australian Business Number (ABN). An ABN is available to an entity "carrying on an enterprise in Australia" excluding "activities done as an employee or other PAYE earner". The definition of business in section 41 of the ABNA is the same as the definition of 'business' in subsection 6(1) of the ITAA 1936, and depends on a range of tests established by case law.

In addition, Division 84 of the *Income Tax Assessment Act 1997* provides for deductible business expenses for contractors, based on their carrying on a Personal Services Business. A person must be a common law contractor to be eligible.

Thus, over time, the Commonwealth has used different methods to distinguish between contractors and employees. A person may be treated as a contractor for income tax and ABN purposes but as an employee for SGL purposes. An identical situation prevails at State and Territory level, with little or no co-ordination between State and Commonwealth legislation.

A whole of government approach is needed to clarify the treatment of contractors.

Recommendation One

To remove uncertainty, HIA recommends that all governments in Australia should adopt a common test or tests to identify contractors. These tests should include the Commonwealth's Alienation of Personal Services Income test as well as the common law.

3.3 Contracting under pressure

The ambiguous status of contracting reflects in part the failure of the law to keep pace with the growth and diversity of practices in the marketplace. However, other factors are also at work. Some State governments see contracting as an inconvenient fact which threatens traditional industrial relations systems and/or a loss of revenue.

Critics tend to make one or more of the following claims about contracting:

- contractors need to be protected from exploitation;
- contractors compete unfairly with employees; and
- State payroll tax revenue and workers compensation premiums are reduced by the use of contractors rather than employees.

The first claim often stems from a well-meaning but ill-informed perspective which assumes that all workers wish to have the security of employment provided by the award system. Tenured academics, for example, often regard contractors as vulnerable and insecure, deserving government protection from exploitation. While workers in some industries may face these pressures, and may desire more secure employment, contractors in the housing industry are proudly independent and accept the risks of self-employment in return for its rewards. Workers who do not wish to be contractors have a ready alternative in the commercial construction sector. HIA can speak

4 Vabu Pty. Ltd. v. Federal Commissioner of Taxation 96 ATC 4898, following Neale v.Atlas Products (Vic) Proprietary Limited (1955) 94 CLR 419.

authoritatively for contractors because it has so many contractor members. If they wished to be employees, they would have joined a union, not HIA.

The second claim is made frequently by trade unions. It is a logical extension of the first claim. Contractors are akin to sweated labour, undermining the hard won benefits of employees. Casual or temporary contractors threaten to displace full-time employees, engaged under industrial awards. Underlying this view is hostility to individual bargaining: it is assumed that any departures from the standard terms and conditions set in industrial awards are coerced from vulnerable workers by unscrupulous employers.

The third claim depicts contractors as evading the tax obligations attached to employees. The argument overlooks the fact that contractors are not employees and are responsible, as business people, for managing their risks. Self-provision of insurance, for example, means that workers compensation is unnecessary. A variation of this theme is the claim that a class of virtual employees (labelled "dependent contractors") improperly claim contractor status to obtain business tax deductions. HIA strongly disputes whether the concept of a dependent contractor is meaningful. In any event, recent changes to the income tax law have largely if not completely settled this issue. Claims about 'illegitimate' practices (e.g. underpayment of workers' compensation premiums) applies equally to employers and employees and, if anything, would justify across-the-board measures rather than measures targeting contractors.

These views have led to a coalition of interests opposing independent contracting. In many States, efforts have been made to curb the use of contractors, using industrial, occupational health and safety, and other legislation. The New South Wales President of the Australian Manufacturing Workers' Union has been unusually frank about this strategy:

> "There have been developments in the law – for example we've had some success in getting a position where employers are responsible for safety and a range of other obligations which reduces the incentive to contract peoples' jobs out".[5]

The effect of measures to constrain contracting is to diminish competition, penalise enterprise, promote inefficiencies and deny individuals the freedom to establish their own businesses.

3.4 Regulation of contractors and employees

The treatment of contractors should reflect their position as small business operators, using commercial contracts, rather than be confused with employees. Contractors are NOT employees and should not be regulated as employees. Contracting and employment are equally legitimate ways to organise work in the modern economy, but with different characteristics and requiring different legal frameworks.

Employees receive legislated protections on the basis that they can suffer from a lack of bargaining power. The industrial relations system protects certain rights for employees and offers an avenue for collective bargaining and resolving disputes.

