



ISLINGTON

# Policy and Performance Scrutiny Review

## REPORT OF THE POLICY AND PERFORMANCE SCRUTINY COMMITTEE TAX AVOIDANCE

London Borough of Islington  
May 2016

## **CHAIR'S FOREWORD**

**The Committee conducted a scrutiny into tax avoidance, given its concerns at the recent high profile cases of big, and in some cases, multi-national companies engaging in tax avoidance, whereas smaller companies and individuals pay their appropriate share of tax, placing them at a disadvantage competitively.**

**The Committee have considered measures that they could take to ensure that companies face their tax liabilities and whilst the action that we can take is limited we have recommended a number of actions that we feel the Council can take to mitigate tax avoidance, particularly when allocating Council contracts.**

**The Committee hope that it's recommendations will be adopted by the Executive and where possible in future companies avoiding paying tax have their contracts terminated.**

## **Tax Avoidance Scrutiny Review**

### **Aim**

The Committee carried out a scrutiny into the ability for the Council to only contract with companies and bodies that pay UK tax

### **Evidence**

The review ran from June 2015 until March 2016 and evidence was received from a variety of sources

1. **Presentations from council officers** – Peter Horlock, Head of Procurement, Steve Key, Director Service Finance, Ramani Chelliah, Chief Contracts Lawyer

### **Objectives of the Review**

The objectives of the review were as follows –

To understand how companies avoid paying UK tax, including parent companies that L.B.Islington deals with or has business links to providing a service to the Council and its subsidiaries

To understand our existing legislative requirements around procurement and contract management

To investigate how we can identify businesses that we contract with who avoid paying UK tax

To review and update our procurement processes, within the law, to exclude those businesses that avoid UK tax

To review and update, as necessary, our appointment process for consultants and agency staff

To explore whether the Council can use other powers it has e.g. licensing, to influence companies to pay their appropriate

## **Recommendations**

**That the Executive be recommended that –**

- 1. The Pre- Qualification Questionnaire (PQC) should require tenderers to provide information on their tax compliance. It is proposed that the section on tax compliance is enhanced for contracts over £5m to provide additional information and allow for exclusion, where appropriate**
- 2. The Council's standard contract conditions be amended, for contracts over the value of £5m, to allow for contract termination in relation to non-compliance with tax payment obligations**
- 3. The published HMRC list of tax defaulters be periodically reviewed to ensure that no contractor that the Council uses is on the list, and if there is one, the contract be terminated using 2 above**
- 4. That letters be sent out to companies that the Council contracts with to remind them of their tax obligations. A list of companies will be made available for Council officers to view on the internet**

## **Main findings**

Tax is a mandatory contribution levied by Government on workers income, business profits, or added to the cost of particular goods or services. Levying of tax is the principal mechanism by which the Government pays for the services and facilities that it provides and all taxpayers must pay their contribution. The majority of tax is collected and administered by the Government office HMRC, including demands for interest and penalties when incorrect levels of tax are paid.

Tax avoidance and tax evasion are often used as interchangeable terms although in fact they are very different –

Tax avoidance is taking steps to minimise your tax liabilities and is legal (although sometimes it can be against the spirit of the law), provided there is no objection from HMRC, and you have been open about your action. It is often considered to be taking measures for a tax advantage. On a small personal scale this is ensuring that the correct tax code is used, money is transferred to an ISA, artificial unnecessary transactions by business etc. On a large scale this could be paying a tax expert to find legal loopholes in the system.

Tax evasion is taking deliberate steps to falsify, mislead or defraud the payment of tax. Tax evasion is illegal and may lead to individuals being subject to ten years imprisonment. Examples of this have included hiding money offshore, significant physical or virtual online trading and not declaring the income, failing to file a tax return, i.e. not including your full income, hiding taxable assets etc.

