The PFI companies' windfall from falling Corporation Tax rates

Vivek Kotecha, Centre for Health and the Public Interest (CHPI)

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Appendix: Two important complications

Since the 'tax charge' as per the accounts is not the same as tax paid there are a couple of complications that need to be borne in mind. Firstly, there are differences between accounting profits and taxable profits (used in the tax return to calculate the tax due). These differences are often attributable to income or expenses that are not taken into account by HMRC when calculating the profit that can be taxed but are still part of the profit in the accounts. A review of 105 PFI company accounts has found, however, that these differences and other 'permanent differences' are relatively small.

The second major complication is when there are 'temporary differences' between the tax charge in the accounts and the time the tax in the tax return is due to be paid. This leads to deferred tax being recognised in the accounts which represents a tax payment/credit delayed into future years.

Table 3 shows the split of the 2015 'tax charge' in the accounts (excluding Other Comprehensive Income):

Table 3: Split of the accounting tax charge in 2015 for 106 PFI operators with health PFI schemes that reached financial close before 2008/09 - *£000s*

Current tax charge (tax due to be paid):	23,655
Deferred tax charge (tax paid/refunded in later periods):	3,287
Total tax charge:	26,942

Source: Review of PFI operators' accounts available at Companies House

The analysis in Table 1 overstates how much tax was paid for 2015 (by using the higher total tax charge figure of £26.9m), and therefore understates how much tax was saved due to falling tax rates. This difference is repeated across all financial years to varying degrees and in both directions, with slight understatements in earlier years and overstatements in later years. The variation between the tax charge in the accounts and the tax due in the tax return illustrates why a precise overall figure cannot be calculated based on public information.

Deferred tax and falling tax rates

Over the long term any deferred tax owed will eventually be paid and this matters here because as tax rates fall the associated tax liability falls too.

In 2015, thirty-two PFI operators had deferred tax liabilities, which means that they owe tax in the future for events that have happened already. Any reduction in tax rates reduces the amount of tax they eventually pay on these liabilities, resulting in a gain for them. Seventy-four, on the other hand, have deferred tax assets or nil balances, meaning that they will receive fewer tax credits in the future as tax rates fall, resulting in a loss for them. Given the nature of PFI companies it would be expected that most would have deferred tax liabilities, rather than tax assets, meaning that any fall in tax rates would lead to a saving on future tax which would be reflected in their accounts.

The majority of the deferred tax assets were due to the adoption of the Financial Reporting Standard 102 which recommends that interest rate and inflation swaps be recognised at fair value. Many PFI operating companies took out these swaps to convert variable interest rates on their loans to fixed rates, and to secure protection against inflation devaluing their project income over the decades of the contract. Falls in interest rates from an average of 4-5% to the current low of 0.5%, and even less, means that those agreements that fixed interest rates at around 5% are now worth very little at fair value, creating accounting losses for the PFI operating companies. These losses are recognised in the accounts in Reserves and suggest a large tax credit is due in future.

However if interest rates normalise to around 4-5% and rise over the remaining life of the PFI contracts these losses recognised in the accounts may turn into gains as the value of these agreements rises. Whether tax will actually be due on the gains and losses from these hedging agreements is complicated and will depend on the use of Disregard Regulations for derivatives contracts. For most companies given the general effectiveness of their hedging agreements the tax refundable will not be as high as the deferred tax asset suggests. This means that for most PFI operators, excluding these financial swaps, they will in the long-term owe more tax in the future (have a liability). As tax rates fall the size of the tax owed falls providing them with an additional benefit from changing tax rates.