The situation is not comparable for contractors who are recognised as better placed to assess and manage risks and to negotiate appropriate contracts. Contractors are therefore regulated under commercial law, such as the *Trade Practices Act 1974*. In the case of contractors:

- Contracts are negotiated individually and their contents will reflect competitive forces and relative bargaining power;

[5] "Truckies unload contractors" The Australian Financial Review, 14 January 2005, p.19.

- Unlike employee entitlements under Awards, contracts cannot be changed or varied by central authority across whole classes of contractors;
- individual harsh and unconscionable contracts can be re-made by courts and Industrial Commissions, but only in exceptional circumstances; and
- the *Trade Practices Act 1974* regulates the abuse of market power and prohibits a range of unfair practices including collusive bargaining, price-fixing and resale price maintenance, but accepts that not all or even most contracts have to be equally beneficial to both parties.

Otherwise the law as a general principle upholds certainty of contract and does not seek to interfere in contractual relations. Persons choose to enter into commercial contracts in order to make profits, and in doing so knowingly take risks. The size of the potential profit is usually related to the size of the risk. Some risks do not succeed – otherwise they would not be risks. Thus a contractor may make a loss and even go out of business as a result. This is accepted by all parties as an inherent part of being in business.

Recommendation Two

HIA recommends that the Committee endorse contracting and direct employment as equally valid choices. Contracting should be regulated under commercial law, not industrial legislation.

4 Problems faced by contractors

4.1 Industrial relations difficulties

The activities of the commercial construction sector and the housing industry overlap. Building medium and high-density housing shares much practice and technology with commercial construction, and is often subject to the same industrial relations pressures. Trade contractors may work in both housing and commercial construction, depending on the opportunities available.

In HIA's experience, contractors invariably face restrictive practices when they deal with the commercial sector. Such problems include:

- A non-negotiable demand to sign a union-devised pattern Enterprise Bargaining Agreement (or equivalent) under Federal or State law (EBA);
- A demand to make contributions at the EBA rate to union sponsored redundancy funds;
- A demand to make contributions at the EBA rate to union superannuation funds; and
- A demand to take out union sponsored workers compensation "top up" insurance

Pressure may also be applied to trade contractors by head contractors who feel compelled to impose the above demands as a condition of contract as part of their "managing" the industrial relations on site. HIA provided comprehensive information on these practices to the Royal Commission into the Building and Construction Industry in 2003.

Most of the industrial disputation involving HIA staff in recent years has turned on the 'employee vs contractor' issue. Some typical cases are:

- Unions act to exclude contractors from sites unless they accept an EBA which imposes employee status. Head contractors are torn between choosing the most efficient workers or complying with undertakings they have given to unions to exclude sub-contract labour;

- A union alleges that sub-contractors on site are really employees and seeks to have the head contractor sign an EBA (typically covering the head contractor's entire workforce on ALL sites); and
- Union officials seek to enter a building site but the head contractor refuses entry on the basis that there are no employees working on that site, only contractors. If the head contractor is mistaken, an offence has been committed. Unions exploit this ambiguity to generate disputation to push their wider industrial aims.

4.2 The costs of uncertainty

Disputes over the status of workers can be costly. For example, if a person claiming to be a contractor is later held to be an employee, the head contractor suddenly becomes liable for payment of award entitlements (eg. annual leave and superannuation). In the case of Payroll Tax, the Office of State Revenue in a single decision may classify a large number of contractors as employees, and seek up to 3 years back taxes for all of them. If the employer had other employees but was previously below the payroll tax threshold, the employer may become liable for tax (including back taxes) on the whole wages bill.

Strategies to minimise uncertainty can be costly. A common method for head contractors is to require all trade contractors to be incorporated as a condition of tender. Refusing to deal with unincorporated contractors helps protect head contractors from:

- Complex contract administration problems, requiring constant monitoring of the status of contractors (under some legislation a subcontractor may be deemed an employee *after* the contract commences);
- Retrospective claims for Award entitlements;
- Retrospective liability for workers compensation cover (and sometimes injury payouts);
- Liability to pay Superannuation Guarantee Levy and the cost of administration of contributions, including choice of fund legislation in some States;
- Liability to pay long service leave contributions in some States; and
- Union industrial pressure and right of entry onto building sites.

However, incorporation has no legal effect in relation to payroll tax and Alienation of Personal Services Income legislation, and is useless against union pressure. Incorporation involves the additional costs of maintaining the corporate entity.

