

Facebook UK's accounts: a case study in the tax data we...

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A year ago there was uproar when Facebook said it had paid just £4,327 in tax in the UK in 2014. I offered [analysis in this blog](#) and in [The Guardian](#). Now Facebook has [published its 2015 UK accounts](#). It's [2015 global accounts](#) are already available. I thought it worth having a look at what we know as a result, and to use the exercise the considerable amount we do not know but which I think should be made available to us.

First though, an overview of the result just to get a feel for what we are looking at:

Facebook has apparently said in a press release that the significant increase in its turnover in the year is because it is doing much more business in the UK. Actually, we have no idea of that is true or not. That is because note 4 to the accounts says:

To put it another way, Facebook refuses to say if it is doing more business in the UK or not. All we do know is it is incurring more costs in the UK and is recharging more of these to other Facebook companies. This recharging implies Facebook has near enough doubled the apparent level of UK costs in a year.

The US accounts are no more helpful in providing any information on where the company really makes its sales. The company would disclose this information under what is called segment data. The segment data a company has to publish is that which the key decision makes in the company use to determine the success or otherwise of the company in the various markets in which it operates. On this issue Facebook Inc says in its 2015 filing:

What Facebook would have you believe as a result is that its geographical market data is so sensitive that it would severely prejudice its interests if anyone was to know it, and they're so sure of this that they don't even report it to the CEO who can manage the business without it as a result. The dichotomy between the two claims is, I think, apparent.

The problem is compounded by the fact that we do not know who Facebook UK does actually make sales to. The only reported facts with regard to its relationship with the rest of Facebook come in this note to the UK accounts:

How the ownership is actually exercised, and whether there are other intermediate owners between Facebook Global Holding II, LLC and Facebook, Inc is simply not known. Nor do we have any clue, at all, as to where the companies to which sales are made are located.

In fact, what we are left with is a set of accounts which do not represent anything more than a statement of costs incurred by Facebook in the UK to which some taxable profit has been added (see below).

This then suggests a first series of recommendations on changes required to UK accounting law if it is to come in any way close to providing the information we need on the accounting of a company like this:

Recommendation 1: Ownership data

Any company that is owned or controlled by another legal entity must disclose a) who the ultimate beneficial owner is b) how they exercise their control and c) the identity of any intermediate ownership that might exist. In each case if there are material other parties with an ownership interest (material being defined as owning 10% or more of the equity of any of the companies involved in the ownership structure) then the identity of those other parties should also be published.

Recommendation 2: Sales data: intra-group and other sales

The turnover of a company should always be reported so that the part that is made to related group entities and the part made to independent third parties should be separately identifiable. The identity and location of related group entities to whom sales are made should be disclosed without exception, stating the value of the sale made to them.

Recommendation 3: Sales data: geographical analysis

The geographic analysis of the sales of any company is always material data of use to its management and as such of significance to those supplying it with capital (in any form) as well as to other stakeholders of the company and as such must always be disclosed, without exception being made, in the annual audited financial statements. The analysis should be split between intra-group and third party sales. This is, of course, the corollary of country-by-country reporting in a single set of company accounts.

Recommendation 4: Material contracts

If the results of the company are impacted by material contracts whose performance is of significance to an understanding of its financial results for a period then the nature of the contract in question, the basis on which a charge is made, the annual value of the sales in question and the identity of the other party must be disclosed.

Without this information it's important to note that any analysis of Facebook UK's accounts is very hard: we have no idea who it is selling to, or why, or what for, or what the basis of charging is and whether this is sustainable or not. Almost everything of relevance about the actual environment in which it is operating is therefore unknown to us and the accounts, which are intended to protect the creditors of the company, cannot do so as a result.

Moving on there is much we also do not know about the company's tax bill.

First, it's important to note that the company has reported a loss and has reported that it will enjoy a tax credit of over £11 million as a result, at an effective apparent tax rate of 21.5%. This is deeply misleading. Two things suggest this. The first is note three to the accounts:

As is apparent from the accounts, it seems likely that a substantial part of the £71 million of share based payments to staff are not tax allowable against the income of the UK company in 2015. What this actually means then is that the company has not got a tax loss in the year, but a taxable profit instead. This adjustment alone would suggest that is £71 million is added back to the loss of £52 million a taxable profit of around £19 million would arise.

Note 9 explains the tax what might be due on this:

The suggestion is that almost £4.2 million is payable. As the rest of the note makes clear, the effective tax rate in the year is 20.25% :

Applying this rate to the tax due (£4,168,609) suggests taxable profit was £20,585,723. This is £73,077,686 different from the declared accounting loss: you can see why I think the £71,039,159 of shared based payments may be significant.

