

Funding the Future

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As many will know poet Steve Pottinger has a history of taking on coffee shops who don't pay their tax. He [began with Starbucks](#) and [recently took on Caffè Nero](#).

Having tackled Caffè Nero Steve spoke to me, curious really as to how it did not pay tax when it appeared to be making about £20 million a year in profits. He got my curiosity, [because no one likes an angry poet](#), and as a result I have written an explanation as to how this comes about (featuring a lot of extracts from various of its accounts). [You can see that summary here](#), but the summary from that report is as follows:

Having taken this tour of the Caffè Nero Group a number of conclusions can be drawn:

- * The Caffè Nero operation is successful and profitable, generating an operating profit of about £21 million before tax in 2013.*
- * This operating profit is entirely cancelled at group level by over £40 million of interest liabilities, at least £13 million of which was due to group companies located in either Luxembourg or the Isle of Man in 2013.*
- * The debt burdens of the group were imposed upon it at the time that it acquired Caffè Nero: they were not incurred as a result of trading; they were incurred in the course of purchasing that trade, which is a distinct and separate activity.*
- * The debt burdens arising as a consequence of the purchase of the trade have left the group as a whole in a perilous position: the company acknowledges its marginal solvency and that it can only continue to trade by deferring settlement of its obligations to its parent companies, the top two of which are in the tax havens of Luxembourg and the Isle of Man.*
- * Accounts for the Luxembourg and Isle of Man companies do not appear to be readily available for inspection.*
- * As a result of the tax relief available on the interest payment, even though they were not incurred in the course of the trade of the company, any tax owing on the profits arising from sale of coffee in Caffè Nero stores is entirely cancelled and no corporation tax is being paid by the company and none is likely to be paid for many years to come.*

It is stressed with regard to the tax aspects of this matter choice is in operation. The structuring is deliberate, and is intended to route interest payments out of the UK via Luxembourg to the Isle of Man tax haven in the process stripping profits that would otherwise be liable to UK tax and leaving nothing due in this country. The structure

used is, no doubt, entirely legal and has met with tax authority approval. But that does not mean it is ethical. The intention has been to use an effective tax subsidy secured by cancelling UK tax liabilities with interest charges on sums owing to offshore companies to help finance the cost of acquiring the group. That is the issue subject to ethical challenge here.

Three issues arise as a consequence.

Firstly, the U.K.'s policy of allowing tax relief on interest paid to acquire a trade must be open to question in the future: time after time companies appear to be in trouble because they are laden with debt that their owners have used to acquire them when that liability has nothing to do with the trade that the acquired company actually undertakes. A change in tax law to deny relief on interest incurred to acquire a trade seems long overdue.

Secondly, the use of a Luxembourg company within the structure noted here is not coincidental: under EU agreements tax may not be withheld on interest payments from one member state to another, even if the recipient state then allows the onward transmission of that interest to a tax haven without the tax that might have been deducted in the first state having been charged. This is, therefore, an exercise in tax avoidance. The time for the EU to reconsider the desirability of such arrangements is long overdue.

Lastly, UK company law needs reconsideration with regard to the ability of shareholders to load the debt that they incurred to acquire their interest in a company onto its balance sheet to secure a tax advantage. This debt loading creates financial instability that is potentially harmful to trade in the UK, the stability of employment in UK companies, and the tax revenue stream for the UK Exchequer, all of which are undesirable. Policy in this area is in need of reconsideration.

It's time politicians realise people have had enough of this sort of abuse, whether it's legal or not. Progress towards reform is long overdue, but seems distant. Until it happens this issue is unlikely to go away.