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Answer-to-Question- _1_

Report to the Board of Coua Ltd on the key tax and commercial issues arising from the share sale and subsequent use of the funds

8 May 2025

1. Scope

This report is to advise the Board of Coua Ltd on the following matters:

- The tax implications of the sale of the shares in Eggton
- The tax implications of the construction of the new factory in Windelshire ("Option 1")
- The tax implications of the purchase of shares in a UK-established trading company Unumiota Ltd ("U Ltd").
- Our conclusions and recommendations in relation to the above matters including any commercial issues arising from the transactions

1.1 Disclaimer

This report has been prepared solely for the private and confidential use of Coua Ltd ("Coua") and is not to be shared with or relied upon by any third parties without our prior written consent.

Our advice is based on the tax legislation at the time of writing (8 May 2025) in addition to the information provided in the following correspondence: letter from Manny Singh (CFO of Coua) dated 7 May 2025, email from Alex Hancock dated 6 May 2025 and the supporting schedule of cost information for the two options.

If the tax legislation or the information referenced above were to subsequently change it would be necessary to reconsider the advice provided.

2. Executive Summary

2.1 Tax implications of the shares sold in Eggton & conclusions and recommendations

We advise that the sale of the shares in Eggton by Coua will benefit from the Substantial Shareholding Exemption ("SSE") as more than 10% has been owned by Coua for a continuous 12 month period within the last 6 years therefore, proceeds will not be restricted by corporation tax payable on the gain as the gain will be exempt.

We have concluded that £170,000 of VAT on the costs identified below in section 3.1 that relate to the share sale will not be recoverable therefore, by deducting this irrecoverable VAT we have determined that the net proceeds will be £34,830,000. This is £35million - (£70,000 + £35,000 + £40,000 + £25,000).

We recommend stating that SSE has been claimed on the CT600 for the relevant corporation tax accounting period so that the gain is treated as exempt.

2.2 Construction of new factory (Option 1) vs. acquisition of Unumiota Ltd (Option 2) & conclusions and recommendations

We advise that you proceed with Option 1 and acquire the land in Windelshire and construct and fit-out the new factory and laboratory as our calculations estimate that the expenditure would benefit from significant corporation tax savings owing to the special

reliefs for Research and Development ("R&D") expenditure.

Indeed, there is a first year allowance ("FYA") of 100% available on capital expenditure used for R&D (although this does not include land) and a special tax credit known as an 'RDEC' for R&D revenue expenditure.

As such, capital expenditure is 25% less after corporation tax relief and revenue expenditure is 40% less after corporation tax and the RDEC credit (i.e. 25% + 15%). Based on these revised calculations, the tax saving on the construction would likely be in the region of £13,950,000 which reduces the estimated outlay of option 1 of £197,525,000 down to £183,575,000. This also increases the forecast five year return from 34.01% to 49.0% (i.e. £15,475,000 / £31,550,000).

By comparison, the share acquisition in U Ltd would result in additional costs owing to irrecoverable VAT of £350,000 which increases the outlay from £42,750,000 to £43,100,000. This reduces the forecast five year return from 28.19% to 27.96% (i.e. £12,050,000 / £43,100,000).

Therefore, the five year return under option 1 is far greater than under option 2.

Furthermore, from a commercial perspective, it may also be less risky to construct the land and factory and proceeds with the research and development activity as this is more aligned with the existing business model and doesn't involve crossing over into the clothing sector which is relatively unknown territory for the group.

We recommend that the associated specialised equipment which may be imported under option 1 is accounted for under Postponed Import VAT Accounting ("PIVA"). This enables import VAT to be deferred at the point the goods arrive in the UK. From a

commercial perspective in order to facilitate this, Coua will need to sign up to the customs declaration service ("CDS") and obtain an EORI number if it hasn't already.

It has also been flagged that a share acquisition in U Ltd would mean that historic tax liabilities are retained and inherited by the group, as well as the group incurring stamp duty of £205,000 (see section 5.3) which would be a further irrecoverable tax cost. If you did pursue this option, we would recommend putting in place indemnities and warranties in the share purchase agreement ("SPA") however, we have concluded that option 1 is the better option.

