

FRIDAY 7 OCTOBER 2022



PROCUREMENT SERVICE BRIEFING ON RESPONSIBLE TAX CONDUCT MOTION

Purpose of report: To brief members of the Resources and Performance Select Committee on the Original Motion regarding the responsible tax conduct of suppliers to Surrey County Council (SCC), originally submitted for the Council Meeting on 12 July 2022.

Introduction:

1. On 12 July 2022 an Original Motion regarding the responsible tax conduct of suppliers to SCC was submitted for the Council Meeting.
2. Procurement has spent time considering the motion, and Finance have been consulted where specific resolutions related to SCC activity that falls within their domain.

Approve the “Councils for Fair Tax Declaration”

3. Procurement has reviewed the declaration put forward by The Fair Tax Foundation and notes that by signing up to the Councils for Fair Tax Declaration, councils can demonstrate alignment to their values and encourage responsible tax practice through:
 - 3.1. Leading by example on their own tax conduct;
 - 3.2. Demanding to know who owns and profits from businesses the Council buys from – United Kingdom (UK) and overseas – and their full financial reports; and
 - 3.3. Joining calls for UK public procurement rules to change so that councils can do more to tackle tax avoidance and award points to suppliers that demonstrate responsible tax conduct.
4. 3.1 and 3.3 above seem simple and overall, as a political declaration, the declaration is seemingly uncontroversial.

5. However, some of the details regarding the specific resolutions covered by 3.2 are worthy of further exploration.
6. This paper therefore takes each of the specific resolutions as included in the Original Motion and discusses each in turn.

Lead by example and demonstrate good practice in its tax conduct of both Surrey County Council and its trading companies

7. The wholly-owned trading companies of SCC have limited expenditure outside of interest on loans (to SCC) and staff costs (including recharges from SCC). Finance have confirmed that there is nil or at worst negligible revenue expenditure that could fall into the categories outlined.
8. Neither Finance nor Procurement have concerns with SCC passing this resolution.

Ensure IR35 is implemented robustly such that contract workers pay a fair share of employment taxes

9. There are robust IR35 procedures in place. At the point of requisition via Connect2Surrey or a business case for off contract engagement which suggests the appointment might sit outside IR35, the matter is referred to the Human Resources (HR) Governance & Contracts team.
10. This team carry out the IR35 checks via the governments online checking process, delivering a verdict which is then documented as part of the request. S-net contains information to support staff in this process.
11. Neither Finance nor Procurement have concerns with SCC passing this resolution.

Avoid offshore vehicles for the purchase of land and property

12. The utilisation of offshore holding companies is common amongst property owners but SCC has not acquired any new properties into Halsey Garton Property Investments since 2018 and has no intention to do so in the short-term. Property acquired by Halsey Garton (HG) Residential has all been done on long leases from SCC.
13. Neither Finance nor Procurement have concerns with SCC passing this resolution.

Undertake due diligence to ensure that not-for-profit structures are not being used inappropriately by suppliers to reduce the payment of tax and business rates

and

Demand clarity on the ultimate beneficial ownership of suppliers and their consolidated profit & loss position

14. Currently, financial appraisals of prospective suppliers focus purely on an organisation's financial viability and do not take an ethical view. It would be extremely challenging to investigate tax affairs in the manner suggested as part of this appraisal, given there is no readily available information on how companies pay their taxes, other than in the financial press.
15. For the avoidance of doubt, it is worth making clear that the Public Contracts Regulations 2015 (PCR 2015, regulation 57) provide for contracting authorities to exclude a supplier if they are aware it is in breach of its obligations relating to the payment of taxes or social security contributions, and where the breach has been established "*by a judicial or administrative decision having final and binding effect*".
16. Issues concerning tax avoidance, defined by the Government as bending the rules of the tax system to try to gain a tax advantage that Parliament never intended are, however, significantly more complex.
17. The PCRs do not make provision for discretionary exclusion based on concerns about matters such as tax arrangements or beneficial ownership. Current (and indeed likely future) procurement legislation only allow exclusion in very limited circumstances – that is if a mandatory exclusion is triggered around a breach of obligations relating to the payment of taxes or social security contributions that has been established by a judicial or administrative decision. Offshoring or other legal (but morally dubious) grounds to minimise tax are not legitimate grounds to exclude a company from a procurement and would rightly result in a legal challenge as companies have the right to organise their tax affairs how they like, provided they are lawful.
18. Barring suppliers on this basis would therefore expose the Authority to the risk of legal challenges and, accordingly, risk financial compensation being awarded to the very companies we wished to exclude from being in receipt of funds.
19. It is also relevant to consider the Regulations provision for "self-cleaning". In such an event, a supplier who has been excluded from a procurement process using the type of grounds proposed could challenge the decision and provide evidence