It would be far better if incorporation was freely chosen by the contractor for sensible business reasons (eg. to obtain limited liability) than as a costly way of settling legal uncertainties. The best solution is an objective, unambiguous test or tests of a natural person's legal status.

4.2.1 Deeming Contractors to be employees

The Committee should be concerned that some States infringe the freedom of persons to choose independent contracting. The Queensland *Industrial Relations Act 1999* (and the *Fair Work Contracts Bill* before the ACT Assembly) gives industrial commissions the power to 'deem' a whole class of contractors to be employees, where this is 'appropriate'. Similar provisions in a South Australian bill were defeated in that State's upper house on 10 March 2005. Payroll Tax and Workers Compensation legislation also wrongly treat contractors on the same basis as employees.

Deeming legislation takes away freedom of choice for individuals in the way that they work. Many individuals invest considerable time and resources establishing a contracting business. This

freedom of choice is a fundamental human right as article 23(1) of the United Nations Universal Declaration of Human Rights states -

> " Everyone has the right to work, to free choice of employment, to just and favourable conditions of employment and to protection against unemployment"

The same article guarantees the right to participate in unions.

The dubious basis of this approach is recognised by even members of the Queensland Industrial Relations Commission. Commissioner Blades noted in *AWU v Hammond* B885 of 1999;

> "It is clear that the Act recognises that both systems of employment, i.e. contracts for services and contracts of service, are equally valid systems for organising work. The discretion to use s.275 should take into account that it is an intrusion into an essentially foreign area which may create great uncertainty for business. The discretion should be exercised bearing in mind the serious consequences which may flow both to the individuals directly concerned and to industry generally. …whether the contract avoids the provisions of an industrial instrument is not conclusive but one of the matters to be considered." [6]

HIA notes that avenues exist to remedy individual cases of "unfair contracts", including s.106 of the NSW *Industrial Relations Act* and the *Trade Practices Act.* Using these established avenues is preferable to extending the power of tribunals to amend entire classes of contracts in a single proceeding. By contrast, the ACT *Fair Work Contracts Bill 2005* attempts to set contract rates across an entire industry by arbitration. The Bill converts contractors into employees. Price competition from contractors would be eliminated while the restrictive work practices enshrined in certified agreements would be imposed across the affected industry.

Declaring a class of contractors to be employees prevents persons going into business to provide those services. Small business is a great innovator and is Australia's primary source of new jobs. Skilled workers very often progress from employee status to starting their own business – in many cases these businesses have become very large and successful. Where for example would Transfield or Jennings be today if Mr Belgiorno-Nettis or Albert Jennings had been obliged by law or an industrial commission to remain an employee ?

Heather Fleming began in the industry as a small girl helping her bricklayer father. After an apprenticeship with dad, Heather started her own subcontracting business in country Victoria. She now employs three apprentices, a labourer and two bricklayers (one female). As the mother of two young children, Heather values the flexibility of contracting: "I like working for myself because I can take a day off when I need to".

Jeremy Primrose started in the industry through a group apprenticeship scheme, working for several plumbers over the years of his training. After his apprenticeship, Jeremy subcontracted for established tradesmen while doing necessary post-trade training and work experience to trade as a qualified plumber. Once Jeremy was qualified, he continued subcontracting for three more years before establishing his own business, Primrose Plumbing and Gasfitting. Four years later, Jeremy's business is doing well and he employs two qualified tradesmen and four apprentices.

[6] *AWU v Hammond* QIRC Decision 15 November 2000

Recommendation Three

HIA recommends that the Committee support the removal of contractors from the reach of all State legislation applying to the employment relationship. Deeming legislation should be repealed by State governments.

4.2.2 Dependent contractors

The concept of a 'dependent contractor' or 'quasi-employee' is an academic contrivance. HIA rejects the claim that contractors who mainly or solely sell their labour are really employees. There are many genuine business contractors who sell only their labour but, more importantly, are contracted to achieve a result (e.g. barristers, accountants, certifiers, estimators, project managers). The claim that a person cannot be a subcontractor unless he or she supplies goods is indefensible.