But let's be clear, the notes to the accounts do their utmost to hide what is really going on.

They do not reconcile accounting and taxable profits.

The terminology used in the tax reconciliation is an exercise in maximum opacity: so, there is no explanation of what costs are not allowable for tax, or why.

£24,682,649 of deferred tax has appeared from out of the blue without any explanation as to why, and yet some pretty significant decisions must have been made to ensure this figure could be included in the accounts.

But it was thought worth explaining a £1 million movement arising from changes in tax rates, as if to prove how bizarre the omission of data on the other movements might be.

And as if that opacity was insufficient more than £9 million of the total deferred tax movement went through the statement of changes in equity:

So we have £9,639,671 of deferred tax movement here and £16,507,004 in note 9 relating to profit and loss movements, which together come to £26,146,675 but the total deferred tax movement as per the tax reconciliation is £24,682,649 and as per the deferred tax note is £25,130,343. The latter figure does not appear elsewhere in the accounts, but is £26,146,675 less the tax movement relating to changes in tax rates of £1,016,332 (but nowhere is that stated explicitly for the uninitiated). Where £24,682,649 comes from remains something of a mystery I cannot as yet solve: the deferred tax note puts it at a lower figure and changes in tax rates can't be used twice.

To put it another way, the tax notes to these accounts are another massive exercise in opacity.

One way of understanding that is to note that the taxable profit of the company just happens to be very close to 10% of the turnover. We are aware that HMRC now agree fixed 'cost-plus' ratios for some companies supplying agency services. Might that be the case here? Is the similarity between a neat round sum and taxable profit just chance? Who knows? We aren't told, but I think we should be if that is the case, as I suspect.

As if to demonstrate this point on opacity further, take another issue, drawn from the notes on debtors and creditors in the accounts:

Note the corporation tax debtor in 2014. Then note the corporation tax creditor in 2015. Add them together and you get the current year tax bill in 2015. But what this says is that the year end debtor from 2014 has not been repaid by HMRC. Now there must be good reason for that, but no hint of it is given. Why? The accounts are riddled with this missing data. What this might imply is that Facebook and HMRC are in dispute. If so it is not said, but I think it should be if that is the case.

I would also add two things. First this means Facebook paid no tax in the year: last year's £4,237 liability was not settled. And second, but for the fact that this structure was so simple we could not have worked this out because there is no cash flow statement, which is a massive deficit in any set of accounts because it leaves tax paid unstated.

There is a final point on the deferred tax. £25 million is stated to be recoverable but no indication at all is given as to when this might turn into a tax saving. The quality of this significant asset cannot be appraised as a result, leaving considerable doubt about the accounts as a whole as a result.

This then suggests a further series of recommendations:

Recommendation 5: Reconciliation of taxable profits

The accounting and taxable profits of a company for a year must be reconciled with all reconciling items sufficiently described so that their cause can be properly understood. Generic terms must be avoided.

Recommendation 6: Tax reconciliations

Tax reconciliations must first explain current tax liabilities and then deferred tax liabilities: mixing the two together results in incomprehensible data being presented.

Recommendation 7: Material tax agreements

If there are material agreements relating to the tax that the company owes they should be disclosed.

Recommendation 8: Tax disputes

If there are tax disputes in progress they should be disclosed.

Recommendation 9. Cash flow: statement of tax paid

All accounts, irrespective of size, must state the amount of tax paid by a company in a year.

Recommendation 10: Overall tax presentation

A company must show that its opening tax liability, plus its tax charge for the year, less its tax paid in the year equals its closing tax liability or explain the difference.

Recommendation 11: Deferred tax

All deferred tax movements must be explained in plain language. The timing of assets and liabilities having cash consequences must be estimated and stated, with assumptions being provided.

So where does this leave us?

In essence what the Facebook UK accounts provide are a limited view of that organisations costs in the UK, but tell very little at all about its revenues.

The statements it makes on why it will not disclose its revenues are dichotomous, at best.

The information on the trading of this company and the real risks within it are scant.

Worse, given that tax is known to be the focus of concern for this company we are left guessing as to many issues relating to its tax because of a lack of disclosure.

And on all this the auditors had nothing to say.

Whilst UK accounting standards, which are essentially set by the auditing profession for the convenience of its clients, permit all this to happen.

The result is that we have a conspiracy of opacity when the virtue of transparency is required.

If the profession will not act to reform this then a government committed to tackling tax abuse should.

I look forward to their statement on the issue.