The Chartered Institute of Taxation

Application and Professional Skills

Taxation of Larger Companies and Groups

November 2025

Suggested answer

REPORT TO Bersea Ltd
ON the tax and other implications of the proposed new cosmetics venture

Introduction

This report has been prepared to advise the board of Bersea Ltd on the tax implications of the proposed new cosmetics venture. It should not be relied on for any other purposes or by any other persons.

It is based on information provided by you at our meeting on 23 October 2025, and on legislation in force at today's date. If there is a delay in implementing our recommendations, a significant fiscal event (such as a Budget), or a change in circumstances, it should be confirmed whether this affects the conclusions and recommendations in this report.

Tax Partners LLP

30 October 2025

EXECUTIVE SUMMARY AND RECOMMENDATIONS

The Bersea group has the following options for pursuing a new venture in premium cosmetics:

- To develop the new products in the UK or Zevmark; and
- Under either location option, to continue operating under a licensing model or establish an integrated model by acquiring Estcon BV to manufacture the products.

There are therefore four possible operating models.

We estimate the integrated model would yield £100 million more pre-tax profit over the first five years compared to the licensing model. Under the integrated model, the group would need to fund the purchase of Estcon BV, however management analysis has determined that outlay, including funding costs, would be recouped after five years from Estcon BV's existing profits. We have therefore considered whether the tax costs and risks of the integrated model outweigh these clear commercial benefits.

Our conclusions are:

1. Under the licensing model developing the new products in Zevmark will not increase the group's tax cost because of the Zevmark free zone tax exemption whereas developing the products in the UK will increase the group's tax cost by £5 million over five years (reflecting the UK's 10% patent box profit tax rate and research and development expenditure credits (RDEC) of £15 million).

2. Under the integrated model the group will be in scope of UK Multinational Top-up Tax (MTUT) and Domestic Top-up Tax (DTUT). If the products are developed in Zevmark, the Zevmark profits from both new and existing activities will be topped up to an effective tax rate (ETR) of 15% which, together with £4.5 million of Estmark tax annually, means additional tax of £60 million over five years. By contrast, if the products are developed in the UK, the group's overall UK ETR will remain above 15% so no DTUT charge will arise. Bersea UK Ltd will retain the full benefit of the 10% patent box rate in relation to profits from the new products. The group would still pay MTUT of £3 million annually in respect of existing Zevmark activities and Estmark tax of £4.5 million annually in respect of Estcon BV, resulting in a total additional tax exposure of £37.5 million over the five years.

The integrated model has some disadvantages:

- it is more complicated, introducing judgmental transfer pricing considerations,
- it involves buying Estcon BV, requiring due diligence and possibly acquisition structuring, and
- it subjects the group to significant new reporting burdens.

However, the commercial benefits of the integrated model outweigh the additional tax cost and these disadvantages, as the group will benefit from Estcon BV's profits from both existing and new sales (which will cover its acquisition cost within five years).

We therefore recommend adopting the integrated model and developing the products in the UK. Under the integrated model, over the five-year period, the tax cost of developing in the UK is £22.5 million lower than the tax cost of developing the products in Zevmark (and the UK may also have reputational advantages), and the group benefits from the net profits of the new product sales.

Under all the options the group should carefully monitor its exposure to royalty withholding taxes (including treaty relief availability).

The group should mitigate risks of tax authority challenges to the transfer pricing of its intra-group transactions for the new venture by ensuring it has robust governance processes, and engaging proactively with the relevant tax authorities (possibly by applying for a binding advance pricing agreement (APA)).

Business model

Transfer pricing

All Bersea group companies are under the control of Bersea Ltd, and are thus subject to transfer pricing requirements in their residence countries. If the intra-group transaction pricing differs from what would be agreed between independent parties, countries may require tax adjustments to those transactions to an arm's length price to prevent the group gaining a tax advantage.

To avoid such adjustments (and resulting double taxation risk) we recommend that all transactions take place at an arm's length price.

Licensing model

Under the licensing model, one company (Bersea UK Ltd or BZ Inc) would conduct all of the development and licensing of the new compound and product. The profits from that activity would be attributed to it for tax purposes.

Integrated model

Under the integrated model two companies will be involved:

- either Bersea UK Ltd or BZ Inc (the developer) will develop and commercialise the products; and
- Estcon BV will manufacture and sell the products.

Estcon BV would receive the income from selling the products to third parties, realising an additional annual operating profit of £120 million (£600 million sales less £480 million costs), in addition to its existing business.

