# The Chartered Institute of Taxation

## Application and Professional Skills

## Taxation of Larger Companies and Groups

May 2026

Suggested answer

**Report to the Board of Nuevo Pharmaceuticals plc**

**Proposed construction of new factory in either UK or Arcadia**

## Introduction

This report has been prepared for the Board of Nuevo Pharmaceuticals plc. It identifies the tax issues arising from the proposed construction of a new factory, either in the UK or in Arcadia, and gives advice on how best to deal with these. The report also considers the ethical and reputational issues arising from a possible investment in Arcadia. Our advice and recommendations are included in the Executive Summary.

The report should not be relied on for any other purposes or by any other persons.
We have relied on information provided by Lynne Robertson (CFO) at a meeting with Mine & Pitt LLP on 28 April 2026, and the Nuevo Pharmaceuticals plc internal paper "Project Arcadia", a copy of which was provided at that meeting.

This report is based on our current understanding of the tax regime in the UK, and information provided about the legal and tax regime in Arcadia. We recommend that independent advice is taken in Arcadia before acting on any recommendations in this report.
Before you implement our advice, please ask us to advise on changes to UK tax legislation that could impact on our advice.

Ms J Smith
Mine & Pitt LLP
May 2026

## Executive summary

The following issues are considered separately within the body of the report:

1) Comparison of net costs of construction in UK and Arcadia.
2) Value Added Tax (VAT) regime in the UK.
3) How best to finance an investment in Arcadia, and profit repatriation.
4) Comparison of post-tax profits after repatriation.
5) Transfer pricing issues in respect of movement of goods, cross-border financing and royalties.
6) Implications of purchasing an Arcadian company with historical losses.

We have concluded that the cost of building the factory in the UK, after taking account of available grants, is £6.5 million higher than if the construction took place in Arcadia. Furthermore, there is an additional VAT compliance burden requiring you to monitor taxable and exempt outputs of a new UK factory. This could lead to a clawback of some of the input VAT that will initially have been recovered, which would be a further increase in the cost of establishing the factory in the UK.

If the factory were built in Arcadia, the investment from the UK to Arcadia should be made 50:50 between equity and debt. This would optimise the opportunity to repatriate profits as interest and royalties, leaving the smallest possible residual profit to be distributed to the UK as dividends (which are subject to 25% withholding tax). However, it would expose you to transfer pricing compliance burdens that do not exist under the UK investment route.

Assuming a 7% interest rate and maximum permitted royalties, after-tax repatriated profits from Arcadia over ten years would be £5 million lower than if the operations were UK based.

Therefore, most of the additional capital costs in the UK of £6.5 million would be recovered by higher UK profits, subject to the possible VAT clawbacks. The availability of additional Structures and Building Allowance (SBA) relief of £2.8 million (albeit over 23 years and therefore its value needs to be discounted) means that there is little material difference between the UK and Arcadia.

However, there is an opportunity to reduce the corporate income tax payable in Arcadia, and thus increase after-tax profits, by purchasing an Arcadian company with pre-existing tax losses. This opportunity is not risk-free, even if due diligence established that the losses were available and relievable, because of the reputational issue that could arise should Nuevo Pharmaceuticals plc be exposed for undertaking tax planning in a foreign country that might not be regarded as acceptable, and which would not be effective, if undertaken in the UK.

We do not know the extent of the available losses and thus the potential enhancement of Arcadian post-tax profits which would then be available to distribute to the UK, subject to withholding tax. We recommend that you establish the amount of losses that are available and calculate the financial benefit that could arise from this arrangement. Given the small difference between the after-tax cost of a UK and Arcadian operation, as discussed above, this planning could make Arcadia financially more attractive.

The Board needs to weigh up the financial advantages against the reputational risk referred to below. Only if the Board decide that the risks associated with the Arcadia loss-buying arrangement are small and manageable, and the rewards (i.e. the extent of losses available) sufficiently large, should you proceed with the Arcadia investment and the purchase of the loss-making company. We recommend buying losses on a contingent basis to be paid for only as their use is agreed by the Arcadia tax authorities, to protect against future legislative changes.

On the other hand, if the available losses are insufficient and/or or if the Board conclude that the risks are large or unquantifiable, we recommend that this tax planning is not pursued and instead that you should construct and operate the new factory in the UK, if only to avoid the administrative inconvenience of operating in Arcadia.