Further to this issue, owing to the risk associated with inheriting historic tax liabilities in U Ltd and their refusal to sell its trade and assets, we expect it is likely to be a lengthy and expensive process to ensure that sufficient indemnities and warranties are included in the "SPA" to protect the group from any historic issues that may be acquired, and so we advise not proceeding with Option 2.

Lastly, from a commercial perspective it is recognised that there is an growing global car market and so the potential for the group's future growth could be greater under option 1 which is another reason why we recommend Option 1 over Option 2.

3. Tax implications of the sale of the shares in Eggton

3.1 VAT

The share sales will be VAT exempt meaning that no VAT will be charged to the buyer, nor will any VAT in relation to the share sale be recoverable by Coua.

Indeed, there was a recent decision in the case of *Hotel La Tour v HMRC* which was over-

turned and it now follows input VAT on costs directly attributable to a share sale, such as legal and professional fees, will be irrecoverable and the link to wider taxable activities of the VAT registered entity is severed.

For example, it follows that VAT on Melanies commission of £70,000 (i.e. 20% x £350,000) will be irrecoverable as it relates to arranging the share sale specifically.

The commission payable to Teddy Wu Associates will follow the general place of supply rules and so will be subject to the reverse charge in the UK (where the customer i.e. the VAT group is based) on the basis that it appears this business is not established in the UK. As such, the group will need to account for UK VAT under the reverse charge mechanism in boxes 1, 4, 6 and 7 of the group VAT return. As the VAT relates to an exempt share sale, the input VAT in box 4 under the reverse charge will be nil i.e. it will be irrecoverable.

Since the price of £175,000 is net of VAT, box 1 will need to include output VAT under the reverse charge of £35,000 (i.e. 20% x £175,000).

The legal fees will be standard-rated at 20% and so VAT on these will equate to £40,000 (i.e. 20% x £200,000) which will also be irrecoverable.

The due diligence and tax advice will be standard-rated at 20% and so VAT on this fee will equate to £25,000 (i.e. 20% x £125,000). Likewise, VAT recovery on the due diligence and tax advice will be restricted to the extent it relates to the exempt share sale of Eggtan.

For completeness, if the tax advice is unrelated to the share sale and is an ongoing cost relating to the VAT group as a whole, it would be 'residual' for VAT recovery purposes,

this means that the tax advice element would be fully recoverable as the VAT group is fully taxable.

As such, if there is a single invoice which includes both due diligence and ongoing tax advice then it may be prudent to treat this cost as directly attributable to the exempt share sale (and thus irrecoverable). If, on the other hand, the tax advice is split out separately on the invoice and is readily identifiable to ongoing activities of the group, the VAT on this element will be fully recoverable by the group.

Given that SSE will apply to exempt the gain under the share sale (see section 3.2 below), there will be no corporation tax on the gain on disposal, and net proceeds after irrecoverable VAT will be £35million - (£70,000 + £35,000 + £40,000 + £25,000) = £34,830,000. This assumes the invoice for the due diligence and tax advice is prudently treated as irrecoverable.

Lastly, note for completeness that the share sale will not result in Coua becoming partially exempt as incidental financial transactions, such as share sales, that arise merely as a consequence of normal business activity are excluded - see HMRC's guidance in VAT Notice 706.

It has been mentioned that taxable management charges of £100,000 will cease once Eggton is sold however, under Options 1 and 2 discussed further below, Coua will have an intention to continue making taxable supplies and so it can therefore remain VAT registered as a group with Norrisco on this basis.

Indeed, a VAT deregistration requirement will only arise when the VAT registered entity ceases to make taxable supplies.

3.2 Corporation Tax

As Coua has held more than 10% of the shares in Eggton for a continuous 12 month period within the last 6 years the disposal will qualify for the substantial shareholding exemption ("SSE") and so no corporation tax will be payable out of the proceeds.

Note that the buyer will inherit historic tax liabilities and capital allowances will continue to be claimed as before by the buyer of the shares, with no break in trade and trading losses carried forward in Eggton. As such, there will be no balancing adjustments on plant and machinery and no stock adjustments either.

