Tax paid by Railway Companies

A report for the RMT

August 2007

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Executive Summary

This report is based on detailed analysis of the accounts of six railway operating companies and three railway leasing companies operating in the UK. In each case their last five available sets of accounts were reviewed, meaning that the survey concentrates on the period 2002 to 2006.

In this period the declared profits of the companies in question increased from £435 million in 2002 to £810 million in 2006. Their sales income curiously varied little over the period, moving about an average of about £11.6 billion a year throughout the period.

The tax they paid did, however, fall dramatically over the period. According to their profit and loss accounts their tax charges fell from £188 million or 51.4% of reported profit in 2002 to £169 million in 2004, when the declared tax rate was 22.1%, a rate that was also seen in 2006.

But this is not the whole story. The profits these companies declare are not the profit figures on which they pay tax. Most of the railway operating companies (but not the rail leasing companies) have significant goodwill charges in their accounts which are highly unlikely to be tax deductible. This increases their taxable profits by this amount.

At the same time, all the companies include in their accounts charges for 'deferred tax', which can best be described as estimated amounts of tax that might be payable at some time in the future as a consequence of transactions that have already occurred, but with there being no certainty as to when, if, or ever that tax might be due. Overall the amount of deferred tax owed by these companies increased from £948 million to £1,297 million over the period. The increase was less than the total deferred tax charged against their profit by all the companies in

the period, which totalled £527 million because of changes in the rules on the way the balances had to be accounted arising as a result of the introduction of International Financial Reporting Standards in 2005.

Two points are however clear: first that these balances seem unlikely to be paid and second that deferred tax charges can therefore be ignored as real tax charges. They should instead be considered to be interest free loans to the railway industry for which there is no repayment date. By 2006 one third of all the finance required by the industry was being provided by the government in this way without it taking any credit for the benefit it was providing.

Taking these two adjustments to the profit and tax charge into account a very different picture of tax paid is revealed. Profits now increased from £584 million before tax to £894 million before tax over the period. Taxes due fell from £109 million to £71 million. The tax rate fell from 18.7% to 7.9% (and just 3.8% in 2005).

If tax had been paid on these profits at the 30% headline UK corporation tax rate the sums due would have been £66 million in 2002 and £198 million in 2006. Over the period £731 million of tax was not paid as a result of the low tax rates the industry enjoyed.

Of this sum £527 million is explained by the deferred tax charges. According to the accounts of the companies themselves the second biggest reason is 'prior year adjustments'. What this means is that they have not had to pay tax that they had declared they might. Almost certainly this means that tax planning arrangements the companies had presented to HM Revenue & Customs but were too cautious to assume would work were accepted as valid by that authority, or at least were not challenged.

The resulting impression is of an industry that has saved itself over £700 million in tax in five years and is sitting with £1.3 billion of unpaid tax on its balance sheet: tax that might never be paid but which is being used to provide one third of the funding required to keep this sector going.

Who benefits from this tax lost? Certainly not the government. And there's no indication that it is the consumer. It must be the companies themselves. Profits of the companies surveyed almost doubled during this period. Their tax paid tumbled. And they paid almost £1.5 billion in dividends to shareholders in this five year period. Half of this sum was financed by tax not paid.

There is an obvious question. What better use could have been made of that tax not paid, in the railway industry or in society at large? And why have we allowed the railway industry become a mechanism for financial planning, one of whose primary purposes is to turn unpaid tax into an income stream for shareholders?

It's certainly no way to run a railway.

Background

In 2006 The Tax Gap Limited (an associate company of Tax Research LLP) published a report entitled 'Mind the Tax Gap'[1]. This found an increasing Expectation Gap amongst the UK's 50 largest companies over the period 2000 to 2004. In particular:

1) These 50 companies paid an average of 5.7% less corporation tax than expected rates would have suggested appropriate over the period;

2) This 'Expectation Gap' increased from 4.2% in 2000 to 7.6% in 2004;

3) Over 5 years, these companies paid maybe £20 billion less tax on their profits than expected rates would have suggested appropriate;

4) In 2004-5 alone this estimated 'Expectation Gap' constituted around £4.6 billion in lost tax revenue from these 50 companies (calculating that 60% of the tax was due in the UK).

By examining these companies' published accounts, the report suggested several reasons for this Tax Gap. The most significant were:

1) Many companies declared tax liabilities on their profit and loss accounts which suggested that they were paying tax at higher rates than those required by UK law. This was misleading because those tax provisions included significant charges for deferred tax, much of which was not paid, and because pre-tax profits declared on profit and loss accounts are not the basis used for calculating a company's taxation liabilities.

2) The deferred tax provisions of the UK's largest companies increased by £3 billion a year in the period 2002 to 2004 and there was no indication that this tax would ever be paid;

3) £36 billion of deferred tax was owed in all by the companies surveyed and they provide no indication of when this might be due. This has in effect allowed companies to enjoy the benefit of using this sum as if it were an interest-free loan from governments with no set date for repayment.

4) The vast majority of deferred taxes related to excessive corporate tax allowances given to encourage investment in plant and machinery. These tax breaks were wholly unrelated to the underlying economic substance of the transactions taking place.

[1] See http://www.taxjustice.net/cms/upload/pdf/Mind_the_Tax_Gap_-_final_-_15_Jan_2006.pdf accessed 21-8-07

5) UK tax relief for interest paid on borrowing, given even if companies then use that money abroad, allowed many companies' UK profits to be taxed well below the headline rate.

'Mind the Tax Gap' attracted national media coverage when first published and has attracted considerable comment since in both professional and academic taxation journals.

The current research was undertaken to see whether a similar situation arose amongst railway operating and railways leasing companies working in the UK.

Looking at the rail companies

The RMT commissioned Richard Murphy[2] of Tax Research LLP to use the same methodology as that used to create 'Mind the Tax Gap' but to apply that approach to six railway operating companies and three railway leasing companies operating in the UK.

1. The companies

The railway operating companies were:

1. First Group PLC
2. Go-Ahead Group PLC
3. Stagecoach Group PLC
4. Arriva PLC
5. National Express Group PLC
6. Virgin Rail Group Holdings Limited

The railway leasing companies chosen were:

1. Porterbrook Leasing Company Limited
2. HSBC Rail (UK) Limited
3. Angel Trains Limited

2. The accounts

In each case five sets of accounts filed on public record have been reviewed. These were the accounts ending in the years 2002 to 2006 for all companies bar HSBC Rail (UK) Limited were the accounts for the years 2001 to 2005 were used since 2006 data was not available. This was statistically acceptable as the data remains the last five sets of accounts on public record. In addition, the first set of accounts for Porterbrook Leasing Company Limited was for the year to 28 February 2003. These were taken to be the accounts for 2002, the following accounts for the ten month

[2] http://www.taxresearch.org.uk/Blog/richard-murphy/ accessed 21-8-07

period to 31 December 2003 being considered those for 2003. This should produce little or no statistical distortion in the results.

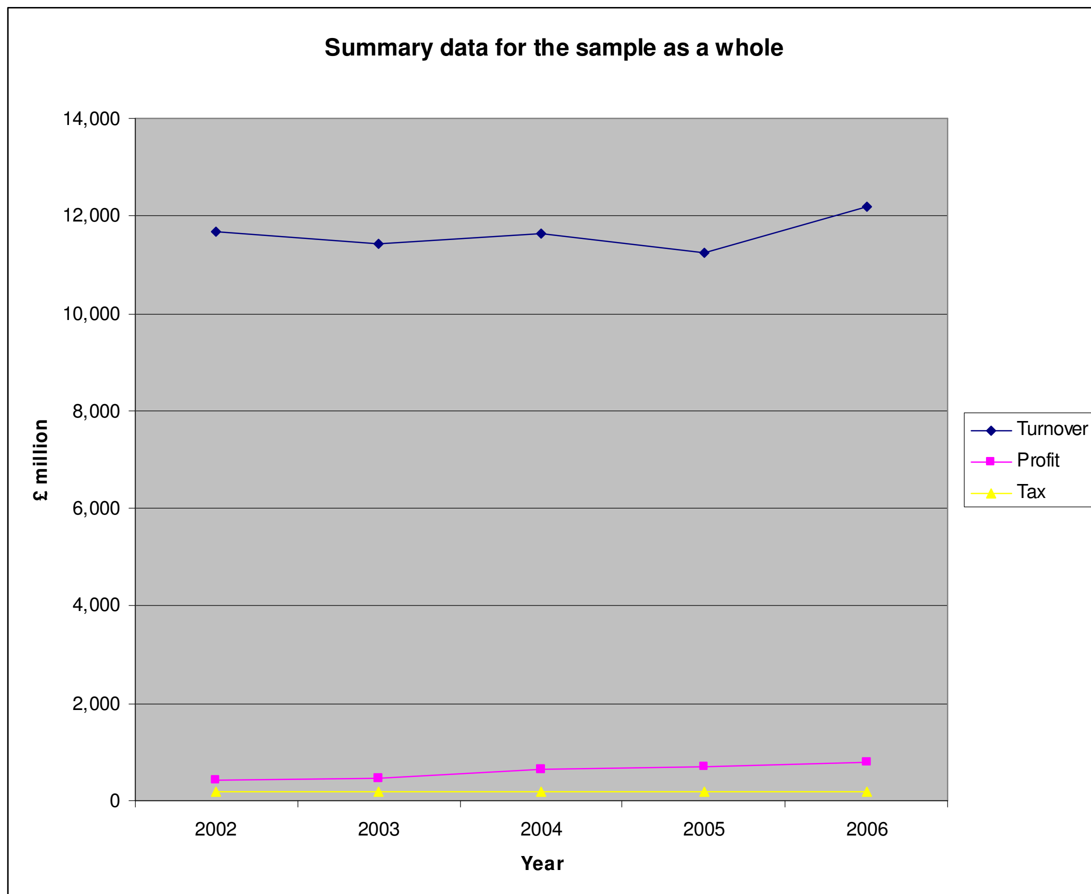
For the purposes of some analysis the loss made by Stagecoach Group plc in 2003, when it made provisions exceeding £500 million for the closure of part of its North American operations, have been excluded from consideration as the provision distorted all remaining data and was not of itself tax allowable. For that year it has been assumed that the profit of Stagecoach Group plc was nil when this has proved to be necessary. Based on the accounting information available this is statistically acceptable.