The common law is reasonably clear. Courts have consistently distinguished between a contract for labour only, and a contract to produce a result. The phrase "a contract wholly or substantially for … labour" was considered by the High Court in *Neale v.Atlas Products (Vic) Proprietary Limited* (1955) 94 CLR 419. The Court concluded that a contract which allows the contractor to employ others to carry out the work is not a contract wholly or at all for the labour of the contractor. It is a contract to produce a given result. This interpretation was followed by the Full Court of the Supreme Court of South Australia in the case of *Filsell v. Top Notch Fashions Pty. Ltd.* 94 ATC 4656; (1994) 29 ATR 224 and again by the NSW Court of Appeal when it looked at similar words in subsection 12(3) of the *Superannuation Guarantee (Administration) Act 1992* in the first *Vabu* Case. The second *Vabu* case did not disturb this understanding.

Thus, a contractor may be supplying only their labour but would not be a "labour-only contractor". This interpretation lead the ATO to develop the new approach in Part 87 of the *Income Tax Assessment Act 1997*, covering persons 'deriving personal services income', defined as income which is mainly a reward for an individual's personal efforts or skill, and where 'mainly' means more than 50% by value.

Nor is a contractor who derives a high proportion (e.g. 80 per cent or more, as suggested by the Ralph Report) of their income from a single source necessarily in the same or similar dependent position to an employee. It all depends on the nature of the work relationship. This fact has now been fully recognised in the APSI legislation.

To force 'labour only' contractors to be employees would put their terms of engagement under one or more awards and make their engagement subject to industrial relations legislation. It would establish union right of control over contractual relations where none now exists; union rights of entry in instances where none now exist; and would impose new employee record keeping requirements on top of the existing arrangements between the principal and the contractor. These impositions can then be triggered by an union. This would involve a significant and inappropriate cost burden and deny many Australians the opportunity to establish their own business.

Recommendation Four

The Committee should note that the concept of a dependent contractor is impractical and does not reflect commercial reality.

4.2.3 Unfair Competition from Contractors

A recurring theme in the union arguments in the Shearers' case before the Queensland Industrial Relations Commission [*AWU v Hammonds*] was that shearing contractors should be deemed to be employees, not to protect them, but to give other employed shearers a 'fair go'. Contractors should

be penalised for being unfairly efficient. The full bench of the Commission unanimously refused to make any order in this case as sought by the union.

HIA does not consider that contractors have an inherent (or an unfair) advantage over employees or vice versa – the relative strengths of contracting and employment depend on the nature of the work and the conditions under which the work is performed.

The problem is that, in so many instances, employees are burdened with restrictions which prevent them working effectively. Employees (and their employers) face restrictive regulation, in the form of industrial awards, union agreements, state and federal acts, codes of practice or 'voluntary' industry schemes. This regulatory burden is the real source of any competitive disadvantage on the part of employees.

The solution is not to handicap contractors but to reform the employment system in Australia. Australia cannot afford to reduce the efficiency of its economy by handicapping its most productive workers in the name of 'fairness'. As an economy open to global competition, Australia cannot afford to run just a "fair race": Australia must run a fast race.

4.2.4 Tax issues

HIA has already mentioned that, whatever may have been the case, the income tax law since APSI is now clear. Contractors can claim business tax deductions only if they are operating a genuine business. HIA considers that there is no justification for singling out contractors. As evidence before the Cole Royal Commission has demonstrated, tax evasion is attempted by some employers, some employees and some contractors. There is no reason or evidence to suggest that one group is worse or better than others.

There are significant problems caused by the vague definitions of "employee" and "deemed employee" in State payroll tax legislation. Only the exemption of many small businesses from payroll tax has prevented this uncertainty being a major grievance for industry.

If an objective and simple definition was adopted in all States and Territories of who was covered by payroll tax and who was not, this would greatly improve compliance. While state treasuries have been at pains to cast the tax net widely, the result has been confusion and higher compliance costs for taxpayers.

Another major problem for HIA members is deciding whether to take out workers' compensation insurance for a particular subcontractor, because of the murky nature of the definition of "worker" in State workers compensation legislation.

HIA has been working with Workcover Authorities on this issue for years. While underpayment occurs, the problem is not confined to contractors or those engaging contractors. The Grellman Report in NSW did not consider that any special measures were required to address problems with contractors that did not exist in relation to employers generally.

HIA notes that the non-compliance figures from the various State Workcover authorities, apart from Victoria and South Australia, do not come close to the 40% to 60% figure touted by the CFMEU. NSW admits that they do not know the extent of the leakage. Victoria estimates that leakage has fluctuated from an estimated 21 per cent in 1996-97 to 34 per cent in 1997-98 and then 24 per cent in 1998-99. Queensland claims leakage of just 13 per cent. South Australia claims about 35 per cent. Western Australia has not provided an estimate. The ACT estimates about 25%.