3.3 Stamp Duty

Stamp Duty will be payable by the buyer at 0.5% within 30 days of the acquisition of Eggton and a stock transfer form will need to be submitted to HMRC by the same date however Coua, as seller of the shares, does not need to file anything for stamp tax purposes.

4. Construction of the new factory in Windelshire

4.1 VAT

The acquisition of the freehold land in this instance will be standard-rated as the vendor has opted to tax. Thus, the gross cost will be £9.6million (i.e. £8million x 120%) as the figures provided state that the price payable is "net of VAT".

Since Norrisco Ltd ("Norrisco") is a member of a fully VATable VAT group and the intention is to manufacture new technology which will either be a standard-rated supply at 20%, if supplied to UK customers domestically, or a zero-rated exported if sold to non-UK customers, the input VAT incurred on the expenditure incurred under this option will be fully recoverable as it will be wholly attributable to taxable supplies.

Note that for such exports to be zero-rated it would be necessary to obtain sufficient official evidence(e.g. a goods departure message) or commercial evidence (e.g. sea / air waybills) within 3 months of the goods leaving the UK.

The specialised equipment will be subject to VAT at the standard-rate of 20%. If this is imported from outside the UK, this will result in import VAT being incurred when the goods arrive in the UK. Norrisco will be able to reclaim this via the group VAT return and it is recommended that it accounts for the import VAT under Postponed Import VAT Accounting ("PIVA") which allows payment of the import VAT to be deferred on entry and subsequently accounted for in boxes 1, 4 and 7 on receipt of the corresponding PIVA statement via the HMRC government gateway.

Note that customs duty incurred importing the equipment will be irrecoverable therefore, Norrisco should ascertain what the applicable customs duty percentage would be via correspondence with the supplier.

The construction and fit-out of the factory and laboratory for £37million will also be standard-rated.

Note that acquisition and associated construction and fit-out will fall within the Capital Goods Scheme ("CGS") since the expenditure exceeds £250,000 excluding VAT. This means that the VAT group will need to monitor use of the factory and lab for 10 years beginning from first use.

As a result, if use of the buildings were to change within 10 years e.g. part of the lab were let by the VAT group, a CGS adjustment would be triggered. This can be prevented by opting to tax the building however, an option to tax is binding on all VAT group

members and after the initial 6 month cooling off period it cannot be revoked for 20 years therefore, a decision to opt to tax warrants careful consideration and we can advise in future should this become more relevant if you expect a change in use.

Furthermore, if Norrisco does not declare end user status to the builder, the construction and fit out work will be subject to the domestic reverse charge ("DRC") which would mean that the supplier would not charge VAT and instead Norrisco would account for the VAT and corresponding net amounts itself in boxes 1, 4 and 7 of the group VAT return.

Note that even if it is apparent that Norrisco is the 'end user' for the purposes of the domestic reverse charge, Norrisco must explicitly declare end user status for the normal VAT rules to apply and in the absence of such a declaration, the DRC will apply instead by default.

It is recommended from a cashflow perspective that Norrisco does not declare end user status, so that it does not need to reclaim VAT charged subsequently via the VAT return.

The loan between Coua and Norrisco will be disregarded as these two entities are VAT grouped and so are viewed as a single VAT entity.

Lastly, the bond issued by the private equity investors will be VAT exempt.

4.2 Corporation Tax

Capital expenditure on research and development ("R&D") qualifies for 100% first year allowances ("FYAs") however, this will not include land. Since the site will be used as a combined factory and R&D lab it is likely the FYA for capital expenditure will be available. This is almost certain in respect of the lab however, if the factory is not used for R&D the FYA will not apply to this element.

As such, although the acquisition of the freehold will not qualify for FYAs (being land) the construction and fit out of the lab and factory will. There is no limit for the FYA and so the £37million of construction and fit out costs would benefit from tax relief of £9.25million (i.e. 25% x £37million).

To the extent that any plant and machinery and fixtures and fittings (i.e. integral features) are not used for R&D purposes, assuming these acquisitions are 'new' / not second-hand, they will qualify for 100% FYAs (i.e. main pool) and 50% FYAs (special rate pool) respectively. This relief is available to corporates buying new plant and machinery.

