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Submission from the Synod of Victoria and Tasmania, Uniting Church in Australia on Increasing the integrity of the Commonwealth procurement process

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The Synod of Victoria and Tasmania, Uniting Church in Australia (further simply "the Synod") welcomes this opportunity to provide input to the Commonwealth Government's work to improve the integrity of its procurement process. The issue of equitable taxation has long been of concern to the Synod, as witnessed for example by our 2015 submission to the Senate Standing Committee on Economics Inquiry into Corporate Tax Avoidance[1]. The Synod strongly supports the intention of the government that government contracts not be awarded to businesses engaged in shadow economy activities, especially tax avoidance and tax evasion of any sort. The Synod takes the view that businesses engaged in criminal activity should not be rewarded for their criminal activity by gaining a competitive advantage in winning government contracts.

The Commonwealth Government procurement process

The primary aim of the Commonwealth Government procurement process is to achieve value for money spent on behalf of taxpayers. The current Commonwealth Procurement Rules (CPRs) specify these aims as follows[2]:

> 4.4 Achieving value for money is the core rule of the CPRs. Officials responsible for a procurement **must** be satisfied, after reasonable enquires, that the procurement achieves a value for money outcome. Procurements should:
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> a. encourage competition and be non-discriminatory;
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> b. use public resources in an efficient, effective, economical and ethical manner that is not inconsistent with the policies of the Commonwealth ;
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> c. facilitate accountable and transparent decision making;

[1] The 2015 submission is available at https://www.aph.gov.au/DocumentStore.ashx?id=a5e93124-c401-4feb-b401-2e40966b19da&subId=303237.
[2] The CPRS are available at https://www.finance.gov.au/sites/default/files/commonwealth-procurement-rules-1-jan-18.pdf accessed 6 June 2018.

d. encourage appropriate engagement with risk; and

e. be commensurate with the scale and scope of the business requirement.

The procurement process should consider the cost of participation for potential suppliers:

> 5.2 Participation in procurement imposes costs on relevant entities and potential suppliers. Those costs should be considered when designing a process that is commensurate with the scale, scope and risk of the proposed procurement.

Other examples of tying public procurement to integrity standards

There are some precedents for tying public procurement to standards of integrity in taxation and other fields.

The most directly relevant example is probably the United Kingdom's *Public Contract Regulations 2015*[3], under which potential suppliers who have not fulfilled their tax obligations are excluded from the procurement process. Sub-regulations 57(3) – 57(5) are as follows:

> *Mandatory and discretionary exclusions for non-payment of taxes etc*
>
> (3) An economic operator shall be excluded from participation in a procurement procedure where—
>
> (a)the contracting authority is aware that the economic operator is in breach of its obligations relating to the payment of taxes or social security contributions; and
>
> (b)the breach has been established by a judicial or administrative decision having final and binding effect in accordance with the legal provisions of the country in which it is established or with those of any of the jurisdictions of the United Kingdom.
>
> (4) Contracting authorities may exclude an economic operator from participation in a procurement procedure where the contracting authority can demonstrate by any appropriate means that the economic operator is in breach of its obligations relating to the payment of taxes or social security contributions.
>
> (5) Paragraphs (3) and (4) cease to apply when the economic operator has fulfilled its obligations by paying, or entering into a binding arrangement with a view to paying, the taxes or social security contributions due, including, where applicable, any interest accrued or fines.

The UK approach has some key features worth noting:

- The exclusion only applies to companies whose non-compliance has been finally established and is no longer subject to an appeals process or negotiation.
- The exclusion ceases to have effect if the company reaches a settlement with the taxation authorities or pays its outstanding obligations.
- A company will be excluded if it is non-compliant in any EU member country, as long as the UK authorities are aware of this.

[3] Available at http://www.legislation.gov.uk/uksi/2015/102/contents/made, accessed 8 June 2018.

However, in practice these features have rendered the provision fairly ineffective, with an absence of evidence that the provisions have had much impact in changing the behaviour of businesses around aggressive or illegal tax behaviour.

Another relevant example is the World Bank Group, which seeks to exclude from procurement processes any company engaged in fraud or corruption. Details of this are set out in *The World Bank Group's Sanctions Regime: Information Note*[4].

The World Bank Group is a multilateral development bank (MDB) whose processes are not subject to national laws or judicial processes. Sanctions are determined by internal Bank processes, which have a number of layers and seek to apply general principles of fairness and due process (including appeals to a higher level within the Bank).