However, under the arm's length principle (ALP) the developer should be compensated for making its unique compound available to Estcon BV. Those companies should enter into a licensing agreement whereby Estcon BV pays the developer a fee reflecting the functions performed, assets provided and risks borne by each (and benchmarked to comparable transactions between unconnected companies).

We analyse the requirements of the ALP below, but advice should be taken on the local requirements in Estmark.

The developer contributes a unique, patented compound which it bears the risk of developing. Estcon BV:

- Contributes its manufacturing facility and know-how, and its procurement and selling capabilities.
- Bears inventory risk and risks relating to availability of raw materials.

The developer's contribution is unique so it is appropriate to price Estcon BV's contribution (for which comparables should be more readily available) and then allocate to it the residual profit.

Estcon BV is a licensed manufacturer with some entrepreneurial functions and which manages some important risks. A fuller analysis is required; however, it may be appropriate to price the licence so Estcon BV receives a percentage net margin on sales (known as the "transactional net margin method").

Estcon BV earns a 5% operating margin (£25 million/£500 million) on its existing sales. If the proposed new transactions are on the same terms, this may be a valid comparable. Applying that margin, Estcon BV would be allocated annual profits of £30 million (£600 million x 5%), with the remaining £90 million paid to the developer as a license fee.

Reducing uncertainty

Transfer pricing is inherently judgmental, naturally leading to some uncertainty. Several aspects of the proposed transactions' transfer pricing could attract tax authority scrutiny:

- Under either model, if BZ Inc is the developer HMRC may argue that Bersea UK Ltd contributes to the products through know-how, or personnel and should receive an arm's length reward.
- Under the integrated model, if Bersea UK Ltd is the developer, HMRC or the Estmark tax authority may question whether the licence fee paid by Estcon BV is arm's length.

Any tax authority challenge could increase tax liabilities (plus interest and, possibly, penalties), which risk could be mitigated by:

- Adopting robust governance processes that reduce the group's risk of its operations deviating from the assumed facts underpinning its transfer pricing policies (or allow such deviations to be identified and factored into revised transfer pricing policies).

- Engaging proactively with relevant tax authorities, possibly by:

    - explaining the new venture, and the proposed transfer pricing, to the group's HMRC Customer Compliance Manager to obtain feedback about any points of concern, or
    - applying to HMRC and the Estmark tax authority for an APA, (which is a binding agreement about transfer pricing, subject to factual critical assumptions, covering the license fee.

MTUT and DTUT

The UK has recently introduced two new taxes – MTUT and DTUT – as part of the OECD global minimum tax initiative.

MTUT and DTUT apply to groups with revenues of at least €750 million in at least two of the previous four accounting periods. They charge a top-up tax where the group's ETR in a jurisdiction is below 15%, to bring that jurisdictional ETR up to 15%. DTUT applies to a group's UK profits, whereas MTUT applies to a UK-parented group's foreign subsidiaries and permanent establishments.

Under the licensing model, the Bersea group's consolidated revenues, including from the new products, would be £400 million. MTUT and DTUT will not therefore apply.

If, however, Bersea Ltd uses the integrated model and purchases Estcon BV, the group's annual revenues will be £800 million so MTUT and DTUT would apply.

That would materially increase the group's worldwide tax exposure as explained below.

Exceeding €750 million revenues would also require the group to:

- file annual MTUT and DTUT returns,
- file an annual country-by-country report containing detailed financial information for each country where it is present, and
- maintain a master file and UK local file detailing the group's transfer pricing policies.

Fulfilling these requirements will likely be time-consuming and costly.

Estcon acquisition

If the group purchases Estcon BV it will acquire that company's historic liabilities. To mitigate the risk of undisclosed liabilities (including or tax) we recommend conducting a thorough due diligence process and considering whether to purchase Estcon BV's business either at asset level or "carved out" into a new company. You should take appropriate advice from legal and tax advisers in Estmark.

Summary

The licensing model is the most straightforward from a tax perspective: all profits from the new products being taxed in one country.

The integrated model is more complex since:

- the group will become subject to MTUT and DTUT, significantly increasing the tax cost (irrespective of where the products are developed),
- some of the new products' profits will also be taxed in Estmark at 15%,
- the amount of profit so taxed will depend on the pricing of the licence fee paid by Estcon BV, which is highly judgmental and may be challenged by tax authorities, and
- the group will face significant new reporting requirements,
- it will be necessary to conduct due diligence and consider how the Estcon BV acquisition should be structured.

