

Marks & Spencer – “Knickers to tax”

Summary

This paper looks at the accounts of Marks & Spencer plc from 2003 to 2009 and notes that:

1. The company has paid low current rates of corporation tax for several years;
2. It is not possible to find out where the company's profits before tax are located;
3. A reconciliation of the declared tax rate with the current UK headline rate of corporation tax is hard to achieve;
4. Movements on the company's deferred tax account are hard to explain;
5. No indication is given as to when, if ever, deferred tax will fall due;
6. Deferred tax is not provided in respect of overseas profits not remitted to the UK as the company says it has a policy of not making such remittances which do, however, mean those funds are not available to shareholders.

Everything the company is doing accords with the law with regard to tax and accounting disclosure but having made these observations, which suggest that the company has a policy of seeking to minimise its current taxation bills (hence the slightly tongue in cheek title), the paper then asks in Section 2 a range of questions which the accounts cannot answer but which appear to need answering if the accounts and the tax charges within them are to be comprehensible.

In Section 3 the paper then suggests the policy issues arising from the issues noted and suggests:

1. The adoption of country-by-country reporting in the accounts of multinational corporations;
 2. Reform of deferred tax accounting;
 3. Reform of tax accounting so that the provision for current tax in a set of financial statements is required to balance;
 4. Reform of the published tax reconciliation in a set of financial statements;
 5. Reconsideration of certain aspects of UK tax policy so that large companies make an appropriate contribution to the UK economy at least equivalent in amount to the tax contribution made by ordinary citizens of the UK and that rate paid by small companies in this country.
-
-

Section I

The Marks & Spencer tax rate

Marks & Spencer PLC has a surprisingly low tax rate. This is a summary of relevant data for the last seven years:

| Marks & Spencer | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | Total |
|--------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| | £m | £m | £m | £m | £m | £m | £m | £m |
| Turnover | 8077 | 8302 | 7942 | 7797 | 8588 | 9022 | 9062 | 58790 |
| Profit pre tax | 678 | 782 | 745 | 746 | 937 | 1129 | 706 | 5723 |
| Goodwill | 0 | 0 | 3 | 13 | 14 | 21 | 27 | 79 |
| Profit pre Goodwill | 678 | 782 | 748 | 758 | 952 | 1150 | 734 | 5801 |
| Current tax charge | 199 | 206 | 104 | 154 | 180 | 117 | 122 | 1081 |
| Deferred tax charge | -1 | 24 | 54 | 72 | 98 | 191 | 78 | 515 |
| Total Tax charge | 197 | 229 | 158 | 225 | 278 | 308 | 199 | 1595 |
| Current tax % | 29.3% | 26.3% | 13.9% | 20.6% | 19.1% | 10.4% | 17.2% | 18.9% |
| Current tax % to pre-goodwill profit | 29.3% | 26.3% | 13.9% | 20.3% | 18.9% | 10.2% | 16.6% | 18.6% |
| Total tax charge % | 29.1% | 29.3% | 21.2% | 29.7% | 29.2% | 26.8% | 27.2% | 27.5% |

Compare this current tax % to other retailers in the FTSE:

| Tesco | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | Total |
|--------------------------------------|-------|-------|-------|-------|-------|-------|-------|--------|
| | £m | £m | £m | £m | £m | £m | £m | £m |
| Turnover | 26337 | 30814 | 33974 | 39454 | 42641 | 47298 | 54327 | 274845 |
| Profit pre tax | 1361 | 1600 | 1962 | 2235 | 2671 | 2803 | 2954 | 15586 |
| Goodwill | 23 | 54 | 67 | 76 | 93 | 116 | 153 | 582 |
| Profit pre Goodwill | 1384 | 1654 | 2029 | 2311 | 2764 | 2919 | 3107 | 16168 |
| Current tax charge | 353 | 429 | 442 | 663 | 532 | 597 | 597 | 3613 |
| Deferred tax charge | 62 | 69 | 151 | -14 | 240 | 76 | 191 | 775 |
| Total Tax charge | 415 | 498 | 593 | 649 | 772 | 673 | 788 | 4388 |
| Current tax % | 25.9% | 26.8% | 22.5% | 29.7% | 19.9% | 21.3% | 20.2% | 23.2% |
| Current tax % to pre-goodwill profit | 25.5% | 25.9% | 21.8% | 28.7% | 19.2% | 20.5% | 19.2% | 22.3% |
| Total tax charge % | 30.0% | 30.1% | 29.2% | 28.1% | 27.9% | 23.1% | 25.4% | 27.1% |