HMRC provides guidance on the General Anti Abuse rule (GAAR) into reasonableness in regard to tax avoidance, as required under the Finance Act 2013. The GAAR has made it clear that a taxpayer may decide to operate as a sole trader or through a limited company, whose shares he/she owns or work as an employee. All are perfectly legal means of payment of appropriate taxation, either - by making payments on profits of the organisations, by way of a dividend, or immediate payment from the employee salary.

In September 2012, the Government tasked HMRC and the Cabinet Office to look at whether procurement could be used as a means of promoting good conduct in regards to taxation. The idea was to withdraw opportunities for initially central government contracts from the minority of providers who seek to either evade tax or utilise aggressive tax avoidance schemes. This move led to the Disclosure of Tax Avoidance schemes (DOTAS), and a policy note which mandated central government to ask questions in the procurement process on tax compliance and setting out how to handle the matter.

Under the now repealed Public Contracts Regulations 2006, a contracting authority was always able to disqualify providers if they had not met their taxation obligations in UK law. In preparation for the new regulations, the issue of taxation compliance became an increasing interested area. This led to significant clarity being introduced in the Public Contracts Regulations 2015 – Regulation 57.

Subsequently, a national standardised Pre –Qualification Questionnaire (PQQ) or application pack has been introduced above EU threshold contracts, currently the goods or services threshold is those contracts which aggregate above £164,176, to ensure a simpler and more consistent approach to selection across the whole public sector authorities. It is designed to remove some of the bureaucracy and barriers which make it difficult for businesses, in particular smaller firms, to access public service contracts. The PQQ outlines the Council's ability to exclude organisations from fraudulent evasion of taxes, offences in connection with taxation and non-payment of tax and/or social security contributions.

The Council has limited powers to exercise discretion on matters of taxation and must adhere to the Public Contracts Regulations 2015. It can have a responsibility to promote tax adherence, but limited ability and to verify to take action against inappropriate tax adherence as this would be a matter reserved for the proper authorities, e.g. HMRC, Police and the Courts. The Council are not in a position to impose unreasonable or disproportionate taxation inspections beyond the scope of the PQQ.

Tax avoidance is by its nature a legal act. Suspicions of tax avoidance would not be sufficient grounds to terminate a Council contract, nor exclude an organisation from a procurement process. Tax evasion would need to be proven for the Council to act. Monies due from matters of tax evasion generally rest with the HMRC and thus, whilst the Council has a duty to report on suspicions of this nature, has no direct financial advantage from it.

The Committee considered evidence from the Council's Chief Contracts Lawyer in relation to this issue.

The Committee were informed that the Public Contracts Regulations 2015 has allowed the Council to enhance the enforcement of tax compliance measures and it is recommended that the scope of tax enquiries conducted by the Council is widened during the pre-qualification stage of the procurement process, for contracts with a value of over £5m and that provision is made to terminate such contracts for non-compliance with tax payment obligations.

The Council must exclude an economic operator from participating in a procurement procedure, where it has been established, by verifying in accordance with regulations 59 and 60, or is otherwise aware, that an economic operator has been convicted of cheating the HMRC, fraudulent evasion within the meaning of section 170 of the Customs and Excise Management Act 1979 or the Value Added Tax Act 1994, or an offence in conjunction with taxation in the European Union within the meaning of the Criminal Justice Act 1993.

The obligation to exclude an economic operator also applies where the person convicted is a member of the administrative, management or supervisory body of that economic operator or has powers of representation, decision or control in the economic operator.

An economic operator shall be excluded where the Council is aware of the breach relating to non-payment of taxes and 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 UK.

An economic operator may also be excluded where the Council can demonstrate by any appropriate means that the economic operator is in breach of its obligations relating to non-payment of taxes. This is known as discretionary exclusion for non-payment of tax. The grounds for both mandatory and discretionary exclusion cease to apply when the economic operator has fulfilled its obligations by paying, or entering into a binding arrangement, with a view to paying, taxes due.

There are exceptions to mandatory exclusion and the Council may disregard the prohibitions related to mandatory exclusion on an exceptional basis or overriding reasons relating to the public interest, such as public health or protection of the environment. The Council may also disregard the prohibitions related to discretionary exclusion where such an exclusion would be clearly disproportionate.