3. The data

The data used to prepare this report came from the published accounts of the named companies. All data has been double checked. It is nonetheless stressed that the data published is not meant to be, and should not be assumed to be, an analysis of each of the companies named in isolation. The focus of the work undertaken was to identify data and trends for the industry as a whole and it is these conclusions that are of significance in this report.

Initial findings

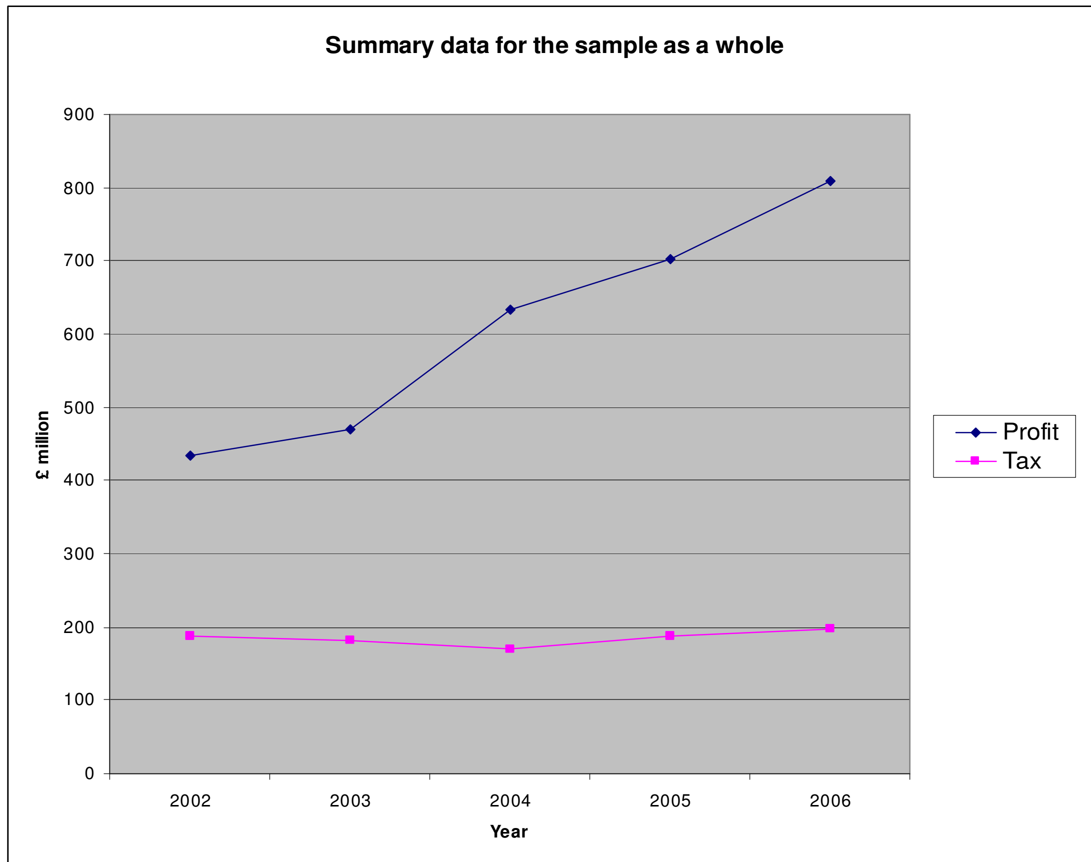
It is easy to be misled by the published accounts of UK companies when it comes to tax. The following graph of summary data for the sample companies as whole makes clear why that is the case:



Three things immediately jump out:

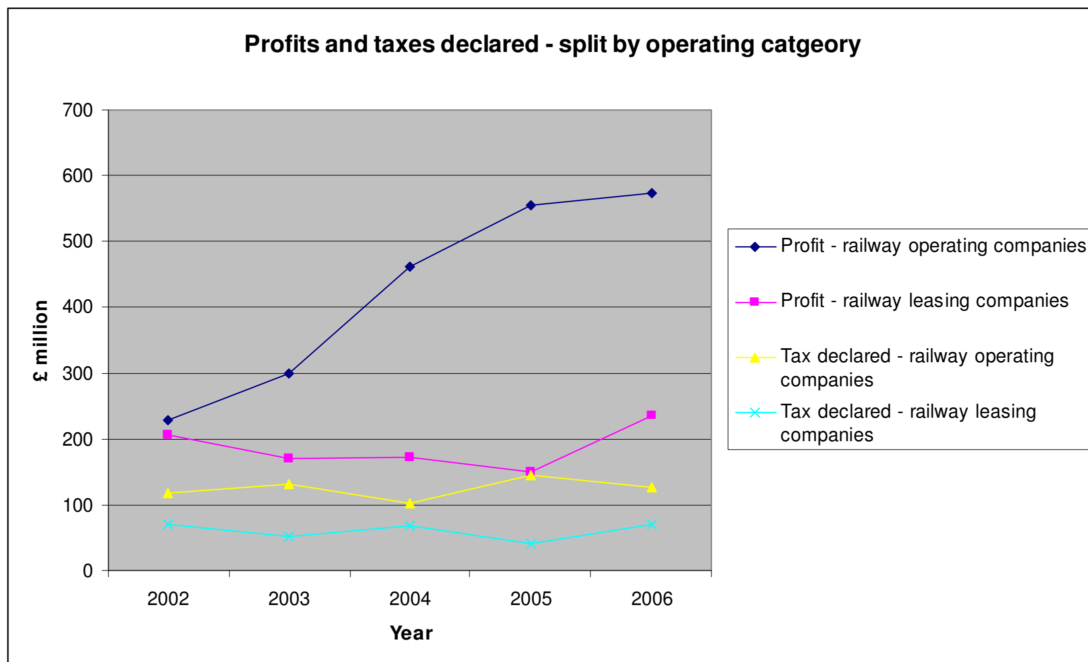
1. Turnover (which usually represents sales) was fairly static over the period;
2. Profit was rising over the period;
3. Tax declared appears almost constant.

If the turnover line is excluded then greater clarity is available:

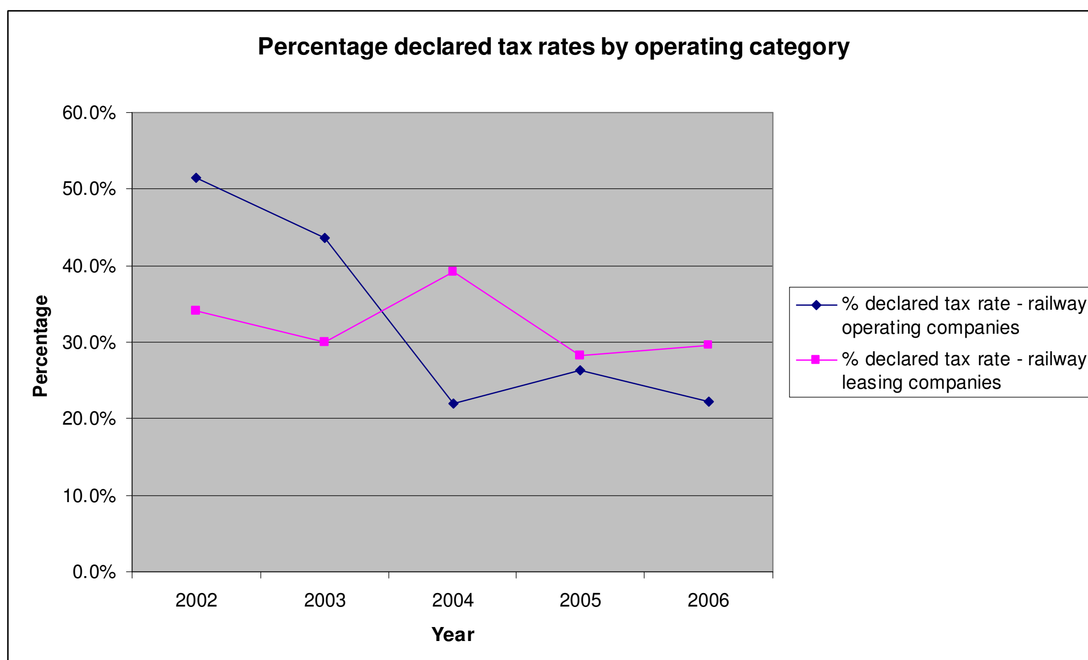


Now it is apparent that despite fairly static revenues the profits of the nine companies being considered almost doubled over the five year period but their declared tax due remained almost completely static.

If this is split between the railway operating companies and the railway leasing companies the following can be seen:



It is now apparent that the growth in profit has arisen largely in the railway operating companies. As this graph shows though, their declared tax liabilities fall heavily over the period:



Railway operating companies appear to have cut their tax rate from a level well above that which appears to be due under UK law to one below that rate over the five year period, whilst more than doubling their profits. Railway leasing companies appear to have tax bills that are at about the 30% tax rate due under UK taxation law.