it is not exclusion is not appropriate. This will add significant additional time and risk to the process.

20. It is also worthy of note that to undertake the level of due diligence and compliance checking that would be required to evaluate bidders and manage suppliers based on their tax arrangements would necessitate a level of skill and capacity not currently available. Therefore, even if there were a legal route available to achieve this, the direct costs of doing so would be substantial.
21. Further, challenges surround potential risks to delivery of core services in sectors where there is the most potential for the existence of complex beneficial ownership structures and sub-optimal tax arrangements. Examples of such sectors include (but may not be limited to):
 - 21.1. The care sectors, including Adult Social Care and Children's Services, where private equity funding arrangements are increasingly impacting on suppliers in the sector, and complex ownerships structures are becoming more common even for smaller, locally owned operations who are restructuring businesses in order to mitigate costs and maintain profit margins; and
 - 21.2. Sectors serviced by large multinational corporations with complex tax arrangements, such as Microsoft or Amazon, who are known to have non-UK based headquarters to benefit from alternative taxation regimes and complex beneficial ownership and offshore activities.
22. These are just two examples highlighting how adoption of a complex motion could have significant unintended consequences, and where the decisions to examine suppliers would be fraught with subjective decisions.
23. Useful input into this debate can be seen in the Her Majesty's Revenue and Customs (HMRC) Corporate Report "Tax Compliance of HMRC Suppliers", published in May 2022¹. It is noted that HMRC has adopted a *"strengthened approach to tax compliance for its own procurements in circumstances where the Public Contracts Regulations allow for HMRC to take a tougher line than the cross-government position and as such permit HMRC to apply discretion in decisions to exclude a supplier from the procurement process or terminate an existing contract"*. Critically, *"exclusion is based on the grounds of tax non-compliance as determined by 'any appropriate means', which means HMRC has the advantage of being able to use any information it holds"*.
24. SCC does not have such information available to use for such means, and so it is unclear how the Authority would be able to implement tougher restrictions on its supplier base than is seen as standard across Central Government. It is also

¹ [Tax compliance of HMRC suppliers - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/108112/tax-compliance-of-hmrc-suppliers-2022.pdf)

important to note that such a level of due diligence, if even possible, would take substantial investment in resources and skills development.

25. Further, a discussion has been held with the Fair Tax Foundation, focusing on this point. The Foundation provided details of the legal advice they received regarding the compatibility of taking tax behaviour into account during procurement processes, as suggested in this resolution, which can be summed as follows:
 - 25.1. It is difficult to argue that 'poor tax conduct' can be taken into consideration as a factor during the stages of the procurement decision making process, i.e. the technical specification stage, the award stage, or as a contract performance condition.
 - 25.2. This is because a company's tax conduct is not 'linked to the subject matter of the contract', but it instead constitutes general commercial policy. It is therefore not possible to construct a convincing way in which authorities could devise criteria that could satisfy the relevant legal test that the criteria 'linked to the subject matter'.
 - 25.3. That the mandatory and discretionary grounds of exclusion that relate specifically to non-payment of tax are only available in limited circumstances.
 - 25.4. That a better approach may be to argue that 'poor tax conduct' provides public authorities with a discretionary ground for exclusion at the selection stage of a procurement as it constitutes "grave professional misconduct". However, this approach heavily depends on an inadequate European Union (EU) Commission "Blacklist" of tax havens in order to work. It is also a novel argument and is therefore subject to significant legal risk.
26. Continued discussions with the Fair Tax Foundation on this element of the motion highlighted that, whilst it appears many councils have signed the Councils for Fair Tax Declaration, in doing so they have made adjustments to the wording of this element of the Declaration. The Foundation has stated they could work with SCC to agree to some alternative wording that would allow the authority to sign the Declaration.
27. There are however opportunities to evolve in this area along the ethos of the proposed resolutions:
 - 27.1. The new regulations and supporting infrastructure proposed by Central Government will enhance access to relevant supplier data, which may allow contracting authorities to employ this data to make more informed

decisions regarding which suppliers to contract with. Current assessment of what data this central platform will hold includes:

- central debarment list
- central register of complaints
- register of legal challenges

27.2. We could review the supplier questionnaire and consider including enhanced self-declaration/self-assessment as part of the financial checks (on a pass/fail basis), shifting the burden to the suppliers to prove that their tax conduct is in accordance with UK legislation.

27.3. Going further, we could consider the appropriateness of incorporating the Fair Tax Mark into tenders, or ask for proof that suppliers are working towards it (noting it would be advisable to offer an “or equivalent” type option, and/or give the Fair Tax Mark as simply an indication of how good tax conduct could be evidenced, rather than favour a sole indication which carries a cost for the supplier). Note that extensive consultation should be undertaken with potentially impacted Services, and consideration given to what we would do should suppliers refuse to complete this. Also note that proportionality would have to be considered here, with the proposal that such measures were only taken with respect of contracts above certain threshold(s).

27.4. The above points 2 & 3 should be considered in tandem with a review of the Orbis Supplier Code of Conduct and implementation of the new Contract Management Advisory Service.

28. Procurement is therefore not able to recommend passing these resolutions as currently drafted. There remains the possibility of agreeing alternative wording with the Fair Tax Foundation, allowing SCC to sign an amended declaration and therefore publicly support the objectives of the Foundation.

Include tax conduct in social value scoring for assessing contracts
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29. In the broadest sense it seems reasonable to state that fair tax conduct has value for society. However, it would be hard to argue that conducting tax affairs to a higher moral standard could reasonably be awarded additional points in the evaluation of a tender against an entity whose affairs remained legal but were considered by some measure to be sub-optimal.

30. Further, it is doubtful doing so could be deemed to constitute social value as per the Public Services Act (Social Value) 2012. That act requires the public sector to ensure that the money it spends on services creates the greatest economic, social and environmental value for local communities

31. Government has defined social value through a series of priority themes and policy outcomes which are important to deliver through the public sector's commercial activities. Nowhere in that definition are tax arrangements highlighted as potential social value.
32. It is felt that it would not be possible to objectively rule that it was and apply this in a fair and transparent manner that was legal under the PCRs.
33. The new regulations will provide a greater scope - to a degree - to include environmental and social value selection criteria, but the principle that criteria must go to the heart of the contract remains. The requirement to comply with World Trade Organisation rules will continue to limit the scope here.
34. It is also noted that such a resolution would require a fundamental reconsideration of the application of social value to SCC tenders, and members would have to be aware that doing so might be at the expense of the additional social value commitments the Authority is currently obtaining during the tendering process.
35. Additionally, it would be a very imperfect mechanism, and one in which the outcome of a tender evaluation could conceivably be the highest scoring bidder securing a contract despite having declared what could be deemed to be sub-optimal tax arrangements as part of their tender response; such an outcome would present moral and reputational risk to the Authority.
36. Discussions with the Fair Tax Foundation identified that this element of the motion is not included in the wording they propose for this fair tax declaration pledge, and they agree that it would not be possible to include tax conduct in social value scoring for assessing contracts.
37. Procurement is therefore not able to recommend passing this resolution..

Support Fair Tax Week events in Surrey and celebrate the tax contribution made by businesses who pay their fair share of corporation tax.

38. The Fair Tax Foundation's website describes Fair Tax week as:

"A UK-wide recognition of the companies and organisations that are proud to promote responsible tax conduct and pay their fair share of corporation tax. Using #CelebratingFair, the week will highlight digital events and provide a platform to explore the positive contribution corporation tax makes to society."

39. Procurement could consider what activities planned for Fair Tax week 2023 it would be acceptable to support when they are published next year.
40. Procurement does not have concerns with SCC passing this resolution.