Or Sainsburys:

| J Sainsbury | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | Total |
|---|-------|-------|---------|-------|-------|-------|-------|--------|
| | £m | £m | £m | £m | £m | £m | £m | £m |
| Turnover | 17430 | 17141 | 15202 | 16061 | 17151 | 17837 | 18911 | 119733 |
| Profit pre tax | 667 | 610 | 15 | 104 | 477 | 479 | 466 | 2818 |
| Goodwill | 18 | 13 | 8 | 21 | 21 | 18 | 15 | 114 |
| Profit pre Goodwill | 685 | 623 | 23 | 125 | 498 | 497 | 481 | 2932 |
| Current tax charge | 196 | 174 | 5 | 36 | -23 | 164 | 146 | 698 |
| Deferred tax charge | 10 | 32 | -55 | 10 | 176 | -14 | 31 | 190 |
| Total Tax charge | 206 | 206 | -50 | 46 | 153 | 150 | 177 | 888 |
| Current tax % | 29.4% | 28.5% | 33.3% | 34.6% | -4.8% | 34.2% | 31.3% | 24.8% |
| Current tax % to pre-goodwill profit | 28.6% | 27.9% | 21.7% | 28.8% | -4.6% | 33.0% | 30.4% | 23.8% |
| Total tax charge % | 30.1% | 33.1% | -217.4% | 36.8% | 30.7% | 30.2% | 36.8% | 30.3% |

or even

| Morrisons | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | Total |
|---|-------|-------|-------|-------|-------|-------|-------|-------|
| | £m | £m | £m | £m | £m | £m | £m | £m |
| Turnover | 4289 | 4944 | 12116 | 12118 | 12462 | 12969 | 14528 | 73425 |
| Profit pre tax | 277 | 320 | 297 | -313 | 369 | 612 | 655 | 2217 |
| Goodwill | 0 | 0 | -58 | 124 | 0 | 0 | 0 | 66 |
| Profit pre Goodwill | 277 | 320 | 239 | -189 | 369 | 612 | 655 | 2283 |
| Current tax charge | 97 | 120 | 122 | 8 | 115 | 104 | 135 | 701 |
| Deferred tax charge | -3 | 2 | -30 | -71 | 7 | -46 | 60 | -81 |
| Total Tax charge | 94 | 122 | 91 | -63 | 121 | 58 | 195 | 620 |
| Current tax % | 35.2% | 37.6% | 40.9% | -2.6% | 31.0% | 17.0% | 20.6% | 31.6% |
| Current tax % to pre-goodwill profit | 35.2% | 37.6% | 50.9% | -4.3% | 31.0% | 17.0% | 20.6% | 30.7% |
| Total tax charge % | 34.1% | 38.2% | 38.3% | 33.2% | 32.9% | 9.5% | 29.8% | 27.2% |

They actually make Barclays look like high tax payers:

| Barclays | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | Total |
|---|-------|-------|-------|-------|-------|-------|-------|--------|
| | £m | £m | £m | £m | £m | £m | £m | £m |
| Turnover | 12411 | 13945 | 17978 | 22170 | 23492 | 23352 | 29925 | 143273 |
| Profit pre tax | 3845 | 4603 | 4280 | 7136 | 7076 | 6077 | 11336 | 44353 |
| Goodwill | 265 | 299 | 88 | 143 | 200 | 288 | 488 | 1771 |
| Profit pre Goodwill | 4110 | 4902 | 4368 | 7279 | 7276 | 6365 | 11824 | 46124 |
| Current tax charge | 882 | 1202 | 1524 | 1937 | 2374 | 1660 | 1104 | 10683 |
| Deferred tax charge | 194 | 87 | -85 | 4 | -393 | -870 | -57 | -1120 |
| Total Tax charge | 1076 | 1289 | 1439 | 1941 | 1981 | 790 | 1047 | 9563 |
| Current tax % | 22.9% | 26.1% | 35.6% | 27.1% | 33.6% | 27.3% | 9.7% | 24.1% |
| Current tax % to pre-goodwill profit | 21.5% | 24.5% | 34.9% | 26.6% | 32.6% | 26.1% | 9.3% | 23.2% |
| Total tax charge % | 26.2% | 26.3% | 32.9% | 26.7% | 27.2% | 12.4% | 8.9% | 20.7% |

How come a UK High Street retailer that is supposedly committed to the UK has a lower current tax rate when compared to its pre-tax profits than a bank with hundreds of subsidiaries in tax havens? And a lower tax rate than another retailer, Tesco's, that has attracted considerable attention for its tax affairs? Its rates are, in fact, overall lower than those of IKEA, which is opaque, private, and dominated by activity in tax havens according to at least some reports. It had tax charges of 13.1% in 2009 and 19.3% in 2008ⁱ.