By themselves these figures are of interest. But they are a very long way from being the whole story. Tax is not that simple, and nor is tax accounting. A lot more analysis is needed to find out what is really going on.

Extending the analysis

Appearances can always be deceptive, and never more so than when it comes to accounts.

1. Changing accounting rules

First of all, it is important to note that during this period the rules of accounting changed. In either 2004 or 2005 all the companies had to change the basis on which they prepared their accounts to what are called International Financial Reporting Standards. Although comparison has to be made between the accounts prepared under the old rules and those prepared under the new rules the results will never be the same. In one year only each company had to provide figures under both the old rules and new rules. The comparisons for pre tax profits declared and tax liabilities declared are as follows:

IFRS Profit comparison	Non IFRS	IFRS
First Group PLC	128.9	155.7
Go-Ahead Group PLC	97.3	93.9
Stagecoach Group PLC	108.3	104.9
Arriva PLC	98.4	109.3
National Express Group PLC	63.1	77.9
Virgin Rail Group Holdings Limited	23.2	26.6
Porterbrook Leasing Company Limited	8.9	-8.1
HSBC Rail (UK) Limited	54.4	54.4
Angel Trains Limited	87.6	71.0
Total	670.1	685.6
Average	74.5	76.2

On average declared profits went up, slightly. With regard to tax the opposite was true:

IFRS Tax comparison	Non IFRS	IFRS
First Group PLC	32.7	41.1
Go-Ahead Group PLC	22.8	25.7
Stagecoach Group PLC	29.5	25.3
Arriva PLC	27.6	26.0
National Express Group PLC	22.3	22.8
Virgin Rail Group Holdings Limited	8.0	9.0
Porterbrook Leasing Company Limited	19.7	3.9
HSBC Rail (UK) Limited	16.2	16.2
Angel Trains Limited	25.3	20.3
Total	204.1	190.3
Average	22.7	21.1

The average tax charge went down. This contributed slightly to the trend noted of rising profits and falling tax charges, but does not explain it.

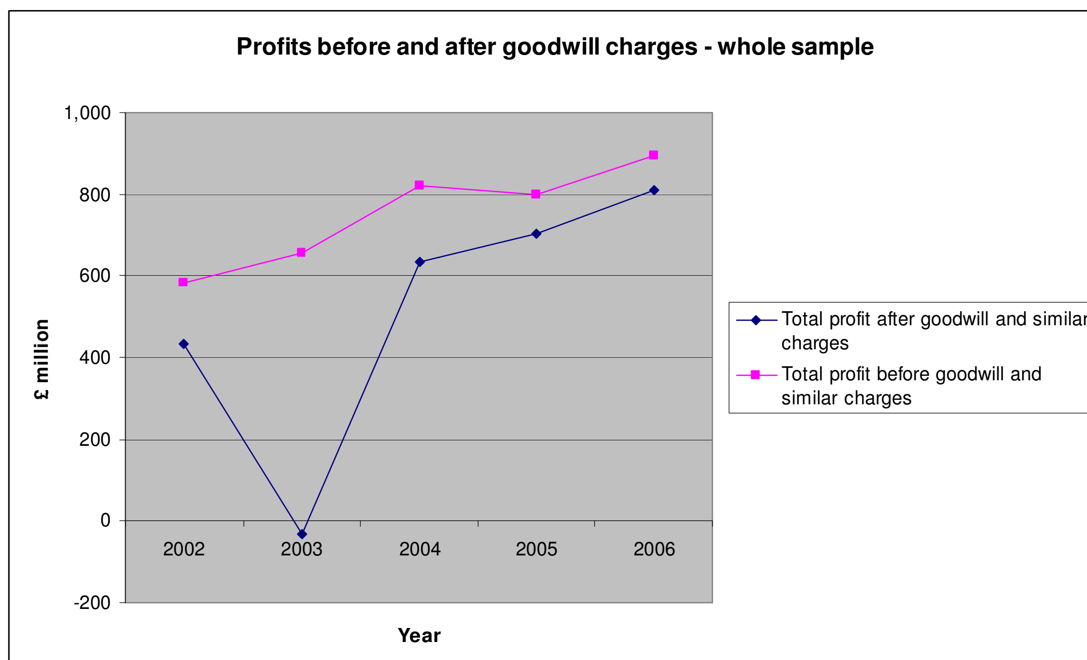
2. Profit isn't profit

The second reason why all is not what it seems is that the profit declared in a set of accounts is not the figure on which tax is paid by a company. There are almost innumerable reasons why this is the case, but the most obvious differences are:

- It is rare for any charge for goodwill included in a companies accounts to be allowed as a deduction for tax purposes;
- Almost all provisions for closure and similar costs are disallowed for tax, at least at the time first recorded;
- Depreciation is charged in the accounts of companies as a measure of the wearing out of the physical assets they use to undertake their trade but this expense is not allowed for tax purposes. An alternative deduction, called capital allowances, is used for tax purposes. These tend to be much more generous than depreciation charges;
- Some expenses e.g. the costs of raising money, some legal fees, entertaining costs and some repairs that are charged against company profits are not allowed as deductions for tax purposes;
- Some income a company might recognise is not taxed or is taxed at lower rates than those charged on other income. This especially relates to transactions involving the sale of trades themselves, but this is an area where tax accountants are particularly keen to find loopholes that allow companies to report profits without having to pay tax for the benefit of doing so.

Unfortunately most of these items cannot be readily identified in the accounts of a company. For example, depreciation is a figure that is disclosed but the amount of capital allowances claimed as a consequence of expenditure on assets is not required to be disclosed so no effective adjustment can be made in the analysis undertaken here.

The exception is the case of goodwill and provisions for losses. These figures must be disclosed and are often significant in amount. Goodwill represents the 'wearing out' of the excess sum paid for acquiring a business over the value of the tangible assets (such as plant and equipment, stocks of goods, etc.) acquired when a business is bought. It is assumed that this has a limited life and as such accounting rules do, in general, require that the sum be written off (although this rule has been relaxed somewhat under International Financial Reporting Standards). Since this sum is invariably disallowed for tax it is fair to do so the same in calculating the profits on which taxes are paid by companies when reviewing their accounts. The differences in reported profits for the sample as a whole are as follows:



By far the biggest change is in 2003 when Stagecoach Group PLC had total goodwill and similar charges of £578 million. It should be noted that none of the rail leasing companies had any such charges in any year.

The higher profit figure is used as the basis for calculation in the rest of this report unless otherwise noted since this will be much closer to the actual taxable profits of the companies.

3. Tax isn't tax

Just as profit in a companies accounts is not all it appears to be, nor is the tax charge. When considering complex companies of the type included in the sample for this survey the tax charge that is declared on the profit and loss account of a company is never the tax that the company actually pays. The charge is actually made up of at least three parts:

- The current tax charge for the year, which is the tax that the company thinks it might pay as a result of the profits earned in the year;
- The prior year tax charge, which is the adjustment made in the current year to tax charges declared to be due in earlier years where that estimate has subsequently proved to be incorrect;
- The deferred tax charge.

None of these is straightforward, and all require interpretation.

4. Prior year adjustments

First of all, as is obvious from the fact that prior year tax charges take place companies do not get the estimates of the tax that they owe right. In fact, for sample as a whole the prior year tax charges (excluding those related to deferred tax) in each year were as follows:

Prior year tax charge	2002	2003	2004	2005	2006	Total
	£ mil	£ mil	£ mil	£ mil	£ mil	£ mil
First Group PLC	-1	0	0	-1	-12	-14
Go-Ahead Group PLC	0	-2	-1	-2	-2	-6
Stagecoach Group PLC	-2	-4	-27	0	3	-29
Arriva PLC	-4	-5	-10	-9	0	-29
National Express Group PLC	0	-6	-2	-12	-9	-29
Virgin Rail Group Holdings Limited	-2	2	-5	0	-2	-7
Porterbrook Leasing Company Limited	0	-3	13	-4	-2	4
HSBC Rail (UK) Limited	-1	0	2	0	0	1
Angel Trains Limited	-8	-9	2	-3	0	-18
Total	-17	-26	-29	-30	-24	-127
Average	-2	-3	-3	-3	-3	

As a percentage of the current year tax charge these sums represent the following amounts:

PYA as % of Current Tax	2002	2003	2004	2005	2006	Average
First Group PLC	-5.1%	-1.5%	0.9%	-2.6%		-1.6%
Go-Ahead Group PLC	-1.7%	-9.9%	-1.8%	-11.5%	-11.2%	-7.2%
Stagecoach Group PLC	-8.2%	-13.3%		0.9%	14.4%	-1.2%
Arriva PLC	-16.4%	-22.7%	-47.7%	-93.5%	0.0%	-36.1%
National Express Group PLC	0.0%	-33.7%	-10.9%		-64.5%	-21.8%
Virgin Rail Group Holdings Limited	-22.3%	14.8%	-44.7%	-4.3%		-11.3%
Porterbrook Leasing Company Limited	0.0%	16.4%		9.6%	-13.1%	2.6%
HSBC Rail (UK) Limited	-4.2%	16.7%	-29.3%	1.5%	0.0%	-3.1%
Angel Trains Limited	68.2%	49.2%	-30.6%	0.0%	-6.1%	16.1%
Total	10.3%	15.9%	-164.2%	-100.0%	-80.4%	-63.7%
Average	**1.1%**	**1.8%**	**-18.2%**	**-11.1%**	**-8.9%**	

Where rates exceeded 100% the figure has not been shown to prevent excessive distortion of averages.