Support calls for urgent reform of UK procurement law to enable local authorities to better penalise poor tax conduct and reward good tax conduct through their procurement policies.

- 41. The government recently ran a consultation regarding the impending changes to procurement regulations, and procurement collaborated with the Local Government Association (LGA) in terms of making submissions to this consultation. That consultation is now closed, so it is unclear what route could currently be employed to achieve this resolution in an efficient manner, prior to the implementation of the new regime.
- 42. The new regulations are likely to make greater provision for discretionary exclusions and more variable evaluation criteria.
- 43. It is therefore suggested any activity against this proposed resolution would have more success once the application of the new regulations have been fully implemented and tax conduct could be better considered against them.
- 44. However, there is nothing to prevent SCC supporting calls for reform of procurement law in the manner suggested.
- 45. Procurement does not have concerns with SCC passing this resolution, on the understanding that SCC utilises existing channels such as our membership of the Local Government Association and County Council Network.

Conclusions:

- 46. In summary, whilst SCC could pass the overall motion as a political gesture to influence government, it is not clear how much impact it would have or how much action SCC could take in respect of it. Additionally, there are serious concerns with passing some resolutions as currently drafted.
- 47. Specifically, the detailed discussion of each resolution highlighted questions regarding SCC's ability to impact which suppliers the authority does business with based on an assessment of their tax affairs.

Recommendations:

- 48. A summary of the recommendation for each resolution contained in the motion is detailed in the table below:

Resolution	Procurement's Recommendation
i. Approve the "Councils for Fair Tax Declaration".	As a political declaration, the declaration is seemingly

	uncontroversial, and Procurement is not concerned with the proposal that SCC signs it, provided revised wording could be agreed for some of the declaration.
ii. Lead by example and demonstrate good practice in its tax conduct of both Surrey County Council and its trading companies.	Neither Finance nor Procurement have concerns with SCC passing this resolution.
iii. Ensure IR35 is implemented robustly such that contract workers pay a fair share of employment taxes.	Neither Finance nor Procurement have concerns with SCC passing this resolution.
iv. Avoid offshore vehicles for the purchase of land and property.	Neither Finance nor Procurement have concerns with SCC passing this resolution.
v. Undertake due diligence to ensure that not-for-profit structures are not being used inappropriately by suppliers to reduce the payment of tax and business rates.	Procurement is not able to recommend passing these resolutions as currently drafted. It is however possible alternative wording could be agreed with the Fair Tax Foundation, allowing SCC to sign an amended declaration and therefore publicly support the objectives of the Foundation.
vi. Demand clarity on the ultimate beneficial ownership of suppliers and their consolidated profit & loss position.	
vii. Include tax conduct in social value scoring for assessing contracts.	Procurement does not recommend using social value evaluation to achieve the objectives stated. The Fair Tax Foundation does not believe it is possible to use social value evaluation in this manner.
viii. Support Fair Tax Week events in Surrey and celebrate the tax contribution made by businesses who pay their fair share of corporation tax.	Procurement does not have concerns with SCC passing this resolution.
ix. Support calls for urgent reform of UK procurement law to enable local authorities to better penalise poor tax conduct and reward good tax conduct through their procurement policies.	Procurement does not have concerns with SCC passing this resolution, on the understanding that SCC utilises existing channels such as our membership of the Local Government Association and County Council Network.

Select Committee Recommends:

49. The Resources and Performance Select Committee recommends that Surrey County Council signs up to the Fair Tax Declaration with the following exceptions:

49.1. Agree to alternative wording with the Fair Tax Foundation regarding the following items:

- Undertake due diligence to ensure that not-for-profit structures are not being used inappropriately by suppliers to reduce the payment of tax and business rates
- Demand clarity on the ultimate beneficial ownership of suppliers and their consolidated profit & loss position

49.2. Remove the following item:

- Include tax conduct in social value scoring for assessing contracts.

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Sources/background papers

Finance has been consulted in the development of this paper.

[Agenda item - ORIGINAL MOTIONS - SCC Info \(surreycc.gov.uk\)](#)

[Tax compliance of HMRC suppliers - GOV.UK \(www.gov.uk\)](#)