## 1. <u>Comparison of net costs of construction in UK and Arcadia</u>

<u>Factory constructed in the UK</u>
Stamp Duty Land Tax (SDLT) would be payable on the cost of land at:

a) 0% on first £150,000 of the consideration for the land;
b) 2% on next £100,000 (i.e. £2,000); and
c) 5% on everything over £250,000 (i.e. £487,500).

The total is almost £500,000, so increasing the effective cost of the land to £10.5million.
The net cost after grant aid will therefore be as follows:

| | Gross expenditure £million | less grant aid@ 20% £million | Net cost £million |
|---|---:|---:|---:|
| Land | 10.5 | | 10.5 |
| Construction | 20 | 4 | 16 |
| Plant and machinery | 10 | 2 | 8 |
| Total | 40.5 | 6 | 34.5 |

<u>Factory constructed in Arcadia</u>
There are no stamp taxes or similar duties on the cost of land.

| | Gross expenditure £million | Less grant aid £million | Net cost £million |
|---|---:|---:|---:|
| Total construction costs | 28 | 0 | 28 |

<u>Comparison</u>
The net cost in the UK at £34.5 million is £6.5 million more than the equivalent cost in Arcadia at £28 million.

## 2. Value Added Tax (VAT) regime in UK

The supply of pharmaceutical products (without associated medical care) within the UK is generally standard rated. Exports are zero rated, but with a right to recover all VAT incurred on the purchase of goods and services attributed to those supplies.

However, the supply of certain health services is exempt, which gives rise to the Nuevo Pharmaceuticals plc group's partially exempt VAT status. This means that input VAT incurred on goods and services attributed to exempt outputs are not recoverable, and input VAT on other supplies that cannot be specifically attributed to either taxable or exempt supplies is subject to a partial exemption restriction on recovery thereof.

Input VAT will be incurred, at 20% of costs incurred, on the construction costs of a new factory in the UK. The costs of plant and machinery will be liable to VAT, as will the land if a previous owner has opted to tax the land.

Insofar as all these costs, and the associated VAT, are directly attributed to standard or zero-rated supplies then the VAT will be fully recoverable. Such supplies would include the sale of pharmaceutical products for export, as is intended, and as such there would be no VAT cost.

However, you have suggested that in future some of the new factory's output could be used to supply your private hospitals. The new factory will fall within the capital goods scheme due to its cost. Because of the group's partially exempt VAT status, some of the VAT recovered initially on the constriction costs would be clawed back if any of the exempt supplies made by the group related to supplies generated from the factory. In the immediate future this may not be an issue, but the group would need to keep records, over a ten-year period to identify any exempt supplies and then undertake the necessary adjustment calculations. At best, this would be an administrative burden and at worst an additional cost in having to repay previously recovered VAT. It may also be advisable to consider a special partial exemption calculation method to reduce the amount of irrecoverable VAT.

## 3. How to best finance an investment in Arcadia, and profit repatriation

If you decide to build the new factory in Arcadia, you will need to consider how to make the cash investment into Arcadia and how to repatriate profits to the UK, in accordance with existing group policy.

Arcadian corporate law requires that any business in Arcadia is conducted through an Arcadia registered and tax-resident company, and that the factory must be owned by such a company. Nuevo Pharmaceuticals plc does not presently have a corporate presence in Arcadia.

The options are therefore to:

a) create a new subsidiary company (Newco) in Arcadia, funded from the UK to enable that company to undertake the construction work; or
b) buy an existing Arcadia registered and tax-resident company and then inject the necessary cash requirements for the construction work from the UK. There is apparently an opportunity to buy such a company, with unutilised tax losses that would be relievable against future profits in Arcadia.

Creation of a Newco

If the investment were by way of equity investment, no interest would be payable. Profits generated in Arcadia would have to be repatriated to the UK by way of dividends. Such dividends from a wholly owned overseas subsidiary company will generally not be taxable in the UK. However, those dividends would be subject to a 25% withholding tax in Arcadia, and that tax would represent an additional layer of taxation (in addition to taxation of the profits out of which the dividends are paid) that could not be relieved or removed.