Marks & Spencer and deferred tax

It is important to note that the M & S accounts give a somewhat different impression from this low tax payment rate. This table shows the declared tax percentage in the accounts, highlighted in yellow:

| Marks & Spencer | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | Total |
|---|-------|-------|-------|-------|-------|-------|-------|-------|
| | £m | £m | £m | £m | £m | £m | £m | £m |
| Turnover | 8077 | 8302 | 7942 | 7797 | 8588 | 9022 | 9062 | 58790 |
| Profit pre tax | 678 | 782 | 745 | 746 | 937 | 1129 | 706 | 5723 |
| Goodwill | 0 | 0 | 3 | 13 | 14 | 21 | 27 | 79 |
| Profit pre Goodwill | 678 | 782 | 748 | 758 | 952 | 1150 | 734 | 5801 |
| Current tax charge | 199 | 206 | 104 | 154 | 180 | 117 | 122 | 1081 |
| Deferred tax charge | -1 | 24 | 54 | 72 | 98 | 191 | 78 | 515 |
| Total Tax charge | 197 | 229 | 158 | 225 | 278 | 308 | 199 | 1595 |
| Tax charge % | 29.1% | 29.3% | 21.2% | 30.2% | 29.6% | 27.3% | 28.2% | 27.9% |
| Current tax % | 29.3% | 26.3% | 13.9% | 20.6% | 19.1% | 10.4% | 17.2% | 18.9% |
| Current tax % to pre-goodwill profit | 29.3% | 26.3% | 13.9% | 20.3% | 18.9% | 10.2% | 16.6% | 18.6% |
| Total tax charge % | 29.1% | 29.3% | 21.2% | 29.7% | 29.2% | 26.8% | 27.2% | 27.5% |

This is, however, misleading. It is only the current tax bill the company pays. The deferred tax bill is tax that it could pay in certain circumstances in the future, but in the case of Marks & Spencer it looks very unlikely that those circumstances will arise: the deferred tax bill has gone up and up, and has never reversed over the last few years, meaning that none of this has been paid to date, and nor does it likely that it will be paid, meaning that it is quite fair to consider only the current tax bill when appraising the tax situation of M and S, because that is all it is likely to pay, and that's what counts.

That said, deferred tax accounting is really useful for M & S. As the data shows it lets it put figures on the face of its profit and loss account that hover around 30% - the statutory corporation tax rate in the UK throughout this period bar 2009, when it was 28% (and when M & S declared a tax rate of 28.2%). But the truth is it has not paid at anything like that rate since 2004 – when the Stuart Rose regime really got to grips with the company.

If M & S had paid tax at the UK headline rate from 2005 to 2009 (five years) then they would have paid £589 million more in current tax. If it had just paid the tax it declared on its profit and loss account it would have paid £492 million extra.

This needs putting in context: it apparently costs £162 million a year to provide school sport, or about £810 million over five years. M & S could have paid for 72% of that if it had paid the full rate of UK tax on its profits or 60% if it had just settled the tax it advertised it paid.

What's the reason for the low tax rate?

So how has Marks & Spencer reduced such a low tax charge? It is not legally obliged to say, so whilst many companies offer an explanation for their tax charge in their directors report, Marks & Spencer do not. That leaves the accounts themselves to work on. There are several clues here.

First, note where Marks & Spencer operates outside the UKⁱⁱ:

Our International operations

Mediterranean and Islands

21 stores

Including a new store
in Marbella

Ireland and Channel Islands

28 stores

1 new store in 2008/09

Middle East

20 stores

3 new stores opened in 2008/09,
with 4 planned in 2009/10

Indian subcontinent

14 stores

First non-franchised store opened
in Mumbai in April 2009Southern and
Eastern Europe

136 stores

23 stores opened in the region

Far East

76 stores

Flagship store in Shanghai
opened in August 2008

Other: Bermuda

1 store

Ireland, the Channel Islands, many locations in the Middle East, Bermuda and some other places will, no doubt, offer very low tax rates. M&S seems to be drawn to tax havens.