The Bank applies five levels of sanctions:

- Debarment with conditional release. The company will be debarred for a minimum of three years, after which it may be released if it has complied with certain defined conditions.
- Debarment for a fixed term. The level of this sanction can vary significantly. If, for example, the firm has put in place a corporate compliance program, and the culpable employees have been terminated, the debarment can be for a relatively short period, such as a year. On the other hand, if there is no prospect that the firm will mend its ways, the debarment can be permanent.
- Conditional non-debarment. The firm is not debarred, provided that it complies with certain conditions within a specified time. This is sometimes applied to parents and affiliates that have not themselves engaged in misconduct.
- Letter of reprimand. This is applied where other sanctions are considered disproportionate to the offence. Once again, it can be applied to parents and affiliates.
- Restitution. The firm is required to disgorge illicit profits, or remedy the harm arising from its actions.

The Bank can also impose an early temporary suspension during the investigation phase.

A debarment can arise from a Bank process running its full course, or it can be the outcome of a settlement with the firm before sanctions proceedings have been finalised. This is an important difference from the UK tax sanctions process, where a settlement automatically erases a firm's non-compliance.

The World Bank Group has a cross-debarment agreement with four other MDBs: the African Development Bank; the Asian Development Bank; the European Bank for Reconstruction and Development; and the Inter-American Development Bank Group. A firm debarred by one of these MDBs is automatically debarred by the others.

The World Bank Group strictly delineates grounds for debarment, and does not seek to debar firms for tax evasion and other matters not pertaining directly to the Bank:

> … the Bank has not asserted the authority to debar parties based on the misuse of project co-financing, nor has it debarred for wrongdoing that may be illegal or immoral (such as tax evasion) that does not impinge on the use of Bank loans, credits or grants[5].

[4] Available at http://siteresources.worldbank.org/EXTOFFEVASUS/Resources/The_World_Bank_Group_Sanctions_Regime.pdf accessed 8 June 2018.

Another example of using government procurement in an attempt to modify business behaviour on an ethical issue, is the United States' Executive Order (EO) 13126 of 1999, which aims to ensure that US federal agencies do not procure goods made by forced or indentured child labour.

Under EO13126[6], the US Department of Labor (DOL) consults with the Department of Homeland Security (DHS) and Department of State (DOS) to create a list of products, identified by country, that may be the result of forced child labour. Federal contractors who supply products on this list must certify that they have attempted to determine whether the products are the result of forced child labour. Sanctions for non-compliance range from termination of the contract, suspension of the business or debarment of the business for a period of up to three years.

The first list was published in 2001 and contained 11 products. The current list contains 35 products from 26 countries[7]. Examples included are garments from Argentina, bricks from China, and cocoa from Côte d'Ivoire. To date, only one item has been removed from the list: charcoal from Brazil. The removal was the result of an extensive process where the Brazilian government demonstrated that it had taken appropriate steps to eliminate forced child labour.

EO13126 has assisted in making businesses more focussed on taking steps to ensure their supply chains are free of forced child labour.

Similarly, in September 2012, President Barack Obama issued Executive Order 13627- *Strengthening Protections Against Trafficking In Persons In Federal Contracts*[8] which required updates to the Federal Acquisition Regulation and the *Ending Trafficking in Government Contracting Act*. As a result of the Executive Order, measures were introduced to combat slavery in federal procurement. These were developed in consultation with federal contractors, academia, NGOs and other stakeholders.[9]

The Executive Order requires US federal contractors with public contracts in excess of USD $500 million to take steps to ensure that there is no slavery within their supply chains. Contractors are prohibited from charging employees recruitment fees or using misleading or fraudulent recruitment practices. Part 52.222-50 of the Solicitation Provisions and Contract Clauses requires certain contractors to develop and maintain a compliance plan and to certify that, to the best of their knowledge, they have not engaged in trafficking-related activities.[10]

Lessons for the Commonwealth Government procurement process

When introducing a new integrity criterion to procurement policy, a filter that excludes no-one or does not cause any businesses to modify their behaviour is a mere form-filling exercise with no real impact.

The UK integrity test uses a narrow legal definition to exclude companies: their non-compliance must be finally established (ie not subject to any further appeals). Further, the non-compliance is

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[5] Quoted from p. 12 of the Information Note, under "What is the legal basis for the World Bank sanctions regime?"

