

THE CHARTERED INSTITUTE OF TAXATION

APPLICATION AND PROFESSIONAL SKILLS

Taxation of Larger Companies and Groups

November 2023

TIME ALLOWED

3 HOURS 30 MINUTES

- In order to secure a pass in this exam, you will be required to demonstrate competence in each of three skills.

You will be assessed across your answer as a whole for Structure. A pass or fail grade will be awarded.

You will be assessed for competence in a number of broad topics for the following skills:

- Identification and Application
- Relevant Advice and Substantiated Conclusions

For each topic for each of these two skills, a grade will be awarded. The grades for those topics will be weighted and averaged to produce a final grade for each skill of 0, 1, 2, 3 or 4. A grade of 3 or 4 is required to demonstrate competence.

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.
- Scots law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.
- Unless otherwise indicated by the provision of additional information in the question, you may assume that 2022/23 legislation (including rates and allowances) continues to apply for 2023/24 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

You are a tax manager at Lambert Maskell LLP, a firm of Chartered Tax Advisers.

Your clients include the EastTeaCo plc group, a multinational group in the food processing sector with focus on teas and coffees. EastTeaCo plc is a UK tax resident.

Your tax partner, Sam Nigh, has received an email (**EXHIBIT A**) from Anna Anderson, the Finance Director of EastTeaCo plc.

It concerns a potential collaboration with another business, M20 Projects Ltd, in respect of two projects.

The following exhibits are provided to assist you:

EXHIBIT A: Email from Anna Anderson to Sam Nigh

EXHIBIT B: Notes of an internal meeting on 30 October 2023

EXHIBIT C: Email from Marvin Blaise to Anna Anderson

EXHIBIT D: Pre-seen information

Requirement:

Prepare a report to the Board of EastTeaCo plc advising on the most appropriate structure for the potential collaboration.

Continued

EXHIBIT A

Email from Anna Anderson to Sam Nigh

To: Sam.Nigh@LambertMaskell.co.uk
From: Anna.Anderson@eastteaco.com
Date: 1 November 2023
Subject: Potential collaboration with M20 Projects Ltd

Sam

You will be aware that the EastTeaCo group has a well-established research and development function with an excellent track record in both improving industry-wide processes and launching new products.

An opportunity has arisen that would involve one of our UK companies, EastTeaCo UK Ltd, collaborating with an independent company, M20 Projects Ltd, on two new but related projects.

Further information about the two projects is set out in the attached notes of our recent internal meeting, held with our in-house accounting, legal and research and development teams (**EXHIBIT B**).

We have identified two possible structures for the collaboration:

- 1) Set up a joint venture on a technical collaboration basis; or
- 2) Incorporate a new company ('Newco') with both EastTeaCo UK Ltd and M20 Projects Ltd holding shares.

Our accounting department has sent me information about M20 Projects Ltd which you may find useful. (**EXHIBIT C**).

We do not normally collaborate with other companies and therefore we would like your advice on the most appropriate structure, particularly from a tax perspective.

We do not require your advice on the financing arrangements at this time.

Please contact me if you have any questions.

Regards

Anna Anderson
Finance Director
EastTeaCo plc

EXHIBIT B

Notes of an internal meeting on 30 October 2023

Attendees

Cormac Watson – Legal
Marvin Blaise – Accounting
Ffion LI – Accounting
Bryan Cobb – R&D
Chantal Cervantes – R&D
Kyran Mendoza – R&D
Aliya May – R&D

Background

The industrial process for extracting caffeine from various types of plants is very well established and no patents are required.

The process produces a number of waste by-products, and costs are incurred to dispose of this waste.

M20 Projects Ltd has carried out initial research into one of these waste by-products, omegeine, which is a caffeine-like substance.

They have made two exciting new discoveries.

First, if omegeine is processed in a certain way, it can be used as an alternative to caffeine in any manufacturing process.

Second, there are indications that omegeine could be a healthier alternative to caffeine.

We are considering two projects to build on these discoveries.

