

## **Treasury Invitation to Comment – Government Procurement**

KPMG response

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## **Executive Summary**

KPMG welcomes the invitation to comment on the proposed requirement for bidders on certain Commonwealth government contracts to obtain a statement of tax record (“STR”).

In principle, we support the introduction of the STR as a means of reducing the risk of the Commonwealth government awarding contracts to businesses who do not make an acceptable effort at complying with their tax obligations.

As a consequence of Australia’s self-assessment system of tax return lodgement, the information that could be readily verified by the Australian Taxation Office (ATO) in order to determine eligibility for an STR would not “weed out” all black economy participants. For example, a company could in theory have lodged all of its returns and paid all of its self-assessed taxes and superannuation contributions punctually, yet not have disclosed all of its assessable income or withholding payments. It would be impractical for each applicant entity to be audited by the Australian Taxation Office before a STR could be issued, and therefore the company in our example could be expected to be able to obtain an STR.

It would also be in the nature of black economy participants for them to seek to circumvent any potential adverse consequences arising from the STR process. This could include additional use of subcontractors and the establishment of new entities with a “clean” tax history specifically to undertake tenders for government work. The integrity measures supporting the STR process will therefore be of great importance.

For increased effectiveness in combatting the black economy, in parallel to the STR it will be necessary for government procurement teams to maintain a “black economy-aware” perspective in assessing and comparing bids.

Nonetheless, the introduction of the STR requirement would send a signal to the community that businesses which do not take reasonable care over their tax obligations will be barred from tendering for government contracts.

KPMG’s response addresses each of the questions raised in the consultation paper. To begin, we have set out three tables of criteria that we believe would form a workable basis for the issuance of the STR to a taxpayer bidder.

## Statement of Tax Record (“STR”) – suggested qualifying and excluding criteria

<i>Category A: activities that will result in the denial of a STR</i>		
<b>Activity</b>	<b>Standard to be achieved</b>	<b>Rationale</b>
Fraud or evasion generally	<p>An STR applicant cannot be granted an STR where there has been:</p> <p>(1) A Corporate offence in this category in the last 6 years;</p> <p>(2) A director offence in this category in the last 3 years;</p> <p>(3) A senior management offence in this category in the last 3 years;</p> <p>Consideration should be given to allowing a Corporate to obtain an STR where it has taken reasonable steps to try and prevent director / senior management offences.</p>	<p>This means that taxpayers who have been engaged in egregious or criminal activity will not be able to qualify for an STR.</p>
Failure to answer questions when attending before the Commissioner of Taxation (section 8D <i>Taxation Administration Act 1953</i> (“TAA”))		
Recklessly or knowingly making false or misleading statements (sections 8N/8P TAA)		
Recklessly incorrectly keeping records (section 8Q TAA)		
Incorrectly keeping records with the intention of deceiving or misleading (section 8T TAA)		
Falsifying or concealing identity with the intention of deceiving or misleading (section 8U TAA)		
Conducting affairs so as to avoid tax file number requirements		
Phoenixing (to be defined narrowly)		
Penalties in relation to a shortfall amount – intentional disregard		
Penalties in relation to a shortfall amount – recklessness		
Entering into a sub-contracting arrangement where there is actual knowledge of an offence		