However, this must be balanced against the integrated model's commercial benefits.

Under that model the group-wide annual profit from the new products will be £60 million (Estcon BV's £120 million operating profit, less the developer company's expenses of £60 million). That is £20 million more annually than under the licensing model (£40 million annually) which over a five-year period is a good return on the initial investment of £100 million to purchase Estcon BV.

Although some profits will be taxed in Estmark, that does not worsen the group's position: Estmark's 15% tax rate is lower than the UK's (25%) and the same as Zevmark's (0% rate but topped-up to 15% as explained below).

Product development location

<u>Licensing model</u>

<u>Zevmark tax</u>

BZ Inc is exempt from Zevmark tax because it operates in the free zone. If BZ Inc develops the new products, it should not have a Zevmark tax liability (although this should be confirmed with local tax advice).

<u>UK</u>

Corporation Tax (CT)

If Bersea UK Ltd develops the new products its additional profits would as a starting point be subject to UK CT at a rate of 25%. However, UK tax reliefs that may improve that position.

RDEC

The RDEC rprovides companies with a repayable credit equal to 20% of their qualifying expenditure on R&D.

Qualifying expenditure must be revenue expenditure incurred on a specific project to make an advance in science and technology. The advance must overcome scientific or technological uncertainty, e.g., by creating a process, product or service that it was not previously known as being technologically possible.

The new venture involves developing a unique anti-aging ingredient that is more effective than current products, and should therefore qualify as R&D.

RDEC must be claimed from HMRC, requiring information to support the claim.

Bersea UK Ltd could claim RDEC as follows, over its accounting periods ending 31 December 2026 and 2027:

	£m
Qualifying expenditure (Note 1)	100
RDEC at 20%	20
Less: Corporation Tax at 25% (Note 2)	(5)
Net tax benefit	15

<u>Notes</u>

1. Qualifying expenditure only includes expenditure on staffing costs, software or consumable items, externally provided workers or payments to clinical trial subjects, and must be attributable to relevant R&D undertaken by the claimant. It appears that all £100 million of expenditure on product development should qualify. It can be claimed in the year the expenditure was incurred, notwithstanding its accounting treatment.

   The planned expenditure on commercialisation would not qualify because it does not relate to R&D. However, as a capitalised IFA a tax deduction could still be obtained under the IFA regime which would follow the accounting treatment.

2. RDEC is a taxable receipt.

3. RDEC of £20m must first be used to satisfy any CT liabilities of the claimant in that year. Bersea UK Ltd pays CT of £20 million annually on its existing activities, so it could use all its RDEC that way.

Patent Box

The Patent Box is an elective 10% CT rate that applies to profits attributable to qualifying patent rights. The new products' active ingredients are expected to be patented. Bersea UK Ltd will develop and manage the rights itself and so it should be able to make a Patent Box election.

The Patent Box applies to relevant IP income including income from licensing patents (in this case £100 million annually, as forecast from the year ended 31 December 2028). Expenses are apportioned to relevant IP income on a just and reasonable basis and deducted. Here, annual expenses are £60 million (£30 million development expenses plus £30 million ongoing operating expenses).

Bersea UK Ltd's approximate annual CT liability in respect of this activity (from 2028 – for five years) would therefore be:

	£m
Relevant IP income	100
Less:	
Expenses	<u>(60)</u>
Profits eligible for Patent Box	<u>40</u>
CT @ 10%	4

Further adjustments may be needed to deduct a mark-up on routine costs and a return attributable to marketing assets.

While the Patent Box may apply to profits earned while a patent is pending, the tax deduction may only be claimed once the patent has been granted. It may take time for Bersea UK Ltd's patents to be approved, which will delay the tax benefit.

MTUT and DTUT

Under the licensing model, Bersea UK Ltd would not be in scope of DTUT or MTUT because the group's revenues would be below €750 million.

Integrated model

Under the integrated model, the group would incur the additional domestic tax costs detailed above. However, because its revenues would exceed €750 million it would also be exposed to DTUT and MTUT.

Zevmark

If the new products were developed in Zevmark, Bersea Ltd would have a UK MTUT liability in respect of BZ Inc's low-taxed Zevmark profits, both from the new products and existing activities.

The group's Zevmark ETR would be 0%, because it does not pay Zevmark taxes. Bersea Ltd would therefore be charged a 15% top-up tax as follows:

BZ Inc	**Profit £m pa**	**MTUT £m pa**
Existing activities	20	3.0
New products (£90 million licence fee - £60 million costs)	30	4.5
Total	50	7.5

These figures are based on BZ Inc charging an annual licence fee to Estcon BV of £90 million for the new products, as discussed above.