What is clear though is that:

a. Some companies are much better than others at estimating their tax charges correctly. This might be seen as a measure of quality of reported financial information;
b. There is a persistent trend for companies to restate their tax liabilities downwards. There are a number of explanations for this. One might be caution. Another might be their attitude to risk. A company that is confident of its tax charge because it has undertaken few, if any, contentious transactions will record the tax liability that it actually thinks owing. A company that has undertaken transactions which might be open to challenge by tax authorities will not claim the benefit of them until they have been submitted to the tax authorities and survived challenge. If this latter behaviour exists then it will give rise to a regular pattern of downward restatements of previously declared tax liabilities.

All calculations for tax due in this report should be considered in this context. It is likely that on average that the liability has been overstated in the year reported and will be reduced in subsequent years.

5. Tax not paid

Even when a company declares its current tax bill, as adjusted for prior year items, this still does not mean that the tax is actually paid. This can be tested in assessing the sample companies' accounts. The test undertaken is to take the opening

declared tax liability owing, add to it the declared tax due for the year as adjusted for prior year items, take off that the tax paid in cash for the year as reported in the cash flow statement and then compare the resulting figure with the declared closing liability for tax. The figures should logically be the same. In many cases they are not, as this table shows:

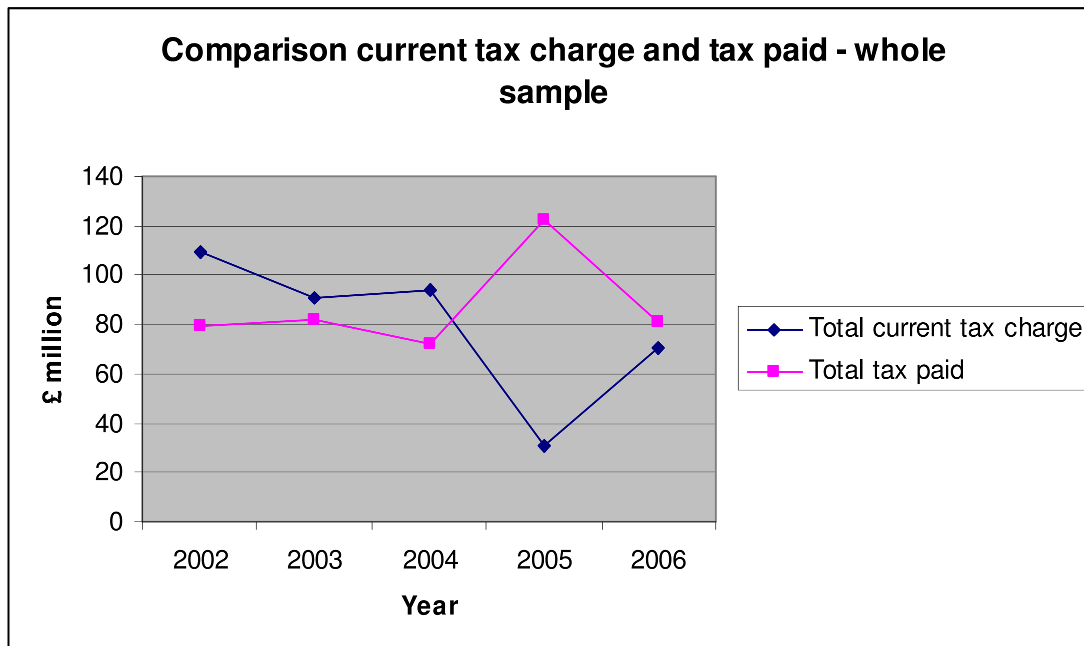
Tax not paid	2002	2003	2004	2005	2006	Total
First Group PLC	0	0	0	0	-2	-2
Go-Ahead Group PLC	9	-9	0	-1	4	3
Stagecoach Group PLC	-2	-3	9	6	0	11
Arriva PLC	3	-4	-3	-2	5	-2
National Express Group PLC	5	1	-1	6	3	15
Virgin Rail Group Holdings Limited	1	2	1	1	0	5
Porterbrook Leasing Company Limited	-7	-11	-7	-37	17	-45
HSBC Rail (UK) Limited	7	16	-6	-27	-32	-43
Angel Trains Limited	0	0	0	0	0	0
Total	16	-8	-8	-54	-4	-57
Average	2	-1	-1	-6	0	

For the six rail operating companies the adjustments are almost certainly technical accounting adjustments made for a wide variety of reasons and which do not pass through the profit and loss account.

Most of the differences arise on two of the rail leasing companies, Porterbrook and HSBC. These companies did not in fact pay any tax at all during the five year period. This is because they would have 'sold' their tax positions (which it should be noted amount to refunds owing) to other members of their financial groups (Abbey National and then Banco Sanatander in the first case and HSBC in the second). These companies would then reduce the tax payments they made to HM Revenue & Customs as a result using what is known as 'Group Relief'. Angel Trains did not use this mechanism. It did instead receive tax refunds throughout the period.

It is however appropriate to note that if they stood in their own right rather than as members of the groups of which they are members the tax paid and refunds received by these companies would have been quite different and as such the tax payments made and the tax liabilities reported in the accounts of the companies are different over the period.

In addition, it should not be supposed that payments are made in the years in which tax bills are declared. Tax payments made when compared to tax liabilities declared look as follows:



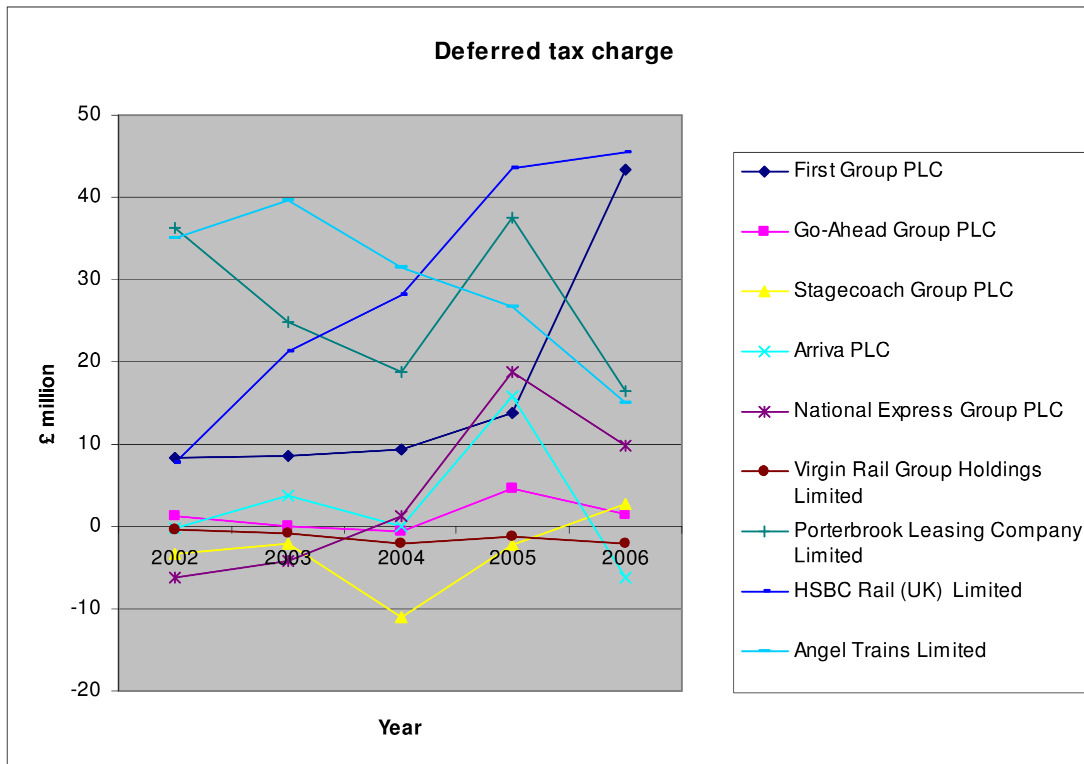
No obvious explanation can be given for the high tax paid in 2005 in proportion to tax apparently due by a number of companies in the sample. There was no obvious technical reason for this to occur.

6. Deferred tax

Deferred tax is an accountant's nightmare, and almost incomprehensible to anyone not trained in the dark art of calculating this number which features in all the accounts in the sample selected for this review.

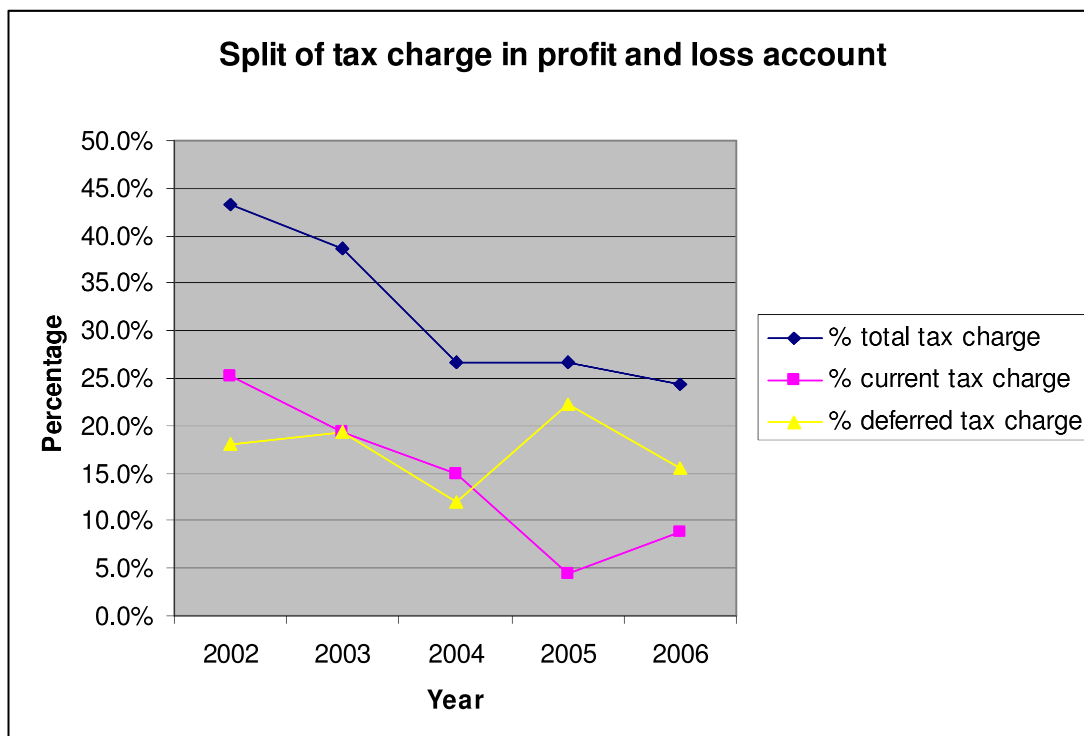
Deferred tax might be defined as tax that might be payable at some time in the future as a consequence of transactions that have already occurred, but with there being no certainty as to when, if, or ever that tax might be paid.