<i>Category B: pattern of behaviour on carelessness</i>		
<b>Standard of behaviour</b>	<b>Requirement to achieve standard</b>	<b>Rationale</b>
Taking reasonable positions on uncertain areas of Commonwealth taxation law	<p>This standard will not have been met, and a STR applicant cannot be granted an STR, where there has been:</p> <p>(1) More than 3 instances of an administrative penalty of 25% or more of the tax shortfall being applied in relation to the three most recently completed income / fringe benefits tax years.</p> <p>(2) More than 3 instances of entry into a sub-contracting arrangement where one ought reasonably have known that an offence was being committed under Category A.</p>	<p>This would mean that the taxpayer could have a limited number of technical disputes with the ATO and still obtain the STR. The 25% “no reasonable care” penalty could theoretically apply if the taxpayer lost a technical argument in court, so the threshold should allow for some instances of this. Taxpayers who obtained a remission of some of the “no reasonable care” penalty through voluntary disclosure or prompt cooperation would not have that instance counted.</p>
<i>Category C: pattern of behaviour on timeliness</i>		
<b>Standard of behaviour</b>	<b>Requirement to achieve standard</b>	<b>Rationale</b>
Timely lodgement of tax returns and business activity statements (BAS)	No more than six distinct instances (aggregated) in the last three years of any of the following:	<p>This means that in the last three years, there would have been only a minimal amount of timeliness breaches, with reasonable leeway provided for:</p> <p>(1) Overdue income / fringe benefits tax lodgements by a small number of days (regardless of when the STR request is made).</p> <p>(2) Instances where a modest amount of GIC has been imposed but remitted (which one would generally expect to occur in isolated cases of late payment).</p> <p>(3) Lodgement of annual reports under the Taxable Payments Reporting System that are overdue by a small number of days (where a broader commitment to compliance beyond the taxpayer’s own affairs is nevertheless demonstrated by lodgement).</p> <p>(4) Minimal underpayment of superannuation guarantee (with no disincentive for VD).</p>
Timely payment of Commonwealth tax liabilities (including PAYG withholding from wages)	(1) Receipt of a “failure to lodge” penalty for income / fringe benefits tax / BAS as a consequence of a late lodgement of more than 28 days.	
Timely lodgement of annual reports under the Taxable Payments Reporting System (where applicable)	(2) Non-remittal of general interest charge. (3) Late lodgement by more than 28 days under the Taxable Payments Reporting System.	
Timely payment of superannuation contributions on behalf of employees	(4) Aggregate superannuation shortfall exceeding \$50,000 for a completed year of income, disregarding shortfalls identified via voluntary disclosure.	

## 1 What should be taken into account in determining a satisfactory tax record?

Please refer to the above table.

For a bidder which is member of a tax consolidated group or a goods and services tax (GST) group, the attributes of the taxpaying entity for the group should be considered in determining the bidder's STR eligibility, in addition to the tax obligations specific to the bidder (for example fringe benefits tax and superannuation contributions). Therefore the STR application process would need to allow the applicant to provide the name and identifiers of those other group entities.

Where the bidder is a partnership, to the extent that the tabled criteria were applicable to an individual taxpayer a threshold percentage would need to be determined for acceptable compliance by partners. For example, it could be a requirement that at least a certain percentage of partners (as of the date of the STR application) should meet the criteria.

In order to keep the work involved for the ATO within reasonable limits when it comes to assessing STR eligibility, the tax compliance history of persons or entities related to the bidder should generally not be taken into account (in circumstances other than those identified above).

However a bidder should also be required to provide a separate STR for a related entity if the bid draws on commercial experience, expertise or personnel of that related entity (please refer to further analysis at Question 6 below) which would be used in carrying out the work under the contract with government.

**2 What could objectively be considered a “satisfactory” versus “unsatisfactory” tax record?**

See above table

**3 What things should be taken into account if tax history not perfect but should not prevent an STR being issued?**

See above table.

**4 What length of time should be taken into account in STR?**

See above table.

**5 Should business with >\$100m turnover be required to show evidence of adopting the voluntary Tax Transparency Code (“TTC”)?**

Requiring adoption of the TTC (by those bidders who are within its scope) could encourage transparency.

**6 What should be the approach for new and international business?**

It would be too administratively burdensome to have the STR take into account the foreign tax compliance history of a business, in the case where that business has little Australian tax history. Foreign jurisdictions will have a variety of administrative practices which could make it more difficult to obtain an officially-endorsed record from some than from others. A bidder should not be disadvantaged for this reason because of its country of origin.

A “self-assessed” declaration of compliance with overseas tax obligations would be of little value in deterring black economy behaviour in Australia.

A shorter validity period for the STR could be considered for businesses with less Australian tax history. Consequently, these businesses would need to maintain a good record during their term as a supplier to government, in order to remain entitled to obtain renewed STRs.

Another approach could be to require any person / entity with more than a certain threshold of beneficial interest in a bidder to also obtain an STR, where the bidder itself does not have a tax history covering a full STR look-back period.

It would be in the nature of black economy participants for a bidder who would not be eligible for an STR to seek to overcome that problem by setting up a newly-incorporated entity with minimal tax history to act as the bid vehicle. However bidders with an acceptable tax history, who would be entitled to an STR, might for commercial reasons also want to use a “cleanskin” entity to carry out the contract with the government.