[6] General information on EO13126 in this submission is drawn from the US Department of Labor publication *FREQUENTLY ASKED QUESTIONS: Executive Order 13126 of 1999*, available at https://www.dol.gov/ilab/reports/pdf/EOFAQS_2015.pdf accessed 6 June 2018.

[7] The list is available at https://www.dol.gov/ilab/reports/pdf/EO_Report_2014.pdf accessed 9 June 2018.

[8] Available at: https://obamawhitehouse.archives.gov/the-press-office/2012/09/25/executive-order-strengthening-protections-against-trafficking-persons-fe. Accessed on 30 March 2017.

[9] Available at: https://obamawhitehouse.archives.gov/blog/2015/01/29/combating-human-trafficking-supply-chains. Accessed on 30 March 2017.

[10] https://www.acquisition.gov/far/html/FARTOCP52.html

erased if the company reaches a settlement with taxation authorities or simply pays its outstanding obligations. The apparent outcome is that no-one has been excluded from UK government procurement for taxation reasons. Most companies challenged by the taxation authorities simply reach a settlement, with Google's agreement to pay £130 million in back taxes as one example[11].

The World Bank debarment process has a number of useful features:

- Sanctions can be calibrated according to the level of non-compliance.
- Cross-debarment with four other major Multilateral Development Banks maximises the effectiveness of any sanction. A non-compliant company is severely constrained in seeking work on multilateral-financed projects.
- The power to sanction parents and affiliates closes a potential loophole. Companies subject to sanctions could otherwise simply transfer their activities to related companies, which might even share all directors and employees. That would make the sanction largely ineffective.
- The ability to set conditions (for non-debarment or for renewed admission to procurement processes) allows the Bank to provide incentives for improved behaviour.

The World Bank's debarment process appears to have genuine practical impact. For example, in March 2018 the Bank "announced the debarment of three companies and a settlement with one company in connection with sanctionable practices under projects in Bangladesh, India and Timor-Leste". The debarments ranged in length from 15 months to two years, and in one case the parent company was sanctioned with conditional non-debarment for 15 months. If the parent did not comply with the conditions, the conditional non-debarment would convert to a debarment with conditional release, making the parent ineligible to participate in projects funded by the World Bank Group. All the debarments qualified for cross-debarment by the four other MDBs.[12]

It is worth reiterating, however, that the World Bank is not subject to national laws and judicial processes. This gives it greater flexibility than is likely to apply to the Commonwealth Government's taxation and procurement agencies.

The integrity component of the Commonwealth Government's procurement would therefore ideally have at least some of the following features:

- The ability to calibrate sanctions according to the level of non-compliance. This should include sanctions as part of a settlement with tax authorities. The simplest approach might be for a settlement with taxation authorities to include an exclusion period by default, with any variation (or waiver) to be the subject of negotiation with the central procurement agency. The procurement agency is more likely than the taxation agency to have the relevant expertise.
- The ability to set conditions that provide an incentive for improved behaviour.
- Co-operation with other levels of government within Australia. A company blocked from obtaining taxpayers' money from the Commonwealth Government should not be able to

[11] https://www.taxjustice.net/2018/03/02/guest-blog-stopping-public-contracts-tax-cheats accessed 4 June 2018.

[12] *World Bank Group Announces Debarment of Companies in Connection with Misconduct in Projects in Bangladesh, India and Timor-Leste*. Press release 28 March 2018. Available at http://www.worldbank.org/en/news/press-release/2018/03/28/world-bank-group-announces-debarment-of-companies-in-connection-with-misconduct-in-projects-in-bangladesh-india-and-timor-leste accessed 7 June 2018.

obtain this money from state and local governments. There is also potential to include in the integrity criteria payment of state and municipal taxes such as land tax and council rates. However this is ultimately a matter for each of those other governments. There may also be privacy issues around the release of taxation information to other governments.

- The power to apply sanctions to parents and affiliates. This would prevent non-compliant companies from avoiding sanctions by transferring government-related activities to a different corporate structure with essentially the same people.

Foreign companies and new companies

A particular problem arises with foreign companies and new companies. New companies have no track record for assessment of tax compliance, and foreign companies may operate in jurisdictions that share limited or no information with Australian tax authorities.

Thus the presence of new and foreign companies is an argument in favour of rules applying to parents and affiliates. A new company formed as an affiliate or subsidiary of a company with a serious history of non-compliance could simply be an attempt to sidestep the integrity criteria, and should be subject to greater scrutiny.

