

# Adopt Federal Procurement Policies to Combat Tax Dodging, Fraud and Corruption

**The Government of Canada contracts with companies that use or have facilitated the use of shell corporations and trusts in tax havens to dodge taxes and, in some cases, have allegedly laundered money or engaged in other forms of corruption.** This not only weakens confidence in the government's ability to effectively crack down on tax avoidance and tax evasion but also undermines the Integrity Regime that guides Canada's procurement process.

The Government of Canada purchases over \$16 billion on goods and services on behalf of federal departments and agencies. **Canada should use its purchasing power to require companies who bid on public contracts to publicly disclose basic information about their ownership and their worldwide business operations.**

Canadians will benefit from procurement transparency because it will help to ensure government contractors and suppliers are compliant with the law and uphold integrity in public procurement. This will also demonstrate that Canada is serious about living up to its international commitments in the fight against aggressive tax avoidance and tax evasion.

## Strengthen Public Integrity in Government Procurement

News reports about tax shams, profit shifting, and complex offshore structures used to conceal assets have become more common. In some cases, these activities involve allegations of money laundering and fraud.

Canadians expect their tax dollars to be used wisely. To ensure that happens, we need an approach that increases accountability on the part of companies who want government contracts. One way to achieve that end is to require basic transparency on the part of companies participating in federal procurement.

The Government of Canada has a public policy objective to stem the flow of public dollars offshore. Federal and provincial governments lose up to \$8 billion annually due to tax avoidance schemes, according to estimates by advocacy groups. "Hiding income and assets in foreign jurisdictions to avoid paying taxes is a serious issue that robs all hard-working Canadians of important services," said Diane Lebouthillier, Minister of National Revenue, in a press release last year.<sup>i</sup>

Although Canada has committed an additional \$521 million in its 2017 Federal Budget to pursue tax avoidance and tax evasion, the fight against secrecy is a game of catch-up in which Canada is lagging behind other countries. Investigative reports stemming from the Panama Papers and other whistleblower leaks have revealed the pervasive use of shell companies and trusts on the part of corporations and wealthy individuals. Meanwhile, Canadian taxpayers are paying billions of dollars to

government contractors and suppliers who have taken advantage of opaque shell corporations and exploited loopholes in domestic and international laws to avoid tax authorities.

The Government of Canada spends approximately \$16 billion every year on behalf of federal departments and agencies.<sup>ii</sup> Public Services and Procurement Canada, the federal government's procurement arm, instituted an Integrity Regime several years ago to protect the integrity of the procurement process and to avoid doing business with companies that have engaged in unethical business conduct.

According to the Integrity Regime policy:

*Canada has an obligation to protect and safeguard the use and expenditure of public funds, to ensure strong stewardship and transparency, and to uphold the public trust in relation to its contracts and real property agreements. Unethical business behaviour by suppliers undermines fair competition, threatens the integrity of markets, is a barrier to economic growth, increases the cost and risk of doing business, and undermines public confidence in government institutions.<sup>iii</sup>*

Corporate activity involving tax avoidance or tax evasion runs counter to ethical business practices. It also undermines the federal government's ability to collect taxes. While the Integrity Regime cites conviction for income and excise tax evasion within the previous three years as possible cause for ineligibility, very few who engage in these activities are actually convicted.<sup>iv</sup> By design, complex offshore structures are created to circumvent detection by tax authorities. Recent statistics reported by the *Toronto Star* show that only a tiny fraction of those who have engaged in offshore tax evasion have been convicted by the Canadian government.<sup>v</sup>

Canada needs basic public disclosure on the part of government contractors and suppliers in order to:

- **Mitigate the risk of doing business with those who may be engaged in tax evasion, aggressive tax avoidance, fraud, money laundering, and corruption;**
- **Promote tax fairness and create a level playing field with those businesses and firms who comply with the letter and spirit of our laws;**
- **Provide legal authorities, journalists, and the public the ability to scrutinize basic information about contractors and suppliers who receive federal tax dollars.**

## Recommendations:

We recommend that the Government of Canada adopt disclosure requirements for businesses receiving federal payments of \$1,000,000 or more annually, for services procured and real property agreements such as those reported in the Public Accounts of Canada. To better serve the public interest, disclosures should be made available through a public online registry.