Before getting to grips with this it is important to note how significant this is. The deferred tax charges included in the profit and loss accounts of each of the companies in the sample during the review period were as follows:



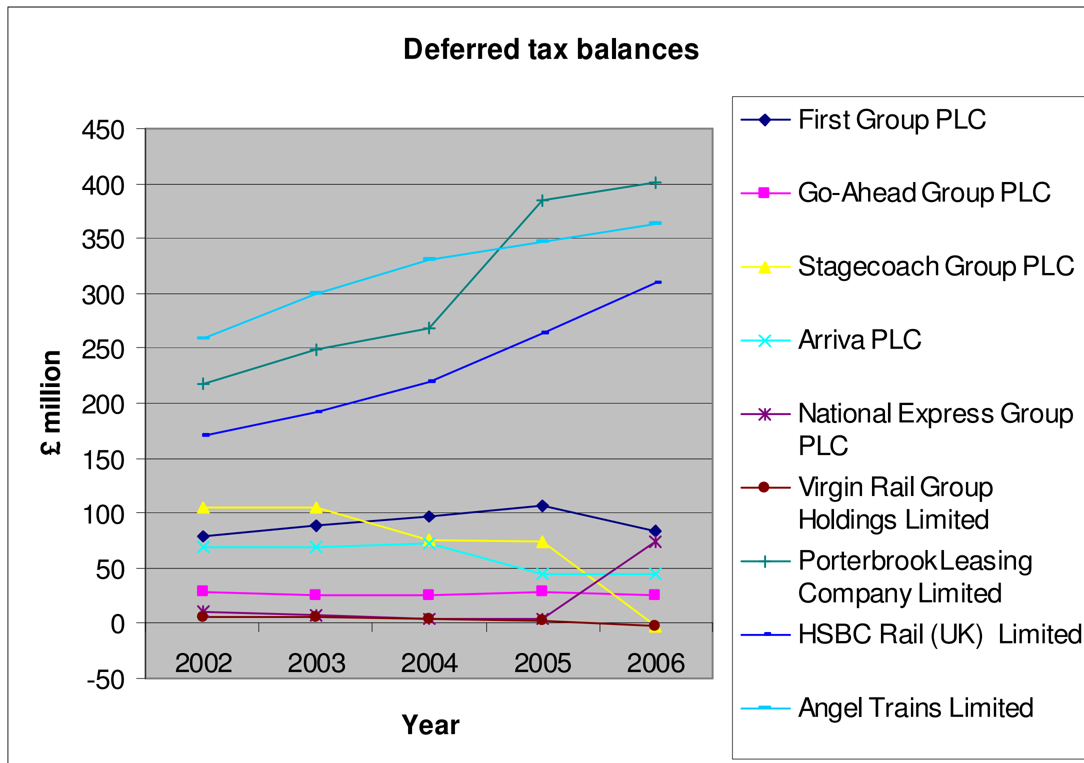
These are significant amounts.

To again put them in context, the tax charge as shown on the profit and loss accounts were split, in total for the whole sample as follows:

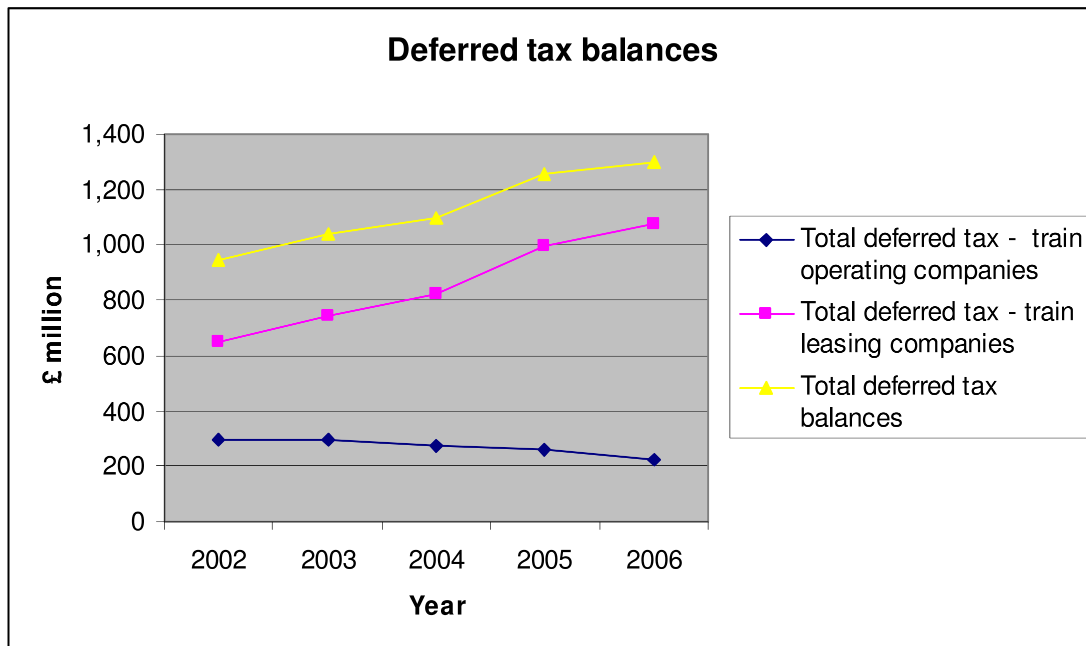


The importance of deferred tax in tax charges is apparent. In 2005 and 2006 it was a much larger part of the tax charge than that part which was ever likely to be paid in cash in the foreseeable future.

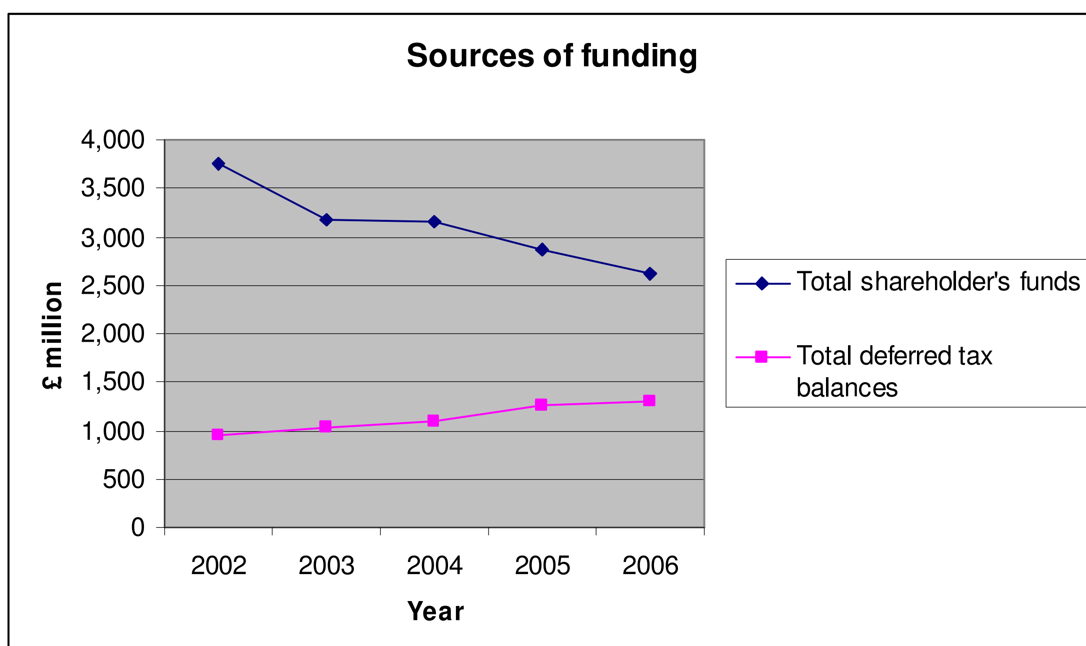
The total potential deferred tax liabilities are also substantial. By company they are as follows:



As this makes clear, it is the rail leasing companies that dominate this issue. This is apparent from this summary, in total and by sector:



In total £1.3 billion in deferred tax balances were owing by the nine rail companies in this sample survey in 2006. In effect this sum is an interest free loan supplied to these companies without any date set for repayment by the government. These loans are significant. When compared with the funds provided by the shareholders in these companies deferred tax balances are substantial:



Assuming, quite reasonably that shareholder's funds and deferred tax together fund the businesses the proportions from each over the five years are as follows:

	2002	2003	2004	2005	2006
% of funding provided by shareholders	79.8%	75.3%	74.2%	69.5%	66.9%
% of funding provided by deferred tax	20.2%	24.7%	25.8%	30.5%	33.1%
	100.0%	100.0%	100.0%	100.0%	100.0%

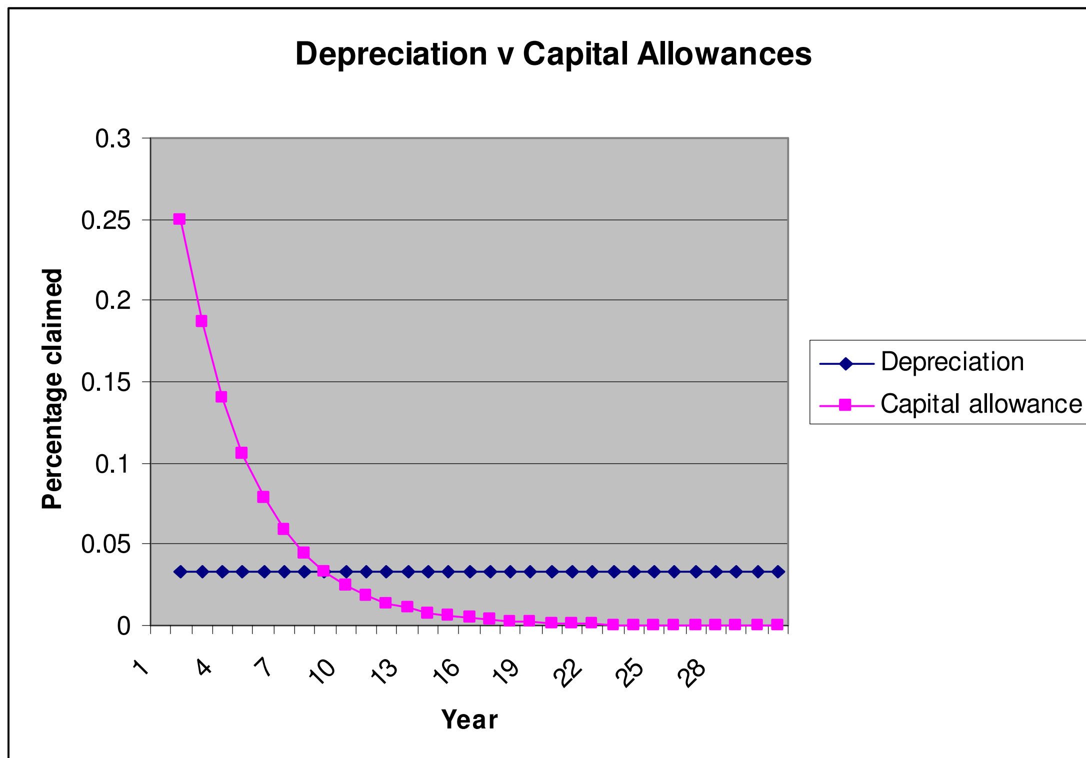
In 2002 just 20% of funding came from deferred tax. In 2006 one pound in every three used to fund the private sector rail operators was, in effect, lent to them tax free by the government. This amounted to a total hidden subsidy of £1.3 billion which was rising at an average annual rate over the five year period of £70 million a year.

Why does this happen? In the case of the rail industry only one explanation need be given. The capital allowances that the government gives to the rail companies are substantially more generous than the depreciation charges the companies include in their accounts for the assets they own. For example, Porterbrook Leasing's 2006 accounts say that its depreciation policy is as follows:

Classes of assets are depreciated on a straight-line basis over their useful life as follows

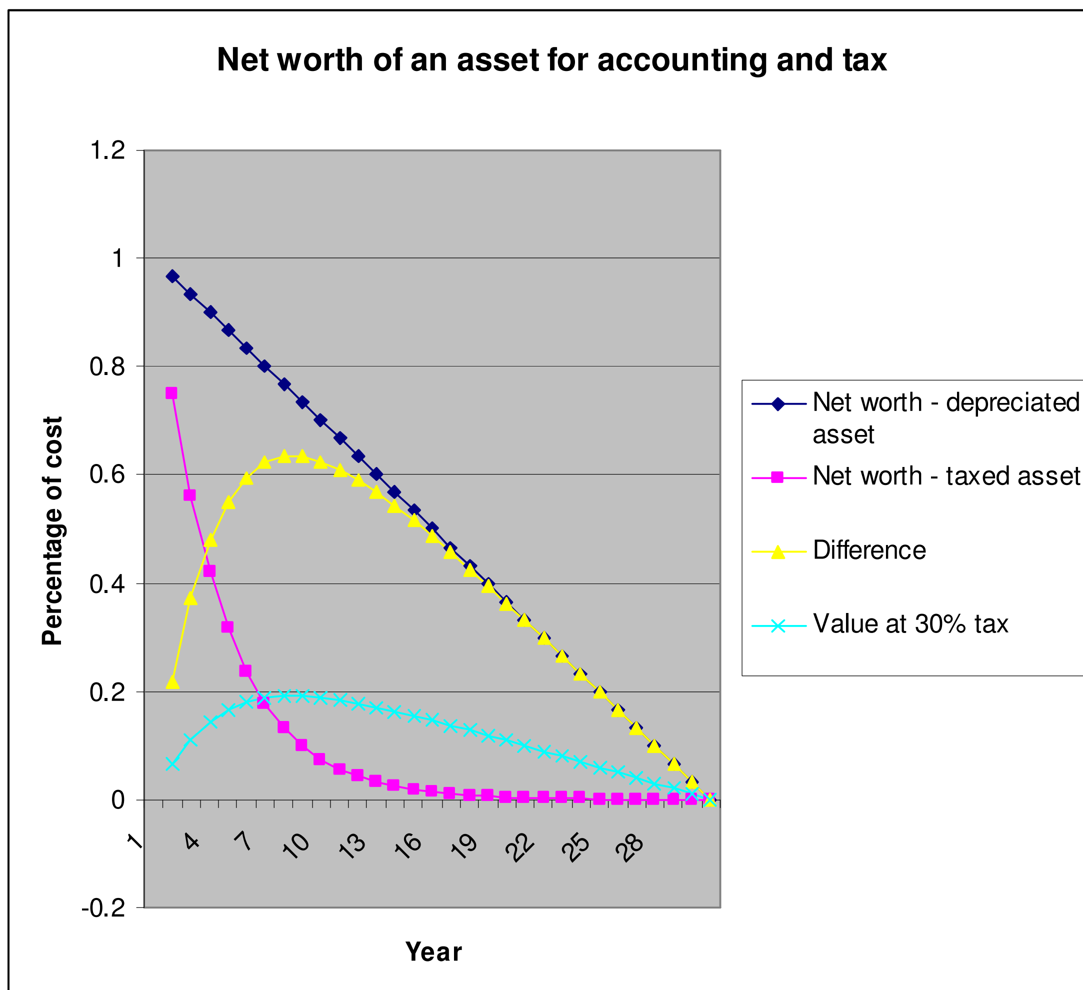
Rolling stock	20 to 35 years
Other fixed assets	2 to 10 years

This means that on average the accounting charge on rolling stock assets (which dominate all Porterbrook's activities) are a little over 3.6% per cent of their cost each year, on average. But for tax the relief is quite different. The allowance is 25% of their cost in the year they are acquired and 25% of the residual balance in the second year, and so on. The difference is stark in terms of the deductions claimed each year:



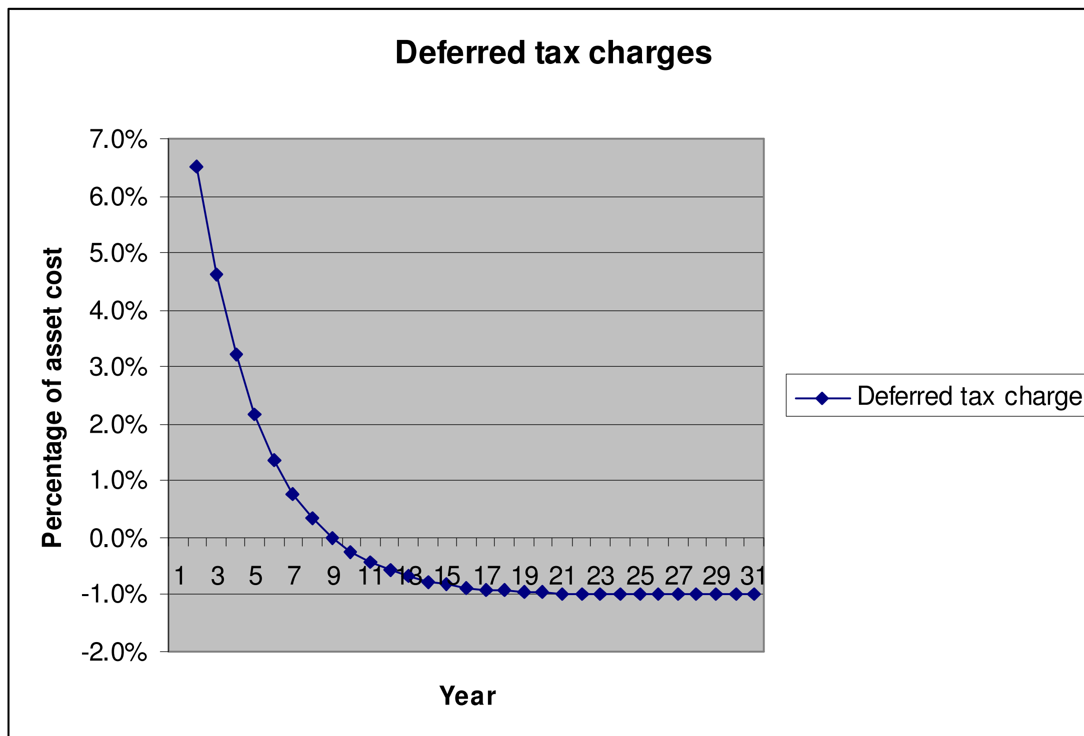
The depreciation is the same every year. That is not true of the capital allowance, which is high at the outset, falls below the rate of depreciation by year 9 and becomes negligible from about year 20.