The meaning of "non-compliance" needs to be understood. The numbers refer to the number of employers and not the scale of the revenue loss. Non-compliance may simply mean a slight under-payment. The Quensland Government notes the small number of claims from people where the employer did not have a policy. This is a better indicator.

The Queensland Government believed a major problem with compliance is a lack of understanding of the definition of worker, and has changed their legislation to include the APSI test in a modified form. This has apparently been a considerable success from an administrative point of view.

One concern within Western Australia is the Section 175 deeming provisions. These provisions enable an employee of a trade contractor to sue the principal contractor for workers' compensation. While this may be the crux of a no fault insurance arrangement, it undermines the concept of responsibility. HIA believes that all employees should be covered but responsibility should rest with those party to the contractual employment relationship. If a trade contractor is aware that the principal is providing coverage, he/she may not takd out suitable coverage for their employees.

Recommendation Five

The Committee should recommend that State legislation be amended to exempt contractors from payroll tax and workers compensation. A clear, unambigious test of status for contractors (ie. the APSI test) should be used to simplify administration of payroll tax and workers compensation.

4.3 Labour Hire

HIA considers that workers working through labour hire firms should continue to be assessed in the traditional legal fashion. If the parties wish an employment arrangement, they can arrange that; if they wish to have a contract arrangement, then that should be their right. There should be no forcing of relationships into a particular legal mould to suit social or legal policymakers. HIA is opposed to artificial legal confections, such as the suggestion in some academic circles that the law should be amended to provide that an employee can have more than one employer.

5 HIA's Proposals for Security for Contractors

5.1 Commonwealth Legislation

HIA strongly supports introduction of a Commonwealth *Independent Contractors Act*. HIA has sought such legislation for many years and made extensive submissions on the subject to the Cole Royal Commission and the Senate Inquiry which reviewed the Cole recommendations.

HIA has prepared a statement of principles which should be the basis for the Act.

5.1.1 HIA's principles of contractor legislation

- The legislation should be simple and straightforward;
- The objects of the legislation should be to enshrine, protect and enhance the freedom of Australian workers to engage in work as contractors if they so choose;
- The legislation should deal in matters of principle rather than detail, which should be reserved for regulations or other statutory instrument;
- The legislation should be co-extensive in its constitutional reach with the *Trade Practices Act 1974* – thus applying to contracts made with corporations, in interstate and overseas trade, in the Territories, and made with the Commonwealth or one of its instrumentalities;
- The legislation should define an "Independent Contractor" in ways reflecting the diversity of independent contracting methods and structures in a variety of industries;

- One definition of an "Independent Contractor" should be the common law definition (**not** further codified) of a person working under a contract for services;
- Another definition of an "Independent Contractor" should be a person working under a contract that meets the 'results test' as used in the APSI legislation and the Qld Workers Compensation Act, as these are well understood in the industry and simple to apply;
- These tests will not be satisfactory for all purposes and suffer from the fact that, while the elements of the tests are well settled, their application to particular cases is subjective;
- At least one definition of an "Independent Contractor" should therefore involve an objective and readily ascertainable fact;
- Tax status is the preferred objective designator of an Independent Contractor, as this is an existing fact, is readily ascertainable and is already an important business indicator. The Commissioner for Taxation has every incentive to ensure that Independent Contractor status is not awarded to those who are really employees and should be paying tax under PAYG;
- The tax test of an "Independent Contractor" should be that the person is *paying tax* as a personal services business under Div 87 of the ITAA 1997. Whether the person *should* be so taxed is for our purposes irrelevant – commercial certainty is far more important than the possibility that the person has been wrongly classified for tax purposes. If independent contractor status has been wrongly claimed and wrongly accorded, the Commissioner can disallow that claim and, subject to appeal, change the tax status of that person retrospectively, requiring tax to be paid on a different basis. For our purposes, status as an Independent Contractor should only change prospectively – i.e., those who honestly and reasonably dealt with the person should not be disadvantaged by a later change in tax status;
- Another objective test could be that the person is working under a contract that provides that the work may be done by that person or by another person i.e. does not require the personal services of the contractor – this test is already in use in the Superannuation Guarantee legislation and should be retained;
- The legislation should cover the situation where the person who actually performs the work is a director of the company that enters into the contract for the performance of the work;
- A person who is an "Independent Contractor" should not be taken to be an employee for any purpose under any legislation, Commonwealth or State;
- A person who contracts with a person who is an "Independent Contractor" should not be taken to be an employer for any purpose in relation to that person. under any legislation, Commonwealth or State;
- A contract with a person who is an Independent Contractor shall not be taken to be a contract of employment for any purpose under any legislation, Commonwealth or State;
- It should be illegal to discriminate against an independent contractor on the basis of their being a contractor and not an employee;
- Contractors should be exempted from coverage under State payroll tax and workers compensation legislation. The aim of the Act is to unequivocally establish the status of contractors as persons who are not employees. There will be little advantage for contractors from a Commonwealth Act if it does not protect them from these State laws. If a person is an independent contractor then they should be a contractor for all purposes, State and Federal, rather than a contractor for industrial relations purposes but an employee for payroll tax etc purposes;