Alternatively, taking into account the debt-to-equity ratio funding rules in Arcadia, up to 50% of the investment can be made by way of debt. Interest on that debt, paid without any withholding tax, would be relieved against profits in Arcadia and taxed in the UK. Assuming there are sufficient profits in Arcadia, this would be tax neutral as the corporate tax rates in Arcadia and the UK are the same at 25%.

This enables some profits to be repatriated to the UK with no withholding tax cost and is therefore more tax efficient than a wholly equity investment.

Another mechanism for repatriating profits is to charge the Arcadian company royalties (up to 5% of sales only, on account of the provisions of Arcadian law) for the use of the patented know-how to be used in the manufacturing process. Royalties would be paid without withholding tax and would be tax deductible in Arcadia and taxed in the UK.

Profits in excess of the amount of allowable interest and royalites payable that are to be repatriated will have to be paid as dividends with the associated withholding tax cost. Accordingly, you should maximise the debt element of the investment and maximise royalties.

<u>Buy an existing Arcadia company with tax losses</u>

You have identified an otherwise dormant company with relievable tax losses, although the quantity of available losses is not yet known. Subject to any price adjustment for any other assets or liabilities it has (for example cash at bank), the price of such a company will be 10p per £1 of available trading losses. Once the company is under group ownership, you can choose to provide it with sufficient funds to invest in the proposed factory, where the tax issues will be as discussed above.

Losses relieved against future profits will reduce the profits liable to tax at 25% in Arcadia and increase group post-tax profit by net 15% of utilised loses (25p tax saved per £1 profits less 10p paid per £1 losses). The additional Arcadia profits would be available for repatriation to the UK by way of interest, royalties or dividends.

You will be exposed to this company's commercial risks and history if you buy it. Therefore, you should undertake commercial and tax due diligence to:
a) identify actual or potential liabilities to which you would become liable;
b) establish the company's negative reserves position, which would prevent profits from being distributed until those negative reserves are eliminated; and
c) establish the extent to which losses are available and relievable.

You should also:
a) seek warranties and indemnities to cover any identified risks;
b) estimate anticipated future profits in Arcadia to establish when the losses can be utilised; and
c) decide whether to pay for the losses as they are relieved or up front (based on their present-day value adjusted to reflect any uncertainty, and the future point at which their value will be realised).

## 4. Comparison of post-tax profits after repatriation

<u>UK</u>

Expenditure on land (including SDLT) does not qualify for capital allowances.
The construction cost of the factory, net of 20% grant aid, is £16 million. This would attract 3% per annum SBAs, i.e. tax deductions of £480,000 per annum for 33 and 1/3 years. Over 10 years the deductions are £4.8 million.
The expenditure on plant and machinery, net of 20% grant aid, is £8 million. This will attract full expensing tax relief at 100% of the expenditure incurred.

Arcadia

All capital costs attract 25% per annum tax relief on a straight-line basis. After 4 years, all of the £28 million expenditure will be relieved.

Summary

| | Factory in UK | Factory in Arcadia | | |
|---|---|---|---|---|
| Company location | UK<br><br>£million | Arcadia<br><br>£million | UK (extra profit)<br>£million | Total<br><br>£million |
| **Tax liabilities** | | | | |
| Operating profits | 76 | 80 | - | 80 |
| Interest<br>(7% x ½ x £28m) | - | (9.8) | 9.8 | - |
| Royalties<br>(5% x 20m) | - | (10) | 10 | - |
| Depreciation<br>(add- back) | 20 | 20 | | 20 |
| Capital allowances | (12.8) | (28) | - | (28) |
| Taxable profits | 83.2 | 52.2 | 19.8 | 72 |
| Corporate tax at 25% | (20.8) | (13.05) | (4.95) | (18) |
| | | | | |
| **Post tax profits** | | | | |
| Operating profits | 76 | 80 | - | 80 |
| Interest | - | (9.8) | 9.8 | - |
| Royalties | - | (10) | 10 | - |
| Corporate tax | (20.8) | (13.05) | (4.95) | (18) |
| Distributable profits | 55.2 | 47.15 | 14.85 | 62 |
| | | | | |
| Dividend paid to UK (approx) 75% x £47.15m) | - | (35.4) | 35.4 | - |
| Withholding tax at 25% | - | (11.8) | 0 | (11.8) |
| | | | | |
| Net profits | 55.2 | 0 | 50.25 | 50.2 |

After-tax profits from operating in the UK would be £5 million per annum higher than from operating in Arcadia over 10 years.