This has a significant impact on the value of the asset for the different purposes of tax and accounting:



The value for accounting falls away in a straight line. For tax it tumbles down and becomes negligible from year 20. The difference is marked. But, most important, this has a tax consequence. 30% of the difference between the values is saved in tax. From years 1 to 9 the tax relief on the asset is more than the depreciation charged. From year 10 on it is less.

So what? Well, accountancy requires that costs and their benefits be matched in a set of accounts. This is called the 'accruals' concept. What this means is that in the accounts of a company relief can only be recognised for tax for the expense claimed in the year in the accounts. So, tax relief for accounting purposes is claimed on the depreciation even though in reality tax relief will actually be claimed under the much more generous tax rules. The conundrum of how to account for the difference between the two has to be solved, and the result is the mysterious art of deferred tax accounting. The deferred tax charge is 30% of the difference between the accounting and tax charges each year (30% being the expected UK tax rate for the period considered – although as the rate is now falling to 28% this will be used in future). These charges have this pattern:



Note that whilst tax relief exceeds depreciation there is a charge and when the situation is reversed deferred tax becomes an income stream for the company. However, these charges are not actually due to anyone. So they are simply put on the balance sheet of the company as a 'provision' against a possible cost. This is the deferred tax balance noted above. And so long as the company keeps buying new rolling stock the position where the overall level of deferred tax reverses does not arise and the balance keeps on rising. This is possible because the assets are considered as whole for this purpose, not individually.

The result is that the more a company spends the more tax subsidy it gets from the government. And the more fictitious its tax charge becomes because the bigger the component of that charge that will be made up of deferred tax. This is obvious from the graphs noted above.

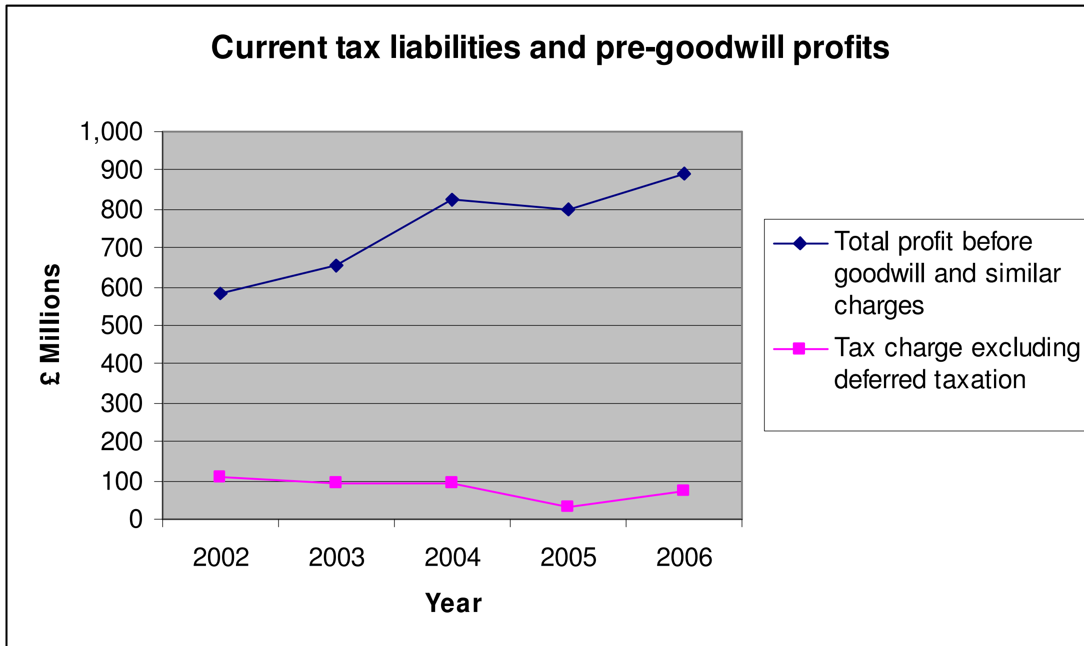
The result is that because there is no seeming prospect that this tax will be paid at any time in the future. As such it can be ignored in all the calculations of the real tax paid by these companies. Tax that will not be paid is not a tax at all. It is a figment of an accountant's imagination invented to make sure that it looks like companies are paying tax when in fact they're receiving interest free loans from the government instead.

A revised view

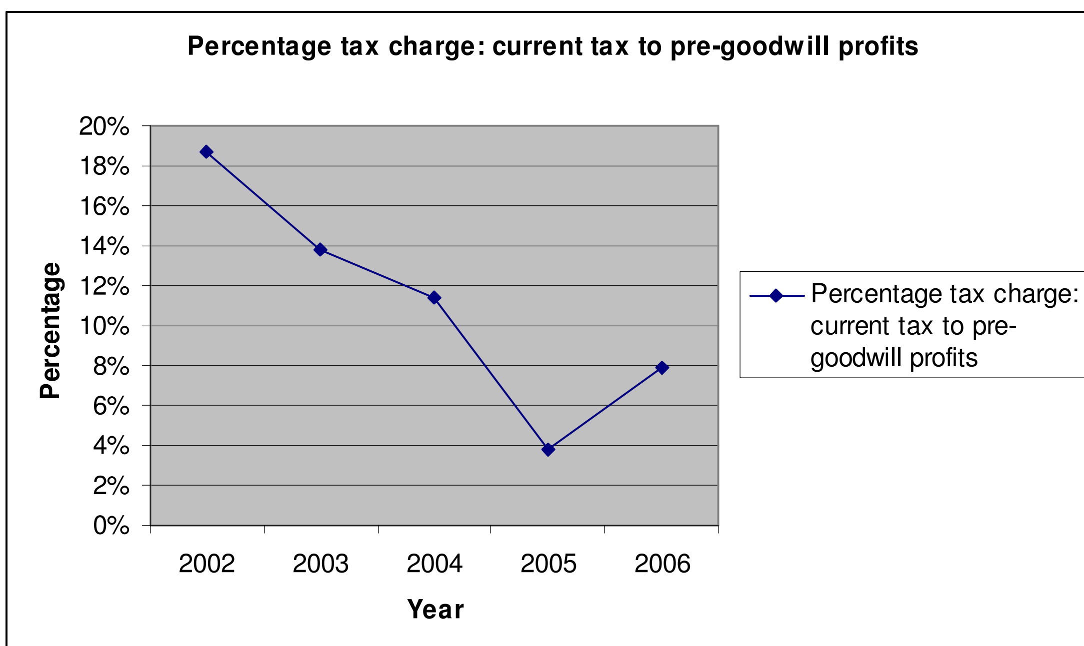
Taking these factors into account it is clear that:

1. the figure for profit to be used in this analysis is that before goodwill charges;
2. The figure for tax is that excluding deferred tax charges, which are unlikely to ever be paid if current trends continue.

When this is done the following graph results for the sample as a whole:



The effective percentage tax rates for the sample as whole:



Throughout this period the tax rate for UK companies of the type being considered here was 30%. The following calculation shows the effective tax not paid as a result:

Calculation of tax not paid	2002	2003	2004	2005	2006	Total	Average
Total profit before goodwill and similar charges	584	654	822	799	894	**3,753**	**751**
Tax charge excluding deferred taxation	109	91	94	30	71	**395**	**79**
Percentage tax charge: current tax to pre-goodwill profits	18.7%	13.8%	11.4%	3.8%	7.9%		**11.1%**
Corporation tax rate for the year	30.0%	30.0%	30.0%	30.0%	30.0%		**30.0%**
% tax lost	11.3%	16.2%	18.6%	26.2%	22.1%		**18.9%**
% tax lost as a part of total profit pre goodwill	66	106	153	209	198	**731**	**146**

A total of £731 million of tax was not paid by these companies as a result of their reducing their effective tax rates below those suggested to be due at headline declared UK rates in this period.