Companies currently engaged in, or seeking to bid on, public contracts with the federal government should disclose the following:

- **Beneficial Ownership:** Beneficial ownership means the natural person(s) who ultimately own or control the entity on whose behalf a transaction or activity is being conducted.<sup>vi</sup> Understanding who owns the companies the federal government contracts with is the most basic element of transparency. As there is no central corporate registry in Canada and no uniform reporting requirement across provinces, the federal government is uniquely positioned to require better disclosure on the part of current and prospective contractors and suppliers. Requiring disclosure of beneficial ownership would not only mitigate the risk of procurement fraud, like that discovered by Quebec’s Charbonneau Commission, it would also combat the secrecy that encourages tax dodging. While Canada has made commitments to adopting beneficial ownership, there has been no commitment to a public registry.
- **Country-by-Country Reporting:** Many federal contractors operate throughout the globe. However, lessons learned from the Luxembourg Leaks, for example, exposed secret tax deals that were arranged between hundreds of multi-national corporations and Luxembourg. This practice has been more widespread than previously understood, and Luxembourg is not the only culprit. Country-by-country reporting would give Canada an additional tool to spot irregular activity, such as profit shifting into jurisdictions away from where the economic value is being created. Country-by-country reporting should be required for all companies awarded contracts and service agreements that surpass the annual contract threshold of \$1 million and would disclose the:

  - Name of each country in which it operates;
  - Names of all subsidiaries and affiliates in these countries;
  - Revenues, profits, taxes paid and accrued, number of employees, stated capital, retained earnings, and tangible assets for each tax jurisdiction in which it does business.

While Canada has proposed legislation to adopt country-by-country reporting, there is no requirement to make the information public and the corporate reporting threshold of CDN \$1.1 billion in group revenues fails to capture significant companies that engage in secret tax arrangements.

- **Offshore Subsidiaries, Trusts & Foundations:** The Panama Papers exposed the extent to which offshore trusts and foundations have been used to circumvent domestic tax authorities. According to Transparency International Canada, a recent assessment by the Canadian government found that the private nature of trusts and absence of record keeping makes them highly vulnerable to money laundering and tax dodging. Moreover, “[l]aw enforcement agencies agree that trusts are “misused to a relatively large extent.”<sup>vii</sup>

Procurement disclosure ought to include reporting about any trust or foundation which has been set up, directly or indirectly, on behalf of a principal officer (e.g. president, vice-president and secretary-treasurer) or beneficial owner and indicate its direct and potential beneficiaries and the settlors of the trust or foundation. In addition, the value of tangible assets held by the trust or foundation, number of employees who work for companies held by trusts or foundations, and taxes paid to respective authorities within that jurisdiction should also be reported.

- **Judgements, Investigations & Other Reporting:** Better accountability means understanding who has respected tax laws and who has run afoul of them. Companies should report whether their parent company, subsidiaries, affiliates, or other entities, including foundations and trusts

of which key principals may be direct or indirect beneficiary(-ies), have been the subject of any action taken by the Canada Revenue Agency or any other government tax authority outside Canada, including any investigations, charges or convictions. They should also indicate whether they have participated in the CRA's Voluntary Disclosure Program or participated in a similar program in another country.

Other measures that can improve accountability include:

- **Penalties for False Reporting:** In order to ensure compliance, we recommend that companies who report false or misleading information be fined up to \$250,000. This fine is like that under Canada's Extractive Sector Transparency Measures Act.
- **Positive Weight in Procurement Tenders:** Positive consideration should be given to prospective suppliers and contractors who pay taxes where the economic value is created and who have not incorporated or registered subsidiaries, affiliates, trusts and/or foundations in noted secrecy jurisdictions for the purposes of circumventing Canadian tax authorities.

**Recognizing the role of transparency and accountability in ensuring compliance, disclosure should be made public once a contract or agreement has been awarded.** Federal suppliers and contractors in existing long-term contracts or service agreements should also be required to provide this disclosure publicly and to regularly update the information.

## Growing International Consensus for Corporate Transparency:

There is growing international consensus on the need for action to crack down on tax evasion and tax avoidance. National governments, including those involved in the G20 and the OECD are adopting transparency measures to more effectively tackle this problem. Several countries have adopted public registries of beneficial ownership, some tied specifically to public procurement, while others are requiring public reporting of corporate taxes paid. Laws allowing for public country-by-country reporting are also making headway. In addition, some international cities are adopting initiatives like "tax haven free cities" targeted at municipal procurement.