In order to exclude an economic operator from participation in a procurement procedure, the Council needs to establish, by verifying in accordance with regulations, or is otherwise aware, that the economic operator has been convicted of any of the offences that give rise to mandatory exclusion.

Regulation 59 relates to the European Single Procurement Document (ESPD), which is designed to be a standardised EU wide process for self-declaration provided at the time of submission of requests to participate. Such self-certification will include the status of the economic operator in relation to the grounds for exclusion. These provisions are not yet in force.

The Council must accept the following as sufficient evidence that none of the cases specified in regulation 57 apply to the economic operator –

- In relation to mandatory exclusions the production of an extract from the relevant register, such as judicial records, or failing that, of an equivalent document issued by a competent judicial or administrative authority in the member state or country of origin or the country where the economic operator is established showing that those requirements have been met
- In relation to mandatory and discretionary exclusion for non-payment of taxes a certificate issued by the competent authority. Where the country in question does not issue such documents or certificates they may be replaced by a declaration on oath made by the person concerned before a competent judicial or administrative authority, a notary or a competent professional or trade body.

With regard to the mandatory exclusion for tax evasion, the period of exclusion is 5 years for the date of exclusion, subject to exemptions and self -cleaning. In relation to discretionary exclusion for tax evasion, the period of exclusion is 3 years from the date of the relevant event.

Self -cleaning is a means by which an economic operator in one of the situations of discretionary or mandatory exclusion may provide evidence to the effect that measures taken by the economic operator are sufficient to demonstrate its reliability, despite the existence of a relevant ground for exclusion.

In order for the Council to be satisfied the economic operator shall prove that it has –

- Paid or undertaken to pay compensation in respect of any damage caused by the criminal offence or misconduct
- Clarified the facts and circumstances in a comprehensive manner by actively collaborating with the investigating authorities and
- Taken concrete technical, organisational and personnel measures that are appropriate to prevent further criminal offences or misconduct

The measures taken by the economic operator shall be evaluated taking into account the gravity and particular circumstances of the criminal offence or misconduct (i.e. requirement for transparency),

The Committee consider that there should be changes to the Council's current procurement practice. The standard form of Pre-Qualification Questionnaire used by the Council asks the tenderer for a declaration in relation to whether any of the grounds for mandatory exclusion apply together with supplementary information where relevant. The standard form of PQQ contains additional provisions in relation to discretionary exclusion for non-payment of taxes but these provisions currently only apply to central government contracts over the value of £5m.

The Committee therefore recommends that the Council amends the standard form of PQQ in order for these provisions to also apply for Council contracts over the value of £5m. The qualifying threshold of £5m has been adopted by the Cabinet Office, in order to avoid adding an administrative burden to lower value procurements and to small businesses and we feel that this threshold should be adopted for similar reasons.

It was noted that the threshold of £5m is actually not high, as it actually appeared as it covers the whole length of a contract, i.e. a 10 year allocation of a contract this equated to £500,000 per annum.

In practice this would mean widening the net of enquiry at PQQ stage for Qualifying Contracts to cover a broader range of Occasions of tax non-compliance including:

- a. A relevant tax authority successfully challenging the supplier under the General Anti-Abuse rule or the Halifax Abuse principle, or under any tax rules or legislation that have an effect equivalent or similar to the General Anti-Abuse rule or the Halifax Abuse principle
- b. The failure of an avoidance scheme which the supplier was involved in, and which was, or should have been, notified to a relevant tax authority under the Disclosure of Tax Avoidance Scheme (DOTAS) or any equivalent or similar regime and/or:
- c. The suppliers tax affairs give rise on or after, a date to be specified), to a criminal conviction in any jurisdiction for tax related offences, which is not spent or to a penalty for civil fraud or evasion

The amendment recommended to the standard form of the PQQ is a deviation and the Council would be required to send to the Cabinet Office a report explaining the deviation.