- There is no need to provide an unfair contracts regime for contractors as these already exist at common law, industrial law, and under State CTT laws, and are operating satisfactorily. Such regimes deal only with particular contracts and generally have little or no flow-on effect to contracts generally.
- The Governor-General should have power to make Regulations to give effect to the Act.

5.1.2 Tax status as the key test

HIA believes the tax status of a contractor should be used to determine whether they should be treated in the same way as an employee. The reasons for this are that –

- A contractor who has passed the tax test of what is an independent business should not have to pass any further tests;
- Businesses may be unsure of their common law status, but have no doubt about their tax status as a business and whether they are subject to PAYG withholding tax
- Tax status is objective and known at any point in time;
- There can be no dispute or debate about actual tax status, only about whether the person has been wrongly classified for tax purposes, which can affect their status only prospectively, when and if reclassification occurs.

HIA considers that the recent APSI legislation provides the most practical test. The APSI test would be in addition to, not a substitute for, the common law tests.

5.1.3 Define Business Contractor, not Employee

Rather than defining 'employee' or 'deemed employee', it is more practical to use the APSI legislation tests to define who is definitely a contractor running a business and therefore someone not to be treated as an employee. That leaves the common law untouched, and avoids re-casting the different definitions of a 'deemed employee' or 'worker', in numerous pieces of legislation.

This would have the advantage of simplicity, certainty and clarity. All that would be required is to add a provision to existing legislation that –

> 'Notwithstanding anything contained elsewhere in this or any other Act, a person who is recognised as a Personal Services Business for the purposes of Division 87 of the Income Tax Assessment Act 1997 is not to be taken to be a worker/employee for the purposes of this Act, and a second person contracting with them is not to be taken as their employer.'

Such a definition was incorporated into the Queensland *Workcover Act* in 2002.

Using the APSI test in this way would extract people who were common law employees from the ranks of those who were claiming to be contractors. APSI tax status would be conclusive evidence that a person was not an employee and would immunise the possessor against industrial, Workcover, payroll tax etc legislation. If 'personal services' businesses were conclusively recognised as contractors and not employees, there would be an objective, verifiable, real-time test which would largely overcome existing difficulties.

6 Conclusion

HIA believes that contracting is the most suitable form of labour for the housing industry and, as such, delivers significant benefits to workers, contractors and the economy generally. Unfortunately, contracting has been impeded by a lack of clarity in Commonwealth and State legislation. At times, the nature of contracting as a business relationship has been confused with employment, with the undesirable result that State industrial legislation has imposed unnecessary constraints on the commercial freedom of contractors. HIA is encouraged by the Commonwealth's decision to clarify the status of contracting through the proposed *Independent Contractors Act*. For the first time, contractors would be recognised in their own right and not merely 'workers who are not employees'.

HIA asks the House of Representatives Standing Committee on Employment, Workplace Relations and Workforce Participation to endorse the legitimacy of contracting as a business practice and to support greater legal security for contractors. HIA would urge the Committee to recommend that all governments in Australia should adopt a common test or tests to identify contractors, including the Commonwealth's Alienation of Personal Services Income test. HIA would welcome a statement from the Committee confirming that contracting should be regulated through commercial rather than industrial law. Consistent with this principle, contractors should be exempt from the reach of State legislation applying to employees, in particular workers compensation and payroll tax. HIA also rejects the notion that 'dependent contractors' is a meaningful concept.

HIA appreciates the opportunity to present its views to the Committee.

Housing Industry Association

23 March 2005.