Second, because M&S operates vertical supply chains because it only sells own brand garments then these goods will almost certainly be subject to transfer pricing arrangements before reaching the UK. Some retailers have used this as an opportunity to locate some profits out of the UK. It is not clear that M & S have done so, but the opportunity certainly exists.

Third, note how M&S splits profit:

The geographic segment results are as follows:

| | Revenue | | Operating profit | |
|---|----------------|----------------|------------------|----------------|
| | 2009 £m | 2008 £m | 2009 £m | 2008 £m |
| UK Retail | | | | |
| Before property disposals and exceptional items | 8,164.3 | 8,309.1 | 652.8 | 972.9 |
| Profit on property disposals | - | - | 6.8 | 28.0 |
| Exceptional costs ¹ | - | - | (135.9) | - |
| Exceptional pension credit ¹ | - | - | 231.3 | 95.0 |
| | 8,164.3 | 8,309.1 | 755.0 | 1,095.9 |
| International Retail | | | | |
| Owned stores ² | 625.5 | 426.7 | 45.8 | 44.5 |
| Franchised stores | 272.3 | 286.2 | 70.3 | 71.9 |
| Before property disposals | 897.8 | 712.9 | 116.1 | 116.4 |
| Loss on property disposals | - | - | (0.4) | (1.0) |
| | 897.8 | 712.9 | 115.7 | 115.4 |
| Total | 9,062.1 | 9,022.0 | 870.7 | 1,211.3 |

UK operations make a profit before exceptional items (which is the fair basis of comparison) of 7.99%. Overseas operations (before property disposals) made a profit of 12.93%. Of course, it could be argued franchise operations will make a higher profit margin, but the difference is significant.

So too is the tax rate. This is the tax note in the accounts:

7 Income tax expense

A. Taxation charge

| | 2009 £m | 2008 £m |
|---|------------|------------|
| Current tax | | |
| UK corporation tax at 28% (last year 30%) | | |
| – current year | 127.4 | 123.0 |
| – prior years | (10.7) | (13.1) |
| | 116.7 | 109.9 |
| Overseas current taxation | 5.1 | 7.5 |
| Total current taxation | 121.8 | 117.4 |
| Deferred tax (see note 24) | | |
| – current year | 70.1 | 184.0 |
| – prior years | 7.5 | 6.7 |
| Total deferred taxation | 77.6 | 190.7 |
| Total income tax expense | 199.4 | 308.1 |

The UK tax charge is, in proportion to operating profit (which is the best ratio that can be used here) 15.4% whereas the overseas tax charge is just 4.4%. Both are exceptionally low.

There are two ways of reconciling this with the expected tax rate for a UK company, which in 2009 would have been due at 28%. They show this tax reconciliation:

B. Taxation reconciliation

| | 2009 £m | 2008 £m |
|---|------------|------------|
| Profit before tax | 706.2 | 1,129.1 |
| Taxation at the standard UK corporation tax rate of 28% (last year 30%) | 197.7 | 338.7 |
| Depreciation, charges and other amounts on non-qualifying fixed assets | (4.0) | 0.6 |
| Other income and expenses not taxable or deductible | 2.9 | (1.3) |
| Exceptional costs | 7.5 | – |
| Overseas profits taxed at lower rates | (1.5) | (6.8) |
| Impact of change in UK corporation tax rate | – | (16.7) |
| Adjustments to tax charge in respect of prior periods | (3.2) | (6.4) |
| Total income tax expense | 199.4 | 308.1 |

Unfortunately, since this reconciles the total tax charge, including deferred tax, it gives no clue at all why the current tax charge is so much less than the rate that is expected.

To find this out we have to look for other clues in the accounts. The first is this, in the group tax note

Deferred tax liabilities are not provided in respect of undistributed profits of non-UK resident subsidiaries where (i) the Group is able to control the timing of distribution of such profits; and (ii) it is not probable that a taxable distribution will be made in the foreseeable future.

This is very significant. What it says is that M & S has no intention at all of repatriating the profits that it earns overseas back to the UK, to then pay UK tax on them. As a result the 4.4% tax charge is all that is going to be settled. This means that about 23.6% tax is saved on overseas profits of about £116 million. That is about £27 million of unpaid tax. But it's not just the UK Exchequer and that should be worried about this. This means that those profits are also unavailable to pay out as dividends to the shareholders. In other words, both the shareholders and the Exchequer are losing as a result of this policy. A little more explanation of this is given in the deferred tax note in the accounts which says:

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries. As the earnings are continually reinvested by the Group, no tax is expected to be payable to them in the foreseeable future. Undistributed profits of overseas subsidiaries amount to £380.6m (last year £295.1m).

