Starbucks Tax Avoidance

The Starbucks with no bucks

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News that Starbucks (and other large multi-nationals) has been paying an "unfair" amount of UK tax has hit the headlines in the last few weeks. MPs have argued that paying just £8.6m tax on revenues of £3.1bn over thirteen years isn't 'right' or 'fair'. The suggestion is, of course, that Starbucks et al have engaged in tax avoidance to the detriment of the hardworking British taxpayer.

Tax avoidance is a minefield that is often mis-reported. The UK tax code allows a business a raft of tax deductions in calculating its taxable profit. It might seem obvious, but where there isn't any profit, there won't be any tax. Starbucks reported a loss of almost £33 million in the year to 2 October 2011 and consequently has not paid any UK corporation tax. But, is it tax avoidance that creates this tax loss? Before we draw any conclusions, it is necessary to look at Starbucks' financial statements as well as those of its UK competitors.

Costa reported pre-tax profits of £49mn with Café Nero reporting pre-tax profits of £17mn. Yet, this is not the whole picture. On a consolidated basis, Café Nero does not, in effect, pay UK corporation tax because its operating profits are relieved against parent company losses that arise as a result of internal and external group borrowings.

Starbucks is by far the bigger brand, both globally and in terms of UK market share, so how have they made a loss when coffee is apparently such a profitable business? Troy Alstead, CFO of Starbucks argues that difficult trading conditions and over-aggressive expansion policies are to blame. The latest financial statements appear to back that up. Property costs eat up 25% of UK turnover, compared with 9% in the US and 12% in Japan. What about staffing costs? Starbucks has almost the same staffing costs (in the region of £124mn) as Café Nero and Costa combined. This is no surprise since Starbucks employed 8,763 people - more than both of Café Nero and Costa combined. Another critical factor is administrative expenses. Both Starbucks and Café Nero have used group borrowings to support their UK expansion. What is interesting is that both parent companies have either recognised that the loans would not be repaid (Nero) or have converted that debt to equity (Starbucks). This supports the assertion that trading conditions are (and have been) difficult.

Starbucks is of course obliged to adhere to US tax and accounting formalities and it is this that will drive (to a certain extent) the tax profile and strategy adopted for the UK. By contrast, Costa and Café Nero are UK headquartered and will likely have adopted similar policies as regards their overseas interests.

This multi-national profile provides perhaps the biggest clue to Starbucks' low rate of UK corporation tax. Most multi-national businesses manage their global tax footprint by adopting specific transfer pricing policies in respect of intercompany financing, licensing, purchasing and so on. The cornerstone to the transfer pricing rules is the "arm's length principle" for the valuation, for tax purposes, of cross-border transactions between associated enterprises. The internationally recognised and accepted standard for transfer pricing and the methodologies to be used in specific situations is provided by the OECD. Unfortunately, politicians and the press do not seem to appreciate that the UK is an OECD Member and has signed up to the OECD Transfer Pricing Guidelines.

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But, while aggressive transfer pricing might result in "profit shifting", tax will generally be paid somewhere and to this end it is not surprising that Starbucks' global effective tax rate is 31.1%. Compare this to Costa's effective tax rate of 26.4% and the conclusion must be that Starbucks is not engaged in tax avoidance as reported. Those that call for Starbucks and their like to pay their "fair share" very rarely suggest how the tax and accounting rules might be changed to accommodate their requirements or for that matter explain what is "fair".

Indeed, the sole focus on corporation tax hides the true picture of a company's UK tax footprint. A statement issued by Starbucks on 16 October 2012 puts this into context. Over the past three years, Starbucks has paid £160mn in business rates, national insurance and VAT.

So, let's return to the question – is all this tax avoidance? The simple answer seems to be 'no' despite the soap-box parroting of several MPs. The current tax legislation allows a business to reflect the 'true' cost of its operations in its tax accounts. While a multi-national business may have additional scope to manage its tax footprint, this article highlights that on a global effective tax rate basis, all of these business pay close (if not more) than the statutory corporate rate. It's relevant that this figure does not account for other tax costs such as national insurance or VAT. Seen in this light, arguing that these businesses haven't paid their 'fair' share seems hard to support.

Milestone is a boutique international tax practice established in Mayfair, London. The team comprises young, dynamic lawyers who have specialised in international tax throughout their careers. They specialise in International Corporate Transactions, International Investment Funds, Structure Finance, International Real Estate and Private Clients.

Miles Dean is a founder of Milestone International Tax Partners, having started his career in international tax in 1994. He is the co-author of International Tax Systems and Planning Techniques (Sweet & Maxwell) and The Principles of International Tax Planning (Corpus), as well as numerous academic articles. Miles has a varied client base ranging from owner-managed businesses to international investment funds and real estate businesses. Miles has recently advised on a number of high-profile cross-border infrastructure and real estate transactions. Miles specialises in finding bespoke, commercially workable solutions that create significant tax benefits for individual and corporate clients.

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Sally Brown has recently joined Milestone. She is a newly-qualified solicitor in England and Wales and completed her training contract at a City law firm where she did seats in Corporate, Tax, Employment and Real Estate. Sally was awarded the Pump Court Tax Chambers Tax Prize for the highest grade in tax law at King's College London in 2008.