Project 1: development of new industrial process

This project will create a new industrial process to isolate and retain omegeine from the waste arising from caffeine extraction.

EastTeaCo UK Ltd could then use omegeine rather than caffeine in the manufacture of certain new products, including omegeine-enhanced energy drinks.

In addition, if the new industrial process were patented, other manufacturers would pay royalties to use this process.

The existing know-how held by M20 Projects Ltd is essential to the project.

However, EastTeaCo UK Ltd has the research and development infrastructure to undertake the required work.

We are proposing that the costs to be incurred in developing the new industrial process of £70 million will be borne by EastTeaCo UK Ltd.

Project 2: determining health benefits

The aim of this project is to determine the health benefits of omegeine.

If health benefits are found, we would not expect to be able to register any additional intangible assets in respect of omegeine, but it would increase the value of patents that would already be registered in respect of the new industrial process (under project 1).

M20 Projects Ltd have considerable experience in running clinical trials, which would be required, and this project could feature in M20 Projects Ltd's business development programme to retain its quality staff.

Although clinical trials are expensive to run, M20 Projects Ltd has indicated that it would be prepared to incur the development costs of £30 million.

Continued

Continuation

Projected costs and income

Project 1: development of new industrial process

| <u>Year to 30 June</u> | <u>Development costs</u> £ million | <u>Third-party royalty income</u> £ million |
|------------------------|---------------------------------------|--|
| 2025 | (30) | - |
| 2026 | (40) | 12 |
| 2027 | - | 20 |
| 2028 | - | 20 |

Project 2: determining health benefits

| <u>Year to 30 June</u> | <u>Development costs</u> £ million | <u>Additional third-party royalty income</u> £ million |
|------------------------|---------------------------------------|---|
| 2025 | (13) | - |
| 2026 | (17) | 6 |
| 2027 | - | 12 |
| 2028 | - | 12 |

No further development costs are anticipated.

After July 2028, third-party royalty income is expected to increase year-on-year for at least the next 10 years.

We have assumed that under the UK patent box regime, the relevant intellectual property profits arising from these projects should be taxed at a Corporation Tax rate of 12%.

Proposed structures to undertake both projects

Joint venture

- 1) Patent rights will be owned in the proportion of 70% by EastTeaCo UK Ltd and 30% by M20 Projects Ltd.

This split recognises the contribution of know-how from M20 Projects Ltd for project 1 as well as the costs of project 2.

- 2) All third-party royalty income receivable for both projects will be payable to EastTeaCo UK Ltd, and then EastTeaCo UK Ltd will make a payment of 30% of this amount to M20 Projects Ltd.

Thus, if EastTeaCo UK Ltd receives £18 million for the year ended 30 June 2026 as projected, it will pay £5.4 million to M20 Projects Ltd.

- 3) In addition, EastTeaCo UK Ltd will pay M20 Projects Ltd for its own use of the patented process.

This is projected to be £3 million in the year ended 30 June 2026, £4.5 million in the year ended 30 June 2027, and £4.5 million in the year ended 30 June 2028.

- 4) The development costs of £70 million in respect of project 1 will be borne by EastTeaCo UK Ltd and the £30 million in respect of project 2 will be borne by M20 Projects Ltd.

New company (Newco)

- 1) A new UK tax resident company, with a 30 June year end, will be incorporated with EastTeaCo UK Ltd acquiring 70% and M20 Projects Ltd acquiring 30% of the shares for a nominal amount.

EastTeaCo will lend £70 million and M20 Projects Ltd will lend £30 million to NewCo.

The loans will be interest free and, subject to the projections of royalty income being achieved will be repaid in the following instalments: 20% on 30 June 2026, 40% on 30 June 2027 and 40% on 30 June 2028.

Continuation

- 2) Newco will hold the patent rights and receive the projected third-party royalty income.

EastTeaCo UK Ltd will make intra-group royalty payments to Newco to use the new industrial process in its own manufacturing business.