This means (when compared to the balance sheet) that about 18% of the total reserves of Marks & Spencer are not now available to their shareholders for distribution as dividends because of M&S's low tax policy. This obviously gives rise to questions about the sustainability of the future income stream the company and the judgement of the management in allocating resources in this way.

The deferred tax note these other clues for the exceptionally low tax rate of Marks & Spencer. It looks like this:

Deferred tax assets/(liabilities)

| | Fixed assets temporary differences £m | Accelerated capital allowances £m | Pension temporary differences £m | Other short-term temporary differences £m | Total UK deferred tax £m | Overseas deferred tax £m | Total £m |
|--|---------------------------------------|-----------------------------------|----------------------------------|---|--------------------------|--------------------------|----------|
| At 1 April 2007 | (90.5) | (103.2) | 183.5 | 21.9 | 11.6 | (7.3) | 4.3 |
| Credited/(charged) to the income statement | 13.7 | (41.4) | (150.5) | (12.9) | (191.1) | 0.4 | (190.7) |
| Credited/(charged) to equity | - | - | (172.4) | (15.1) | (187.5) | 1.8 | (185.7) |
| At 29 March 2008 | (76.9) | (144.6) | (139.4) | (6.1) | (367.0) | (5.1) | (372.1) |
| Credited/(charged) to the income statement | (2.0) | 17.3 | (87.0) | (5.7) | (77.4) | (0.2) | (77.6) |
| Credited/(charged) to equity | - | - | 254.9 | (29.5) | 225.4 | 0.4 | 225.8 |
| At 28 March 2009 | (78.9) | (127.3) | 28.5 | (41.3) | (219.0) | (4.9) | (223.9) |

Perhaps the most important thing to say about this note is that the “other” column can, under existing accounting rules, quite legitimately hide a multitude of issues : my research on such notes shows that the diversity of the issues disclosed, and hidden, is enormous. As a result there is no guarantee that the disclosure made explains all we need to know. This disclosure is, in effect, voluntary and M & S is not showing great enthusiasm for tax disclosure in its accounts, as is its right.

That said, Marks & Spencer will say that the most significant reason for the non-payment of tax is the allowances they are given for spending on capital equipment such as shop fittings, computers, and the like where they make them last a lot longer for accounting purposes than the tax system assumes likely, giving them up

front tax relief and so reducing the overall rates of tax. The difficulty with this explanation for Marks & Spencer's is that other retailers, such as Tesco, Sainsbury's and Morrisons do not appear to be enjoying anything like the same relief. This is not to say that M&S are wrong, but it does not appear a complete explanation, any more than pension fund tax consequences are.

So, the explanation for the low tax charge is hard to find. Some undoubtedly is because of the overseas operations, where a policy of paying low tax and protecting those charges from the UK Revenue is clearly an operation. Some is, undoubtedly, due to investment in new equipment, and the tax system does offer generous reliefs for this. But those by themselves cannot explain why M&S are enjoying tax charges so much lower than those of other retailers, and M&S do not seek to explain why.

Knickers to tax

When this has happened so persistently and for so long there have to be reasons – and they have to be policy reasons. Based on what's said in the accounts that policy appears to be that M & S have said “Knickers to Tax”, and they're getting away with it.

Section 2

The unanswered questions

It would be easy to argue that the issues noted above are not serious, or that at the very least that Marks & Spencer's total tax charge is almost exactly the headline rate of UK tax, it is quite within its rights to retain profits overseas, its claims for allowances are no doubt entirely legitimate and its disclosure is sufficient given the rules that exist. All such claims are true.

However, that being said it appears that on the evidence available that the answers noted below cannot be readily answered, and yet each appears important with regard to the accounts of Marks & Spencer, whether the user of those accounts is an investor or another stakeholder. This case study exists to highlight these issues.