It is also recommended that a specific right to terminate the contract is included within the terms of Qualifying Contracts. This may be done by including additional contract clauses, which provide for a warranty from the supplier in relation to its declarations on Occasions of Tax non-compliance at contract commencement: an ongoing obligation to inform during the term of the contract for breach of warranty or breach of duty to inform.

The Committee did request whether a list of companies that had been found guilty of tax evasion could be made available, in order that we could ensure that the Council did not procure contracts with any firms on the list unless they had self-cleansed. HMRC maintain this list.

The Committee investigated changes to the Council's procurement rules where companies who avoid tax could be refused contracts. There are some companies in Islington that are part of large organisations who supply goods and services to Islington Council and have been accused nationally of avoiding tax. However, the Council can only challenge a company's tax status by asking more detailed questions. The only instance where the Council can decide not to contract with a company on tax grounds is when they have been found by HMRC to evade tax, and then only until they pay their unpaid tax burden.



## **Conclusion**

The Committee have made recommendations, which although not as comprehensive as we would have liked do reflect the limited ability the Council has to affect procurement opportunities with companies that are guilty of tax evasion.

**MEMBERSHIP OF THE POLICY AND PERFORMANCE SCRUTINY COMMITTEE – 205/16**

**COUNCILLORS 2015/16**

**Troy Gallagher – Chair**  
**Una O’Halloran – Vice Chair**  
**Jenny Kay**  
**Martin Klute**  
**Michael O’Sullivan**  
**Raphael Andrews**  
**Jilani Chowdhury**  
**Rakhia Ismail**  
**James Court**  
**Caroline Russell**  
**Kaya Comer Schwartz**  
**Dave Poyser – replaced by Councillor Clare Jeapes**  
**Gary Doolan**

**Substitutes**

**Councillors:**  
**Alice Perry**  
**Nick Wayne**  
**Flora Williamson**  
**Mouna Hamitouche M.B.E.**  
**Theresa Debono**  
**Alex Diner**  
**Alice Donovan**  
**Satnam Gill**  
**Nurullah Turan**  
**Robert Khan**  
**Paul Smith**

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*Peter Moore – Democratic Services*  
*Lead officer/s- Steve Key, Peter Horlock – Finance and Resources Department*

**APPENDIX A – SCRUTINY INTITATION DOCUMENT**

<b>SCRUTINY REVIEW INITIATION DOCUMENT (SID)</b>
Review: Tax Avoidance
Scrutiny Review Committee:
Director leading the Review: Steve Key, Assistant Director - Service Finance and Procurement
Lead Officer:
Overall aim:  To only contract with companies and bodies that do not avoid paying UK Tax.
Objectives of the review:

1. To understand how companies avoid paying UK tax including parent companies and subsidiaries.
2. To understand our existing legislative requirements around procurement and contract management.
3. To investigate how we can identify businesses that we contract with who avoid paying UK tax.
4. To review and update our procurement processes, within the law, to exclude those businesses that do not pay appropriate tax.
5. To review and update, as necessary, our appointment process for consultants and agency staff.
6. To explore whether we can use other powers we have (e.g. licencing) to influence companies to pay their appropriate tax.

How is the review to be carried out: (Use separate sheets as necessary for 1-4 below)

Scope of the Review

To review the current situation within Islington and examine how others deal with this issue

Types of evidence will be assessed by the review: (add additional categories as needed)

1. Documentary submissions:
  - a. HMRC information
  - b. Tax advisers information
  - c. Public Contract regulations 2015
  
2. It is proposed that witness evidence be taken from:
  - a. Representative from Procurement
  - b. Representative from HR
  - c. PWC or another tax expert
  - d. HMRC
  - e. Large companies that we contract with who have been accused of tax avoidance
  
3. Visits
  - a. To be identified

Additional Information:

Programme	
Key output:	To be submitted to Committee on:
1. Scrutiny Initiation Document	29/6/15
2. Timetable	
3. Interim Report	7/12/15
4. Final Report	21/1/15