As M20 Projects Ltd will only own 30% of Newco, these payments will be higher than under the joint venture option and so are projected to be £10 million in the year ended 30 June 2026, £15 million in the year ended 2027, and £15 million in the year ended 2028.

M20 Projects Ltd, as a 30% shareholder in Newco, would then have an interest in the same amount of royalty payments as under the joint venture option (i.e. 30% of £10 million in the year ended 30 June 2026 is £3 million) and EastTeaCo Ltd would have an interest in the remaining 70%.

- 3) The development costs will be borne by Newco.

In the initial years of trading, this will mean that Newco will be in a net loss position, however, the shareholders will undertake to support Newco as a going concern.

Exit strategy

In 2028, M20 Projects Ltd would like to exit both projects with a surplus of £80 million cash (after tax) to invest in a new potential project with a different third party.

EastTeaCo UK Ltd sees the long-term potential of these projects and is proposing to enter into an option agreement with M20 Projects Ltd to either buy M20 Projects Ltd's share of patent rights if there is a joint venture, or its shares of Newco if that structure is chosen. The purchase would take place in July 2028 at a price that would enable M20 Projects Ltd to exit with £80 million after tax from the projects.

If the NewCo structure is used, the £80 million will be reduced in the following way:

- 1) Any R&D tax credit payable in cash or otherwise used to reduce the tax liabilities of M20 Projects Ltd.
- 2) NewCo will declare a dividend equal to all retained profit as at 30 June 2028. M20 Projects Ltd's share of this dividend will be deducted from the £80 million.

If a joint venture is used, the £80 million will be reduced by:

- 1) Any R&D tax credit payable in cash to M20 Projects Ltd in respect of project 2.
- 2) Any royalty income paid to M20 Projects Ltd in respect of project 1 and project 2 less any Corporation Tax payable by M20 Projects Ltd on this income.

This project will take up most of M20 Projects resources. For the purposes of claiming any R&D tax credits, M20 Projects Ltd will be classified as a R&D intensive SME. It is anticipated that the company will break even on any other activities with no profit or loss for either accounting or tax purposes.

No losses or reliefs available from the company's interest in the consortium will be utilised against other activity.

Obviously if the projects are not successful, EastTeaCo UK Ltd would not exercise its option.

Continued

EXHIBIT CEmail from Marvin Blaise to Anna Anderson

To: Anna.Anderson@eastteaco.com
 From: Marvin.Blaise@eastteaco.com
 Date: 26 October 2023
 Subject: Potential collaboration with M20 Projects Ltd

Potential Collaboration Partner – M20 Projects Ltd

The following information was provided by Toby Grant, a director of M20 Projects Ltd, at a recent meeting to discuss our potential collaboration.

M20 Projects Ltd was incorporated in the UK and began trading on 6 January 2021.

The company tax returns have always been filed on time and there are no open enquiries with HMRC.

The directors and shareholders are Baljeet Singh and Toby Grant, and there are 25 employees.

The company is expected to remain profitable after 2023.

The company has arrangements in place for a loan facility (with guarantees covered by the shareholders) to finance the £30 million outlay required for project 2.

Undertaking the project work will require additional staff and there will be a substantial increase in the PAYE and NIC collected from the company.

It is anticipated that there will be no restriction on Research and Development credits based on such payments.

Income statement

| Year ended 30 June | <u>2023</u> | <u>2022</u> |
|--------------------------|----------------|--------------|
| | £'000 | £'000 |
| Revenue | 1,715 | 1,140 |
| Cost of sales | <u>(1,003)</u> | <u>(978)</u> |
| Gross profit | 712 | 162 |
| Administrative expenses | <u>(372)</u> | <u>(98)</u> |
| Operating profit/(loss) | 340 | 64 |
| Finance expense | <u>(20)</u> | <u>(19)</u> |
| Profit/(loss) before tax | 320 | 45 |
| Tax expense | <u>(70)</u> | <u>(12)</u> |
| Profit after tax | <u>250</u> | <u>33</u> |