We also need to consider revenue expenditure and the associated Research and Development credit ("RDEC"). Whilst typical revenue expenditure obtains tax relief at 25%, any qualifying R&D expenditure will benefit from a further 15% by virtue of the RDEC (i.e. 40% tax relief in total equal to 25% + 15%).

For awareness, qualifying research and development revenue expenditure includes:

- Staff costs (i.e. employee salaries, employer's secondary NICs and employer's pension contributions)
- Software (if used to analyse results), data licences, cloud computing and consumables (fuel, power, water etc)
- externally provided workers
- Payments for contracted out research and development

Note the R&D credit will need to be claimed within 2 years of the accounting period to which it relates via the CT600.

We have applied the tax savings explained above to the schedule of expected costs for the construction in appendix 6.2, and it appears the total net cost of £45,000,000 will actually be reduced down to £31,550,000 after corporation tax deductions (including the RDEC). Thus, the initial cash outlay is reduced by £13,950,000. This increases the forecast five year return from 34.01% to 49.0% (i.e. £15,475,000 / £31,550,000).

For completeness, the interest payable on the loan by Norrisco will be deductible from corporation tax whilst the interest received by Coua will be subject to corporation tax under the loan relationship rules. Therefore, it will be necessary to ensure that the loan is drawn up on arm's length terms to prevent a need to make a transfer pricing adjustment. Please let us know if you would like to discuss transfer pricing in more detail.

For the bond issued by the private equity investors, interest on this will be deductible from taxable trading profits of Norrisco.

4.3 SDLT

SDLT will be payable at the non-residential / commercial rates on the land acquisition. The amount payable on the VAT-inclusive cost of £9.6million (i.e. 120% x £8million) is £469,500 (see appendix 6.1).

This SDLT will be payable within 14 days of the transaction date and an SDLT return will be due by the same date. Note that the transaction date is usually completion however, this will be brought forward if the transaction is 'substantially performed' prior to this e.g. if Norrisco were to occupy the land prior to completion or if it paid a substantial proportion of the price prior to completion.

For completeness, works to land acquired under an SDLT chargeable transaction can itself constitute chargeable consideration however, this will not be the case when the

following three conditions are satisfied:

- The work takes place after the transaction date
- The works are carried out on the land acquired
- It is not a condition of the contract that the vendor carries out the works.

Since Norrisco does not appear to have a contract with the vendor to construct and fit-out the factory and laboratory, it appears the works will not form part of the chargeable consideration subject to SDLT however, please do let us know if that is not the case and the vendor will be doing the works.

5. Purchase of shares in a UK-established trading company Unumiota Ltd ("U Ltd").

5.1 VAT

Note that a transfer of a Going Concern ("TOGC") is neither a supply of goods nor a supply of services therefore it is outside the scope of VAT however, as the shareholders of U Ltd will not agree to a sale of the trade and assets, the conditions which determine whether TOGC treatment will apply have not been considered further. Please do let us know if this changes and we can advise accordingly as the TOGC VAT provisions are detailed and include various requirements such as the business being transferred being capable of separate and independent operation, there being no break in trade and the buyer carrying on the same kind of business.

The purchaase of the shares in U Ltd will be VAT exempt and so no VAT will be incurred by Coua Ltd ("Coua") on this aquisiton. However, VAT will be incurred on

legal and professional fees and it appears currently as though this VAT would not be recoverable by Coua even though it is part of a fully taxable VAT group, as Coua has no intention to make taxable management charges post-acquisition.

Indeed, VAT recovery on legal and professional fees has been covered extensively in VAT caselaw (e.g. *Norsemann Gold v HMRC*) and it has been determined that a holding company must actively manage its subsidiaries to be able to reclaim VAT on acquisition costs, and it must not simply be 'passively' holding the subsidiaries as investments with returns by way of dividends or a gain on sale.

Furthermore, VAT on the professional costs passed on by the lender may also not be recoverable by Coua as it is only the true recipient of the supply who is entitled to reclaim the VAT and this is normally determined by the contractual position i.e. if the lender contracts with the advisers it will be their VAT to reclaim / restrict if partially exempt.