Recommendations

The Synod Australia recommends that the Commonwealth Government adopt in its procurement process tax integrity criteria with the following features:

- Sanctions for non-compliance should be flexible and calibrated to the level of non-compliance.
- The central procurement agency should have the power to set conditions that provide an incentive for improved behaviour.
- The power to apply sanctions to parents and affiliates, to ensure that the integrity process cannot be side-stepped by the creation of new corporate entities.
- An automatic exclusion period to be included in any settlement with taxation authorities, with this exclusion period to be the subject of subsequent negotiation with the central procurement agency.
- Co-operation with other levels of government in Australia. This co-operation could entail automatic exclusion by other governments where a firm is excluded for non-compliance with a specific government's obligations.

In response to the questions in the consultation paper:

1. What should be taken into account in determining what is a 'satisfactory tax record'?

A 'satisfactory tax record' should include if the business has been convicted for any breach of tax laws, which should include compliance with corporate income tax, making sure that the correct personal income tax has been deducted and paid from wages to employees (given a key activity in the shadow economy is wage theft and tax evasion associated with the wage theft), compliance with GST requirements and any other Commonwealth tax law requirements.

It should also note if the business has been non-compliant with a directions notice in relation to a tax matter or has been subject to administrative penalties related to their tax affairs.

The proposal to include that a business has:

- Registered for their tax obligations;

- Lodged their tax returns and business activity statements on time; and
- Has paid its tax liabilities on time or as agreed with the ATO under a payment plan.

In addition it should include the risk rating assessed by the ATO under Practical Compliance Guide PCG 2017/4[13], which relates to the level of risk a business poses wit relation to its tax arrangements around cross-border related party loans.

Consideration of similar ATO risk assessments based on objective criteria should also be included in considering if a business has a 'satisfactory tax record'.

The vast majority of businesses are able to adjust their behaviours to reduce ATO risk ratings, so including these is likely to assist in modifying the tax compliance behaviour of companies seeking to bid for Commonwealth Government contracts.

A satisfactory tax record should also take into account compliance with the Taxable Payment Reporting System for those businesses that this is relevant for (cleaning and security businesses).

Ideally the satisfactory tax record would also consider if the business has been the subject of a conviction of a tax related crime in a foreign jurisdiction as well.

2. **What could objectively considered to be a 'satisfactory' tax record and an 'unsatisfactory' tax record?**

An unsatisfactory tax record should include:

- A conviction for a tax related offence in the last five years, including any offence related to wage theft (such as under the *Fair Work Act*) even if the tax evasion part of the criminal behaviour was not prosecuted. In the latter case, for example, a business might have been prosecuted and convicted for deliberate underpayment of wages, but the tax evasion activity may not have been prosecuted. In such a case the business, for example, may have lied to the ATO about the number of employees it has (saying it has less employees than it actually does) to hide the wage theft and be able to justify paying a lower level of tax from its employees wages than it would be required to forward to the ATO were it complying with the legal pay rates of its employees.
- Having a very high risk rating under the ATO assessment for cross-border related party finance, as outlined in PCG 2017/4.
- Having been non-compliant with a directions notice on tax matters in the last five years.
- Having been subject to administrative penalties in relation to tax matters in the last five years.
- Having failed to register for their tax obligations.
- Having failed to lodge a tax return on any of the last five years.
- Having failed to lodge a business activity statement in the last five years.
- Having lodged their tax return late three out of the last five years.
- Having lodged a business activity statement late three out of the last five years.
- Having failed to pay their tax liabilities on time or as agreed with the ATO under a payment plan in the last five years.
- Having been non-compliance with filling out the Single Touch Payroll if they are of a size required to do so, in the last five years.
- Repeatedly failing to report transactions in the time period required by the ATO.

13 https://www.ato.gov.au/law/view/view.htm?docid=%22COG%2FPCG20174%2FNAT%2FATO%2F00001%22#P1

- Having failed to lodge financial accounts with ASIC in any of the last five years when having been required to do so. The relation between a business' accounts and its tax behaviour is important, as demonstrated by the announcement in the 2018-2019 budget that companies will be required to align their asset evaluations between what they include in their accounts and what they claim is the evaluation for tax purposes. This was to address the behaviour where companies are using inflated asset evaluations to be able to load themselves up with greater cross-border related party debt and stay below the thin capitalisation threshold.
- Having been convicted of a tax related offence in a foreign jurisdiction in the last five years.