It would therefore be important for the integrity (and effectiveness) of the STR process that government sets its procurement policy such that if the bidding entity wishes to utilise the commercial attributes and experience of an associated entity (or of that associated entity’s employees) in winning and carrying out the contract, then that associated entity would also be required to provide an STR.

For example, if a bidding entity only has 12 months of Australian tax history on which its STR can be based, but includes commercial experience over the previous 36 months in support of its bid, then an STR would also be required for the related entity that carried out that previous work.

## **7 How should STR be obtained from ATO?**

The bidder should be able to make an online application quoting its TFN and ABN (and that of the taxpaying entity of any tax-consolidated or GST group of which it is a member).

In addition, we recommend that a taxpayer should be able to tick a box on the annual income tax return from that would automatically initiate the STR process. This would over time streamline applications and also reduce the severity of any “spikes” in the timing of applications.

For partnerships, the TFNs of current partners would be included in the application. Larger partnerships could need to provide hundreds of TFNs for this purpose, and we recommend that the ATO be consulted further on this element of the process in order to find as streamlined a way as possible to issue STRs for partnerships.

## **8 STR will take 2-4 days to produce – how will this affect procurement?**

The impact on procurement should not be significant, provided that the STR has a period of validity such that a new STR is not required each time that an entity undertakes a new bid.

It would be of great assistance to business if the application portal could be accessible several weeks before the requirement to produce an STR takes effect. This would enable businesses to enter all their data beforehand, and also potentially allow the ATO to do much of the evaluation work for those STRs before they are required to be issued.

## **9 How long should STR be valid for?**

The STR should be valid for at least three years for an entity that has a tax history covering the full periods contemplated in the above table.

For other entities, the STR should be valid for 12 months only.

It can be expected that many entities would make their application in order that their initial STR could be available from 1 July 2019 (or as soon after). Therefore the ATO could expect a “spike” in renewal applications around that time of year thereafter. If there is a concern that this would adversely affect the processing time for STRs, consideration could be given to issuing STRs with extended validity (say 42 months) to certain taxpayers in order to spread future renewal applications.

## **10 How should business be able to make enquiries?**

The initial online application should result in a unique application identifier number being issued to the applicant. This identifier number should then enable the applicant to track the status of the STR as it progresses, noting that if the processing time can indeed be kept to 2 to 4 days, this should not be a great concern for applicants.

We also recommend that those taxpayers with an appointed liaison officer at the ATO should be able to go through the liaison officer in order to expedite any problems that may arise.

## **11 What arrangements should apply for subcontractors?**

The objective of reducing the risk of black economy participants winning business from government contracts would be substantially compromised unless subcontractors are also required to obtain their own STR. A de minimis exemption may be appropriate, but we would suggest that this should be set at no more than \$1,000,000 in aggregate subcontract(s) value awarded to each subcontractor. Consideration could be given to lowering this threshold as familiarity with the STR system grows and its impact has been analysed.

Without this requirement, there would be a risk that the head contractor’s STR effectively only covers a tiny part of the activities performed under the contract. The STR would then be of little practical use in combatting black economy behaviour.

## **12 What STR information would be useful for a business taking on a subcontractor?**

We recommend that the subcontractor should be required to provide its STR directly to the government procurement team, and that there should be no obligation for the head contractor to act as the go-between. Head contractors should be required to disclose the ABN of all subcontractors to the government procurement team, and each of the subcontractors should then be required to provide their STR direct to government.

It should be the responsibility of the head contractor to advise the subcontractors that their engagement is conditional on being able to provide an STR to government. It would also be up to head contractors to seek appropriate assurances or warranties from potential subcontractors about their ability to produce an STR prior to involving them in any bid.

## **13 What information should be on the STR itself?**

On the understanding that government procurement departments would be well-informed about what the STR represents about the bidder's (or its related entity's) tax compliance history, there should be no need for the STR to contain any more than the entity name, ABN and period of validity.

## **14 What limitations on use of the STR should be noted on the STR?**

It should be stated that the STR is for the purpose of meeting the specific government tendering requirements only.

It would be beneficial for the STR to expressly state that the STR is not to be used by the holder for any other purpose, and may not be relied upon by any other person (other than the government procurement team for legislated purposes).

This would reduce the risk of STR-holders inappropriately using the STR more widely as purported evidence of a sound financial position or of its general corporate citizenship.