Estcon BV would have annual profits of £30 million (£120 million operating profit - £90 million licence fee) that would be taxed at 15%, for an Estmark tax liability of £4.5 million.

Bersea UK Ltd would also be in scope of DTUT in relation to its profits from existing activities, however its ETR is 25% (£20 million / £80 million) therefore no DTUT would be due.

UK

If the new products were developed in the UK, Bersea UK Ltd would be in scope of DTUT in relation to its aggregate profits from existing activities and the new products. Assuming Bersea UK Ltd charges Estcon BV an annual licence fee of £90 million, and incurs £60 million in costs), its UK ETR would be:

	Existing activity £m	**New products £m**	**Total £m**
Profit before tax	80	30	110
Tax thereon	20	3	23
		ETR (23/110)	20.9%

Licensing income from the new products is taxed at the Patent Box rate of 10%. However, because the blended ETR is above 15%, Bersea UK Ltd will not have a DTUT liability. It could therefore retain the full benefit of the 10% Patent Box rate on profits from the new venture.

As noted above, the group would also be in scope of MTUT and have an additional annual liability of £3m in respect of BZ Inc's existing activities.

Again, Estcon BV would have annual profits of £30 million and an Estmark tax liability of £4.5 million.

<u>Wider considerations</u>

The group risks criticism for expanding in Zevmark, which may be seen by some stakeholders as a "tax haven". There may therefore be reputational advantages to developing the products in the UK.

Either location's viability will depend on the recruitment (or relocation) there of staff qualified to perform the development work. We recommend the group's HR team conduct further research before a final decision is made.

Summary

Under the licensing model:

- if Bersea UK Ltd develops the new products (and makes the Patent Box election, and claims the RDEC) the group would suffer net additional UK taxes of £5 million over the venture's five-year duration (£4 million UK CT x 5, less £15 million RDEC); while

- if BZ Inc develops the products the group would suffer no additional taxes.

However, under the integrated model:

- if Bersea UK Ltd develops the products (and makes the Patent Box election, and claims the RDEC) the group would suffer net additional taxes of £37.5 million in total, over the five-year period ([£3 million UK CT as above, plus £3 million MTUT, plus £4.5 million Estmark tax] x 5, less £15 million RDEC); while

- if BZ Inc develops the products the group would suffer additional taxes of £60 million in total, over the five-year period ([£7.5 million MTUT plus £4.5 million Estmark tax] x 5).

Other issues

Withholding tax

Under both business models, the developer company may (subject to any treaty relief) suffer withholding taxes on its royalty income.

Under the current licensing model this appears not to be an issue for Bersea UK Ltd, which benefits from the UK's extensive network of treaties. It should be considered whether, if BZ Inc were the developer, relief would be available under Zevmark's tax treaties.

Under the integrated model Estmark may withhold 10% tax on the fees Estcon BV pays to the developer. However, both the UK and Zevmark have OECD model type treaties with Estmark, giving the recipient country the sole right to tax royalties, so no withholding tax would be applied.

Diverted Profits Tax (DPT)

If HMRC believes the group has entered into arrangements to divert profits from the UK it may issue a DPT charging notice, if several conditions (including that the relevant arrangements lack economic substance) are met. That should not be the case here, as the foreign group companies will conduct substantive activities in their respective countries. We therefore consider the risk of a DPT challenge is low.

Controlled Foreign Company (CFC) charge

BZ Inc is a CFC of Bersea Ltd that is subject to a low rate of tax. Although it could, therefore, be subject to a UK CFC charge, no charge should arise because all of the significant people functions relating to its profits are undertaken in Zevmark. The same comment may be made in relation to Estcon BV should it be acquired by Bersea Ltd.

VAT

Currently Bersea UK Ltd charges licensing fees to third parties in the UK. It should charge the 20% standard rate of VAT and be able to recover VAT that it pays on its expenditure.

Zevmark and Estmark have the same VAT rules as the UK. Under the integrated model the developer company would make supplies to Estmark that are outside the scope of VAT (although it would still be entitled to recover input VAT). Estcon BV should account for VAT on services purchased from overseas under the “reverse charge” mechanism, however that VAT should be recoverable given it relates to onward taxable supplies.

The group’s overall VAT liability should be the same under either approach. However, the licensing model may give rise to a cashflow advantage.