The points in question are as follows:

Profits

- a. What is the UK profit before tax?
- b. How can that be reconciled with UK operating profit?
- c. Where were the finance costs of £214.5 million charged and why is this not disclosed in the accounts when the costs of debt financing are currently considered one of the most important issues in UK tax policy?
- d. Where did M&S earn its £50 million of finance income in the year. Why aren't we told? Why is this not covered by segment reporting data?
- e. What is the profit before tax in each and every country in which M & S trades?
- f. Why should the UK have an indication of what its operating profit is but no other country does - especially when the impact of M & S's trade might be more material to some other states than it is to the UK?
- g. Why is there no indication at all of how profits are reallocated between M & S group companies by intra-group trading? This trade is, presumably, very significant to the group when much of its product is probably sourced out of the UK by M & S buying companies located outside the UK which in turn sell them on to operating companies in many locations where the Group operates. How much internal profit is reallocated by this process of transfer pricing - the other major issue of concern in UK tax at this time?
- h. Where are the consolidation journals that eliminate intra-group profits for group consolidated accounts purposes considered to be located for the purposes of presenting segment data in the group consolidated

accounts i.e. is the profit eliminated inside or outside the UK for segment reporting purposes, and why, which ever answer is given?

2. Current Tax

- a. What is the rate of current tax paid on UK profits before tax?
- b. Likewise, what is the current tax rate paid on profit before tax in each of the locations in which the Group operates - that rate to be stated inclusive of that earned in intra-group transactions?
- c. How can that current rate of tax in each be reconciled with the headline rate due in that place?

3. Deferred tax

- a. Where are deferred tax charges arising, precisely?
- b. How can there be so little deferred tax asset or liability outside the UK?
- c. When will the deferred tax liabilities arise?
- d. What is the probability of the deferred tax liabilities arising? Does management have any clue on this issue, and if not, why is the remoteness of liability not disclosed?
- e. What events might trigger a liability being due?
- f. What is in the 'other' deferred tax and why is part not charged to the profit and loss account?

4. Tax reconciliation

- a. Why is the total tax liability including deferred tax reconciled to the current UK mainstream rate of corporation tax when this gives no explanation as to why the actual rate paid is so much lower than that rate?
- b. Does management believe that this reconciliation is useful? Under UK GAAP the reconciliation had to be with the current tax charge. Does management consider that more useful, and if so, why not offer it either in addition or as an alternative?

5. Tax paid

- a. To which countries is tax paid and in what amount?
- b. The tax account for the company does not reconcile, albeit that the difference is relatively small. Why not? Where has the difference been expenses and to what does it relate?

6. Tax rate

- a. What are future current tax rates expected to be?
- b. If future tax rates increase how will this impact on investment, borrowing and cash available for dividends?

7. Overseas tax

- a. Is the overseas tax rate likely to stay as low as it is at present? If not, why not?
- b. When will the overseas reserves be available for payment to the members?

Section 3

The policy issues arising

Each implies broader questions of policy, such as:

A. The need for country by country reporting

Tax is due to governments and tax reporting makes no sense at all unless related to profit in a jurisdiction and tax due to a particular government.

Many of the questions noted above arise because of the impossibility of reconciling the tax liabilities of Marks & Spencer to sums due to anyone jurisdiction. Without this information it is not, however, possible to assess:

- i. whether the tax liability is fairly stated;
- ii. what tax risk there might be inherent within the accounts;
- iii. whether or not it is plausible to lay observer to assess whether the company is likely to be fulfilling its obligations in all the states in which it trades;
- iv. what risk there might be from transfer pricing;
- v. what risk, if any, arises from the use of tax havens;
- vi. what risks are inherent within the financing structure of the business, particularly with regard to debt capital.

The disclosure required by country-by-country reporting is outlined here:

<http://www.taxresearch.org.uk/Documents/CBC.pdf>

Country by country reporting would require disclosure of the following information by each Multinational Corporation (MNC) in its annual financial statements:

1. The name of each country in which it operates;
2. The names of all its companies trading in each country in which it operates;
3. What its financial performance is in every country in which it operates, without exception, including:
 - Its sales, both third party and with other group companies;
 - Purchases, split between third parties and intra-group transactions;
 - Labour costs and employee numbers;
 - Financing costs split between those paid to third parties and to other group members;
 - Its pre-tax profit;

4. The tax charge included in its accounts for the country in question split as noted in more detail below;
5. Details of the cost and net book value of its physical fixed assets located in each country;
6. Details of its gross and net assets in total for each country in which operates.

Tax information would need to be analysed by country in more depth requiring disclosure of the following for each country in which the corporation operates:

1. The tax charge for the year split between current and deferred tax;
2. The actual tax payments made to the government of the country in the period;
3. The liabilities (and assets, if relevant) owing for tax and equivalent charges at the beginning and end of each accounting period;
4. Deferred taxation liabilities for the country at the start and close of each accounting period.