Of this sum £528 million was accounted for by deferred tax, as follows:

Deferred tax charge	2002	2003	2004	2005	2006	Total	Average
Total	78	91	75	157	126	528	106

The balance is more difficult to analyse. Whilst companies are required to reconcile their tax charges in their accounts with the theoretical tax due at 30% the way in which this was done changed with the introduction of International Financial Reporting Standards, and none do so consistently one with another. However, a review suggests the other reasons why tax has not been paid at the expected rates to be (in approximate order of importance):

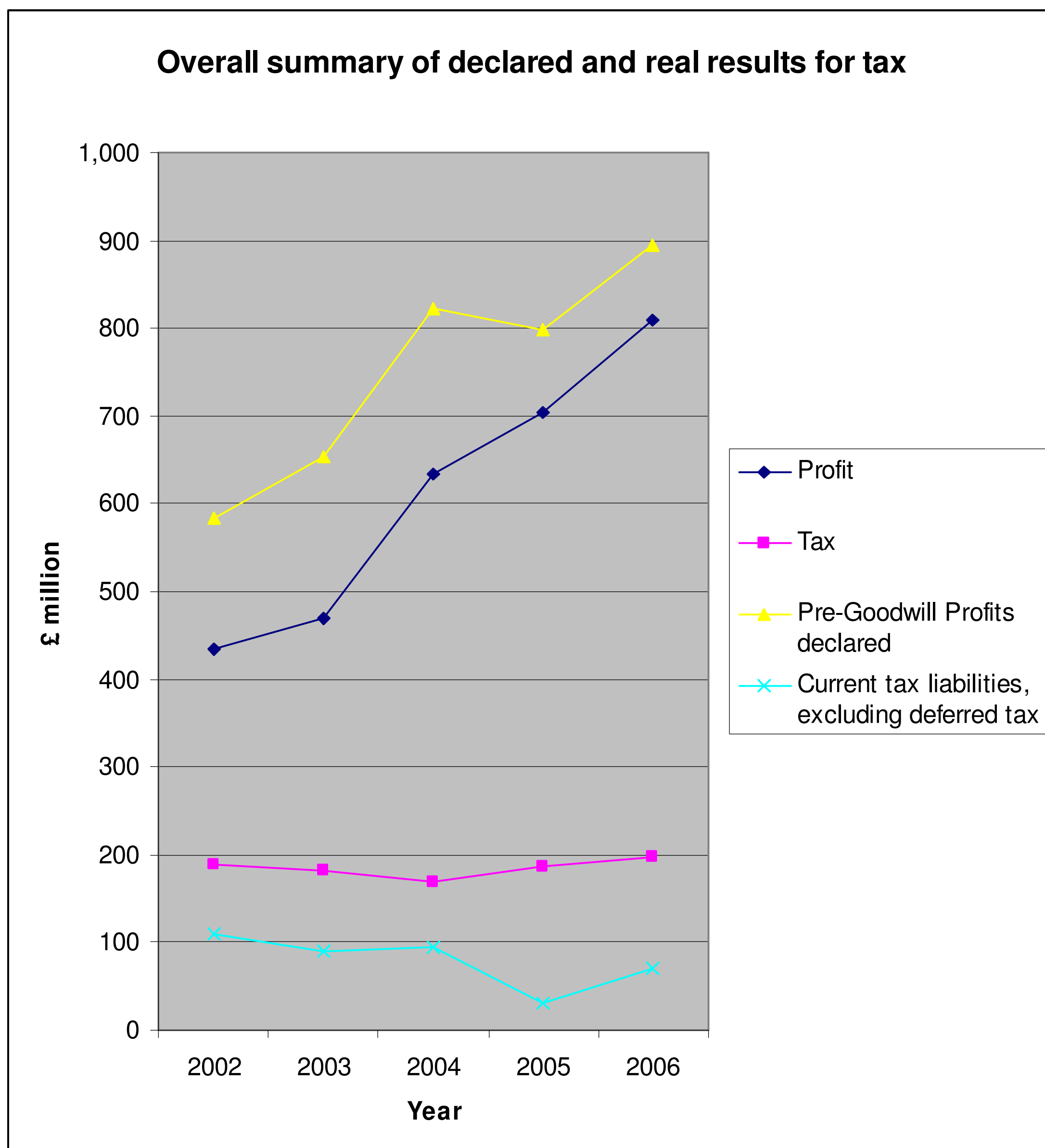
1. Tax not paid because of reduction in prior year declared liabilities;
2. ‘Other reasons’, not specified;
3. Income not taxable (e.g. gains that avoid liability);
4. The use of tax losses.

It should be noted that almost £100 million of costs were disallowed for tax, so increasing the tax liability that should have been expected to offset these deductions. The amount in question was, however, less than total prior year adjustments representing the overstatement of previous claims.

It should also be noted that those companies that have overseas operations claim, overall, that this increases their tax liability. There is no way of knowing if this is true as no company is required to disclose this information and as such some who might have benefited from overseas tax rates may have included this benefit in the 'other' category for which analysis is not offered.

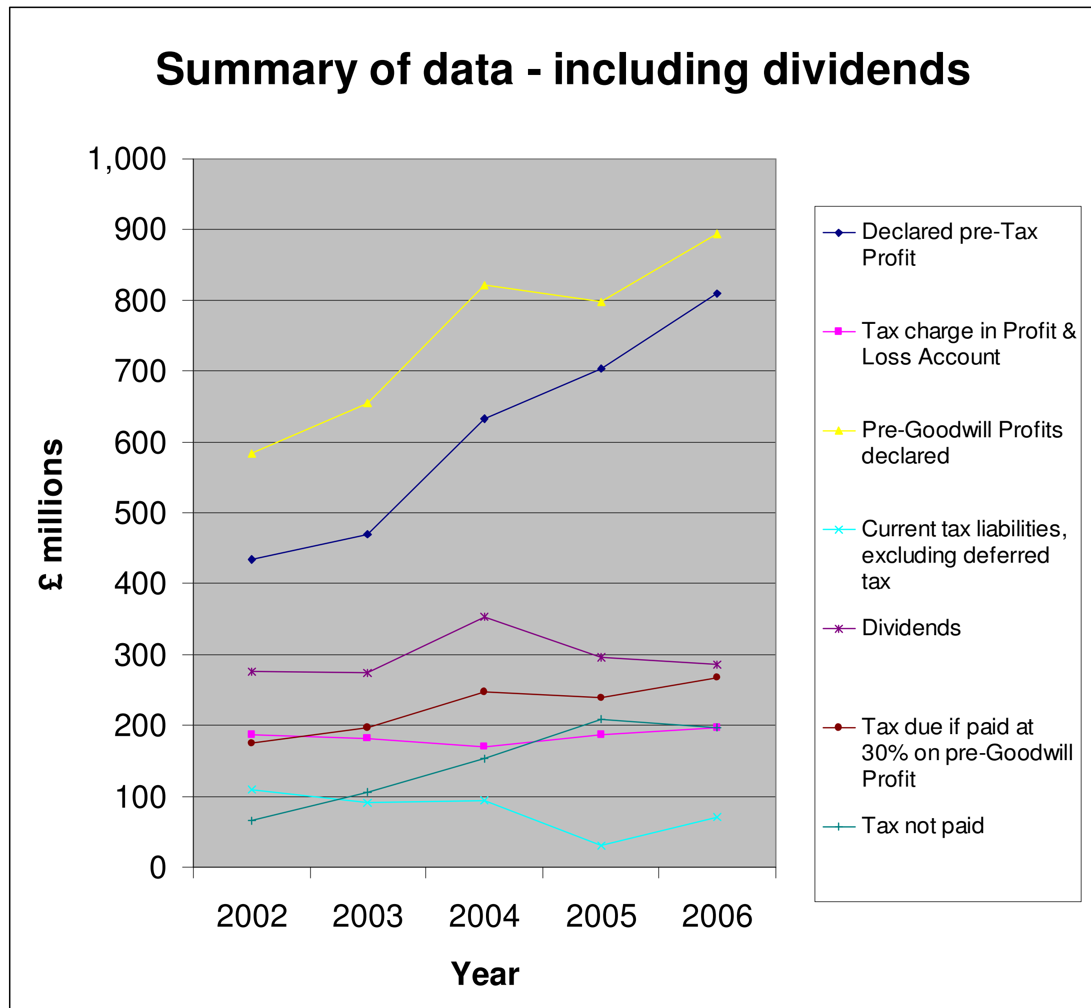
What this does however suggest is that the already low level of liabilities reported in this survey may be overstated: these companies expect to reduce these as a result of subsequent agreements with HM Revenue & Customs.

What this means is the following overall view replaces that offered earlier in this report, and is even more worrying than the picture presented there:



When goodwill is taken out of account the profits of railway companies are rising, dramatically. The return they are paying to society is falling substantially.

So who benefits? Three more lines have to be added to the graph to explain that:



First of all, it is clear dividends must be heavily subsidised by the tax not paid by the companies. Dividends, tax due at 30% and the difference between this sum and the tax actually declared are now all shown on this graph. And as is clear, by 2006 over two thirds of dividends paid by the nine companies in the survey were effectively funded by tax not paid on likely taxable profits of the companies in question.

The consequence is obvious: shareholders in the privatised rail industry are being subsidised by the state through the generous tax reliefs and allowance provided to rail companies that effectively mean they paid tax at little more than 11% on average over a five year period on their likely taxable profits.

As a result of this generosity the government has not collected tax of £1.3 billion from the rail companies in this survey. Nor is it ever likely to collect this tax if

current trends continue. This means that the government now provides at least one third of the finance required by privatised rail companies to keep their companies afloat and is getting none of the benefits of ownership from doing so: it is not even being paid interest on the sums it is effectively lending to these companies on what are, in effect, loans without any set repayment date.

The conclusion is clear. The privatised railway operators are good at making profit from government subsidy, including those provided by the tax system. Whether that is an appropriate focus for those entrusted with running a railway is another question.

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[i] Richard Murphy is a chartered accountant and graduate economist. He trained with KPMG in London before setting up his own firm in 1985 in London. He and his partners sold the firm in 2000 when it had 800 clients. He is a serial entrepreneur, having directed more than 10 SMEs.

Since 2000 Richard has increasingly been involved in taxation policy, both as an adviser and campaigner. He is director Tax Research LLP and advises the Tax Justice Network, the Publish What You Pay campaign and many NGOs on tax and development.

He is a member of the ACCA's Research Committee and is a research fellow at the Centre for Global Political Economy at the University of Sussex and at the Tax Research Institute at the University of Nottingham.

A regular radio and TV commentator on tax and corporate accountability, he has also addressed UN, EU, HMRC and international diplomatic meetings on these issues. He writes a daily blog at www.taxresearch.org.uk/blog