A 'satisfactory' tax record is one free of these features.

3. What things should be taken into account of the tax history is not perfect but should not prevent a satisfactory tax record statement being issued?

Is the breach was relatively minor, only happened once and/or the business took immediate corrective action when it became aware of the issue would be mitigating factors in the decision to issue a satisfactory tax record statement.

No satisfactory tax record should be issued to a business convicted of a tax related offence in the last five years.

No satisfactory tax record should be issued to a business that has ignored warnings issued by a regulatory authority on a matter related to tax, be it from the ATO, from ASIC about the need to file accounts or from the Fair Work Ombudsman about the need to pay legally required wages and collect the tax from those wages to forward on to the ATO.

4. What length of time should be taken into account in the Statement of Tax Record?

Five years would seem a reasonable length of time.

5. **Should large businesses with a turnover of $100 million or more be required to show evidence that they have adopted the Tax Transparency Code?**

The Synod sees no value in the voluntary Tax Transparency Code as proof that a company has a satisfactory tax record as the statements by business for the Code are not audited and there are no consequences for making false or misleading claims in disclosures made under the Code. A business deliberately engaged in criminal activity through the shadow economy is unlikely to be very concerned about producing a false statement of their tax affairs under a voluntary Code that is not checked or audited and where there are no penalties for making false statements. In fact to do so and to get credit for producing such a false statement provides an incentive to do so.

6. What should be the approach for new and international businesses?

For international businesses, their tax record in jurisdictions where they have operated should be considered, especially any conviction for a tax related offence in the last five years, or other sanction imposed by a foreign jurisdiction for breach of tax laws.

For new businesses, the tax records of any businesses owned by the directors or owners in the past five years should be examined for the tax compliance history of those businesses. This is important to stop people engaging in phoenix activity to allow them to have a clean slate to apply for government contracts when they have been responsible for previous non-compliance with tax laws.

7. How should the Statement of Tax Record be obtained from the ATO?

The preference of the Synod would be that as part of the tendering process the business needs to agree to allow the government agency that is procuring the contact the ability to obtain the statement of a satisfactory tax record from the ATO.

8. It is anticipated that the statement will take between 2 – 4 days to produce – how will this affect the procurement process?

The Synod believe that businesses should be allowed to tender for the contract, but the process states that successful awarding of the contract is conditional to a satisfactory tax record. This would provide additional incentive for businesses to ensure they have a satisfactory tax record before committing resources to tender for the contact.

9. The statement will include an expiry date. How long should the statement be valid for?

The Synod supports a statement being valid for two years. However, ideally there should be a central database of convictions for tax offences by the ATO which government agencies would check against even when a company has a statement of satisfactory tax record. In this way a business that has engaged in serious tax non-compliance cannot use the cover of a statement of a satisfactory tax record to continue applying for government contacts.

10. How should businesses be able to make enquiries about their statements?

Businesses should be able to apply to the ATO to obtain their statement.

11. What arrangements should apply to sub-contractors?

If a business seeks to sub-contact the government contract they should be required to alert the government agency of the sub-contracting arrangement. There should be no unauthorised subcontracting, which is not unusual in many standard business practices. Sub-contractors should be required to produce a statement of a satisfactory tax record before they are authorised to undertake the work. This should apply where the sub-contractor will be obtaining a payment of more than $250,000 out of the contract, to avoid the main contractor providing cover for smaller sub-contractors who are actively part of the shadow economy.

As with the main contractor, a sub-contractor with an unsatisfactory tax record might be excluded from the contract, or might be subject to conditions in being permitted to provide the goods or service, depending on the nature of behaviour that has led to unsatisfactory tax record.

12. Would the information provided in a Statement of Tax Record be useful to businesses taking on a sub-contract?

Yes. It would give them more information about the business they are working with.

13. What information should be contained on the statement regarding the tax history of the business?

The statement should contain the information listed in our answers to questions 1 and 2.

14. What are the limitations on use of the statement that should be noted on the statement?

The statement should state the period of tax history it covers and should state that it is not a replacement for other due diligence processes to determine the suitability of a business for a government contract. It should list what criminal and other non-compliant behaviours it has

covered, so that it is clear what other behaviours might need to be assessed in determining if the business is suitable for being granted the contract.

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