Sales information will also require additional analysis. If sales too any state are more than 10% different from the figure from any state then data should be declared on both bases so that there is clear understanding of both the source and destination of the sales a multinational group makes.

The proposal requires this information be disclosed for all jurisdictions - without exception - in which a multinational corporation operates. Anything less will not do or transactions might be lost to view. Importantly, this does not require each country to agree to this disclosure since it is suggested that the requirement should be imposed by an International Financial Reporting Standard.

B. The need for improved deferred tax accounting

Deferred tax is a complex issue, understood by relatively few accountants, and by even fewer users of accounts.

Deferred tax is best understood as a fictional tax charge which only exists in company accounts and is never paid. Deferred tax does not, as such, exist but the rules of accountancy generally require that income be matched with expenses. If an expense is recognised for tax purposes more quickly than it is for accounting purposes (which is common with much plant and equipment expenditure, for example) this means that the tax cost for the years when this happens are understated. Conversely, when all the tax allowances have been used on the assets there might still be accounting charges to make and the tax cost would then be overstated. To balance this equation a notional tax charge called deferred tax is charged to the profit and loss account in the earlier years and put on the company's balance sheet as a liability. The liability is released as a credit to profit and loss

account in the later years and in theory over the life of the asset all should balance out. It is also possible to create deferred tax assets, these being most common with regard to pension costs where tax relief is granted later than the liability is recognised in a company's accounts.

The particular problems with deferred tax accounting are:

- i. Understanding why the charge is being made because companies are not obliged to make full disclosure in this regard, it being quite acceptable to describe some charges as being for "other" reasons;
- ii. Determining if any of the deferred tax charge will ever actually become a real tax charge, there being no requirement at all that companies disclose this;
- iii. Working out in which country a deferred tax liability has arisen, since this need not be disclosed;
- iv. Determining why some of the deferred tax charge has passed through the profit and loss account and, very often, significant amounts are charged to the Statement of Recognised Gains and Losses, without explanation being offered;
- v. Explaining why, very often, adjustments are shown in the deferred tax account note in financial statements without explanation being given (although Marks & Spencer are not guilty of this, it should be stressed).

Given that deferred tax balances are frequently material on a company's balance sheet it is extraordinary that so little information is disclosed with regard to these liabilities, particularly as many may be fictional. Under the rules of the International Accounting Standards Board it is compulsory that all potential deferred tax liabilities the provided for in the company's accounts, whether or not there is any real chance that payment will ever arise for the liability in question. This is wholly irresponsible accounting of the type that is incredibly convenient to the company's reporting using this system. They can, as Marks & Spencer do, report that they have a taxation liability on the face of their profit and loss account that looks remarkably similar to the headline rate of Corporation Tax in the country in which they are incorporated and yet have actual, current, tax liabilities that are substantially different, and usually lower.

It is hard to escape the conclusion that the International Financial Reporting Standard requiring the provision of all deferred tax liabilities, whether or not there was any real possibility of the tax being paid, was little more than a deliberate public relations exercise designed to disguise tax avoidance. The deferral of tax is very often the aim of tax avoidance, complete cancellation of liability being much rarer. In this regard, it must be remembered that the International Accounting Standards Board is

effectively controlled by the Big 4 firms of accountants and some of their largest clients; it is not, despite official sounding title, and government or international agency accountable to any international authority.

The following changes to deferred tax accounting would remedy the defects noted and would make the accounts of Marks & Spencer and other multinational corporations considerably more comprehensible:

1. All deferred tax liabilities should be disclosed by the country in which they arise;
2. All deferred tax provisions must be fully explained, with no “other” categories allowed;
3. The date of estimated settlement of liability should be declared for all deferred tax liabilities, and the date of realisation should be disclosed for all deferred tax assets. If settlement or realisation cannot be predicted within the coming ten years then the liability or asset in question should be considered contingent;
4. All tax reconciliations should be to the current tax liability, with an additional note explaining the composition difference between that current tax liability and the full tax charge including deferred tax;
5. All deferred tax movements, whether they be adjustments, or charges made through the Statement of Realised Gains and Losses, must be fully explained in the financial statements.

There are other deferred tax issues in addition to these, but addressing these issues would have significant impact on the way in which disclosure was made and address the problems noted in interpreting the accounts of Marks & Spencer.