In addition, there are 23 years of unused SBAs in the UK, worth (in tax terms) about £2.8 million (£480,000 x 25% = £120,000 x 23) which will reduce future years' UK Corporation Tax or add to the building's value on a sale.

## 5. Transfer pricing issues in respect of movement of goods, cross-border financing, and royalties

Under both Arcadian and UK tax law, transactions between connected parties must be computed on an arm's length basis for tax purposes.

Goods

Whether the factory is constructed in the UK or in Arcadia, the goods produced will be sold directly to the external client in Arcadia, the local health authority. There would be no transfer pricing issues as this is not a transaction between connected persons. The price charged would be the open market price determined by the contract with the health authority.

Interest

If the factory is constructed in Arcadia by an Arcadia-registered and tax-resident company, that company would be funded by the UK group out of existing cash resources. If that funding were provided by way of a loan, a transfer pricing issue would arise in respect of the amount of and the interest charged on the loan, as the Arcadia company and the UK lending company would be under common ownership and thus connected persons.

From Arcadia's perspective:

a) the amount of debt on which interest is deductible cannot exceed 100% of the equity investment; and
b) the rate of interest charged on the debt must be at an arms' length rate, i.e. not an excessive rate.

From the UK perspective, the rate of interest charged on loans to an Arcadian subsidiary should be at an arms' length rate, i.e. at a rate that is consistent with the rate that would be charged by an unconnected lender.

Insofar as a rate of 7% would be considered an arm's length rate by both tax authorities, the tax impact will generally be neutral to the group, as the interest will be deductible for the payer and taxable on the recipient, both at 25%.

Royalties

Arcadia allows tax deductions for royalties up to 5% of sales. Again, the tax impact will generally be neutral to the group provided the royalty is within that 5% limit. However, there is a risk that HMRC will regard the rate as too low and seek to tax additional amounts calculated at a higher rate. Any excess over 5% would not be relievable in Arcadia.

Generally

If the actual interest or royalty charged is adjusted for tax purposes by either the Arcadian or UK tax authorities this could cause double taxation, for example if the UK required a royalty rate higher than 5%. In those circumstances, Nuevo Pharmaceuticals plc could negotiate with the tax authorities with a view to preventing such double taxation. Such negotiations, however, can be lengthy, costly and time-consuming.

Although transfer pricing principles also apply between UK companies, HMRC will be less concerned where a transfer price is wholly relievable in one UK tax-paying company and wholly taxable in another. However, if you decide to build the factory in Arcadia, transfer pricing considerations in respect of royalties and interest payments will be important.

## 6. Implications of purchasing Arcadian company with historical losses

The use of this company would reduce corporate income tax in Arcadia by 25%, at a cost of 10% in the UK being the purchase price of the company with the losses. So, for example:

a) without the availability of loss relief, £10 million of profits in Arcadia subject to 25% tax in Arcadia and then distributed to the UK would mean £5.7 million of profits received in the UK (£10 million less 25% direct tax leaves £7.5 million to distribute from which £1.9 million withholding tax at 25% is paid); whereas

b) under the loss scheme, all £10 million of profits would be available for distribution i.e. £7.5 million, after deduction of withholding tax of £2.5 million. The UK would have a £1 million cost of buying the losses making a net receipt of £6.5 million in the UK.

The loss scheme therefore generates higher net receipts in the UK.

From a purely financial perspective, the most cost-effective approach to minimising tax exposure on Arcadia profits is to continue maximising interest and royalty payments to the UK, and to cover the remaining Arcadia profits with purchased losses.

There is specific anti-avoidance legislation in the UK which prevents the use of bought-in UK tax losses to shelter future UK taxable profits. Therefore, this tax planning arrangement in Arcadia would not be effective if conducted within the UK.

Although the use of loss-making companies in this way is permitted in Arcadia, you might wish to consider the possible impact on your reputation of undertaking an arrangement that would not only be ineffective in the UK, but which might, at least in some quarters, be regarded as unacceptable tax avoidance. It is quite possible that the arrangement could be discovered by and exposed by the press. While you would have a legitimate defence that the transaction is legal under Arcadia tax law, there could be some reputational damage that could impact on your wider commercial position.