Statement of Financial Position

| At 30 June | <u>2023</u> | <u>2022</u> |
|---------------------|-------------|-------------|
| | £'000 | £'000 |
| Fixed assets: | | |
| Plant and machinery | 120 | 112 |
| Development costs | <u>500</u> | <u>45</u> |
| | 620 | 157 |
| Current assets | 24 | 42 |
| Current liabilities | (315) | (120) |
| Long term creditors | <u>(45)</u> | <u>(45)</u> |
| Net assets | <u>284</u> | <u>34</u> |
| Equity: | | |
| Share capital | 1 | 1 |
| Retained earnings | <u>283</u> | <u>33</u> |
| Total equity | <u>284</u> | <u>34</u> |

Continued

EXHIBIT DPre-seen informationClient Information

Client name: EastTeaCo plc

Country of incorporation: UK

Ownership: Listed on London Stock Exchange. No shareholder holds more than 5% of the shares.

Directors and board members:

| | |
|----------------|--------------------------|
| David Smith | Chairman |
| Sarah Saracine | Managing Director |
| Anna Anderson | Finance Director |
| Chris Jones | Human Resources Director |
| Asif Hashim | Operations Director |
| Ravi Patel | Non-executive Director |
| Jayne Sykes | Non-executive Director |

Background

EastTeaCo plc was admitted to the London Stock Exchange in 2002 having previously been a successful family-owned business for many years. It is the UK parent company of a multinational group operating within the food processing sector, with particular focus on teas and coffees.

Research and development, and manufacturing are carried out in the UK by EastTeaCo UK Ltd, a wholly owned UK resident subsidiary of EastTeaCo plc.

Another UK resident company, ETC Marketing Ltd, is a wholly owned subsidiary of EastTeaCo plc which carries out marketing and sales functions.

Sales outside of the UK are made by wholly owned overseas subsidiaries of EastTeaCo plc. All transactions between UK and non-UK companies are priced on an arm's length basis in accordance with transfer pricing legislation.

The worldwide group has 4,200 employees.

Summarised group financial information for the EastTeaCo groupConsolidated Income Statement

| Year 30 June | <u>2023</u> | <u>2022</u> |
|-------------------------|----------------|----------------|
| | £ million | £ million |
| Revenue | 2,280 | 2,154 |
| Cost of sales | <u>(1,513)</u> | <u>(1,437)</u> |
| Gross profit | 767 | 717 |
| Administrative expenses | <u>(610)</u> | <u>(590)</u> |
| Operating profit | 157 | 127 |
| Finance expense | <u>(75)</u> | <u>(71)</u> |
| Profit before tax | 82 | 56 |
| Tax expense | <u>(18)</u> | <u>(14)</u> |
| Profit after tax | <u>64</u> | <u>42</u> |

Continued

Continuation

Consolidated Statement of Financial Position

| At 30 June | <u>2023</u> | <u>2022</u> |
|----------------------|----------------|----------------|
| | £ million | £ million |
| Fixed Assets | 1,670 | 1,611 |
| Intangibles | 200 | 180 |
| Current assets | 150 | 140 |
| Current liabilities | (500) | (450) |
| Long term creditors | <u>(1,100)</u> | <u>(1,100)</u> |
| Net assets | <u>420</u> | <u>381</u> |
| Equity: | | |
| Issued share capital | 50 | 50 |
| Share premium | 200 | 200 |
| Retained earnings | <u>170</u> | <u>131</u> |
| Total Equity | <u>420</u> | <u>381</u> |

Issued share capital consists of 50 million shares of £1 each.

EastTeaCo plc paid a dividend of 50p per share in March 2023.

The group expects to remain profitable in the year to 30 June 2024.

Corporation Tax information

All company tax returns for the group for the accounting period ended 30 June 2022 were submitted on 22 June 2023.

All previous returns were submitted within the statutory deadlines. There are no open enquiries with HMRC into any of the UK companies.

VAT

EastTeaCo UK Ltd is the representative member of a VAT group comprising itself, ETC Marketing Ltd and EastTeaCo plc. No options to tax have been made.