Among international efforts to improve corporate transparency include:

### Canada

- In 2014, the Government of Canada adopted the Extractive Sector Transparency Measures Act (ESTMA) in an effort to fight corruption globally in the extractive sectors. ESTMA requires large, private mining, oil and gas companies to publicly disclose the payments they make to governments in Canada and abroad on a country-by-country and project-by-project basis for commercial development of oil, gas and minerals. Payments disclosed include those both direct and "in kind" and include reporting of taxes, royalties, fees, production entitlements, bonuses, dividends and infrastructure improvement payments.<sup>viii</sup>

### United Kingdom

- The UK is the first G20 country to establish a publicly accessible central registry of beneficial ownership to show who really owns and controls UK companies. In addition, the UK will also require domestic and foreign companies who enter into public procurement contracts in England to disclose beneficial ownership.<sup>ix</sup>

- In 2016, the UK became the first country to adopt public country-by-country reporting. The measure gives ministers the ability to compel companies to make these reports public.<sup>x</sup> The UK also recently adopted procurement rules that require local councils across England, Wales and Northern Ireland to scrutinize whether potential suppliers have been involved in tax avoidance.<sup>xi</sup>

### *Australia*

- The Report of Entity Tax Information law requires Australian public and foreign owned corporate tax entities with incomes of \$100 million, and Australian-owned resident private companies with total income of \$200 million or more, to publicly report total income, taxable income and income tax payable for these entities.<sup>xii</sup>

### *Netherlands*

- Netherlands has committed to establishing a public central registry with beneficial ownership information. They will also take steps to apply transparency of ownership and control of all companies involved in property purchases and public contracting.<sup>xiii</sup>

### *France*

- France has committed to creating a public beneficial ownership registry.
- Île-de-France, an administrative region in France, will require financial institutions it works with to provide details to verify that they are not linked to tax havens listed by the state. Although the list of jurisdictions is narrow, other regions and cities are considering similar requirements.<sup>xiv</sup>

### *Spain*

- Approximately 28 cities across Spain have signed up to become “tax haven free zones” - an initiative aimed at companies wanting to bid for public contracts at the municipal level. Cities involved in the initiative are developing criteria to penalize companies with ties to tax havens.<sup>xv</sup>
- Barcelona is first city to adopt guidelines on social and environmental public procurement to promote socially responsible criteria in the procurement process. The measure prohibits providers from having any illegal economic activity in countries considered tax havens.<sup>xvi</sup>
- Spain is currently working on a national procurement law to strengthen this initiative.<sup>xvii</sup>

### *Finland*

- In 2012, the City of Helsinki passed a law to sever ties with companies that have links to tax havens, disqualifying such companies from public procurement.<sup>xviii</sup> While the law has not been implemented due to conflicts with EU regulations, the City continues to explore ways to tackle the “grey economy.”

### *Denmark*

- In 2012, tax authorities introduced “open tax lists”<sup>xix</sup> that publicly disclose tax payments reported by Danish companies, including, taxable income after losses, losses from previous years, tax calculated for the assessment year and the tax liability rule applying to the company.<sup>xx</sup>

### *Slovakia*

- In 2015, Slovakia’s parliament passed a law requiring companies who bid for public contracts to disclose beneficial ownership on a public registry. Under the new law, successful bidders who fail to provide beneficiary information can be fined and banned from taking part in public tenders for three years.<sup>xxi</sup>

*European Union*

- EU countries will introduce a beneficial ownership registry for entities registered in their jurisdiction beginning in 2017.

## Conclusion

Canada loses billions of dollars every year due to tax avoidance and tax evasion. While the government has stepped up efforts to deter and combat this kind of activity, the problem has become so pervasive that we need additional tools to ensure the fiscal integrity of public procurement and the tax system.

Canada should require companies who bid on, or currently hold, public contracts to publicly disclose basic information about their ownership and their worldwide business operations. This will serve the public interest by clarifying who the government is doing business with, ensure taxpayer funds are appropriately directed to law-abiding companies, promote a level playing field with businesses that respect both the letter and spirit of our laws, and give stakeholders assurances that taxpayer dollars are being used wisely. Finally, it gives companies who want government contracts a choice. If they want taxpayer dollars, they must choose to leave tax havens behind.

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