C. Tax accounting issues

As a matter of fact the tax accounting of Marks & Spencer does not add up. If the opening tax liability for each year has the current tax liability added to it with the tax payment then taken off the following is found:

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|------------------------------------|-------|-------|-------|-------|-------|-------|-------|
| | £'m | £'m | £'m | £'m | £'m | £'m | £'m |
| Opening CT creditor | 115.9 | 96.9 | 79.8 | 15.5 | 58.7 | 87.3 | 37.5 |
| Add: current tax charge | 198.5 | 205.8 | 103.9 | 153.6 | 179.5 | 117.4 | 121.8 |
| | 314.4 | 302.7 | 183.7 | 169.1 | 238.2 | 204.7 | 159.3 |
| Tax paid | 216.9 | 220.4 | 166.7 | 101.5 | 150.8 | 166.2 | 81.3 |
| Cloaing tax liability (calculated) | 97.5 | 82.3 | 17.0 | 67.6 | 87.4 | 38.5 | 78.0 |
| Closing tax liability per accounts | 96.9 | 79.8 | 15.5 | 58.7 | 87.3 | 37.5 | 78.9 |
| Difference | 0.6 | 2.5 | 1.5 | 8.9 | 0.1 | 1.0 | -0.9 |

In fairness this is vastly better than the average company, an issue reviewed in a previous Tax Research report where it was found that in many cases the difference is more than 5% of the tax charge.

<http://www.taxresearch.org.uk/Documents/Dotheyaddup.pdf>. However, it seems a basic test of credibility that this test be possible in all financial statements and that a reconciliation statement be required if necessary to explain movements not passing through the tax notes to the accounts.

D. Tax policy issues

As a matter of fact:

- i. Marks & Spencer has been paying tax at a rate lower than the basic rate of UK income tax for some time;
- ii. Pays tax at a rate much lower than that of most UK small companies;
- iii. Takes advantages of offshore arrangements probably unavailable to most small UK companies.

All such actions are legal, but each gives rise to policy questions:

1. Is there a minimum rate of tax a company should pay? If so, what is it?
2. Should a large company be allowed to pay tax at less than the small companies' rate of corporation tax?
3. Why should large companies have preferential access to offshore tax arrangements?

These are issues for politicians to consider but they are, equally, a fair response to accounts filed by a major UK based corporation such as Marks & Spencer.

About the author

Richard Murphy (52) is a chartered accountant. A graduate in Economics and Accountancy from Southampton University he was articled to Peat Marwick Mitchell & Co in London. He specialised in tax before setting up his own firm in 1985. In 1989 this became Murphy Deeks Nolan, Chartered and Certified Accountants of which he was senior partner until he and his partners sold the then 800 client firm in 2000.

In parallel with his practice career Richard has been chairman, chief executive or finance director of more than ten SMEs.

Richard has written widely on taxation and accounting, including for the Observer. He has appeared in BBC radio and television documentaries on taxation issues.

Since 2000 Richard has been increasingly involved in taxation policy issues. He is a founder of the [Tax Justice Network](#) and director of [Tax Research LLP](#) which undertakes work on taxation policy for a wide range of clients including governments, government agencies, commercial organisations, aid agencies and pressure groups in the UK and abroad.

Richard has been a visiting fellow at Portsmouth University Business School, the Centre for Global Political Economy at the University of Sussex and at the Tax Research Institute, University of Nottingham.

He was included in Accountancy Age's "[Financial Power List for 2006](#)" as one of the 50 most influential names to look out for in 2006. He was promoted on publication of the 2007 list and in [2009 was placed at number 25](#).

He is a co-author of '[Tax Havens: How Globalization Really Works](#)', Cornell University Press, 2009.

His blog is ranked as the sixth best read blog on economics in the UK. It can be found at www.taxresearch.org.uk/blog

Contact information

www.taxresearch.org.uk/blog
richard.murphy@taxresearch.org.uk
 +44 (0) 1366 383 500

Publisher information

© Tax Research LLP November 2010
 This updated version published 29-11-2010
 The Old Orchard, Bexwell Road, Downham Market, Norfolk PE38 9LJ
 Registered at the above address. Registered number OC316294

Endnotes

ⁱ <http://www.taxresearch.org.uk/Blog/2010/10/03/the-ikea-conundrum/>

ⁱⁱ This and other notes taken from the Marks & Spencer plc 2009 financial statements, available on its web site.