Additionally, even if Coua were made a party to this contract, the economic and commercial reality will be determinative instead and so it is not as simple as novating the contract, more detailed analysis of who the supply is being made to would be warranted. They would also need to hold a valid VAT invoice containing the prescribed information.

It has been demonstrated in Appendix 6.3 that the after-VAT cost of the share acquisition will actually be £43,100,000 i.e. an additional outlay of £350,000 (£43,100,000 - £42,750,000). This reduces the forecast five year return from 28.19% to 27.96% (i.e. £12,050,000 / £43,100,000).

5.2 Corporation Tax

Provided Coua Ltd ("Coua") purchases 100% of the shares, U Ltd will form a wholly

owned subsidiary and will immediately join the corporate group from the acquisition date.

It will be part of a group relief group (which requires 75% direct control or 75% indirect control) for corporation tax purposes meaning that it will be able to relieve trading losses with other members of the group going forwards subject to a major change in the nature or conduct of trade, known as a 'MCINOCOT'. A MCINOCOT will arise if the trade of the acquired subsidiary changes within any 5 year period beginning within the 3 years prior to the acquisition.

Any dividends paid by U Ltd up to Coua would not be subject to corporation tax.

Capital allowances will continue to be claimed as before in the subsidiary and there will be no balancing adjustments or stock adjustments for the seller.

Furthermore, since a possible future disposal of U Ltd has been noted at the end of Sam's email, it is mentioned for completeness that a future disposal of U Ltd would only benefit from the Substantial Shareholding Exemption ("SSE") after 12 months, as SSE requires 10% to be held for a continuous 12 month period within the last 6 years.

5.3 Stamp Duty

Stamp Duty is payable by the purchaser of the shares at 0.5% on the value of the price paid, this will equate to £205,000 (i.e. $0.5\% \times £41 \text{ million}$) and will need to be paid within 30 days of the transaction date and a stock transfer form will need to be submitted by the same date.

For completeness, note that if the seller were to include any contingent consideration e.g. an amount payable conditional on future profits, this would form part of the consideration

subject to the 0.5% stamp duty rate.

Sam Ferrers

Tax Partner

BFR Tax LLP

6. Appendix

6.1 SDLT on the land acquisition under Option 1

<u>Value</u>	<u>SDLT rate (%)</u>	<u>SDLT liability</u>	<u>Notes</u>			
(£150,000 - £0) = <u>£150,000</u>	0%	<u>£0</u>				
(£250,000 - £150,000) = <u>£100,000</u>	2%	<u>£2,000</u>				
(£9.6million - £250,000) = <u>£9,350,000</u>	5%	<u>£467,500</u>	Note that SDLT is payable on the VAT-inclusive value, the price is 'net of VAT' and the property is opted to tax			
	<u>Total =</u>	<u>£469,500</u>				

6.2 After-tax cost of the expected construction of the factory and lab factoring in capital allowances

<u>Item</u>	<u>Net cost £'000</u>	<u>Cost after corporation tax relief £'000</u>	<u>Notes</u>			
Land	8,000	8,000	No capital allowances can be claimed on land			

Construct ion	23,000	17,250	23,000 x (1-25%) i. e. FYAs on R&D CapEx			
Equipme nt fit-out	14,000	10,500	14,000 x (1-25%) i. e. FYAs on R&D CapEx			
R&D expenditu re (qualifyin g for RDEC)	Included in outlays above	-4,200	Further 15% on the £28million of R&D revenue expenditure in addition to the 25% included in the outlays above(see commentary in section 4.2)			
	Total =	31,550				

6.3 After-tax cost of the acquisition of U Ltd

<u>Item</u>	<u>Net cost £'000</u>	<u>Gross cost(after irrecoverable VAT) £'000</u>	<u>Notes</u>			
Shares	41,000	41,000	VAT exempt			
Professi onal costs	750	900	Standard-rated at 20% i.e. 750 x 120%			
Rag Trade Finance plc's professi onal costs	1,000	1,200	This assumes VAT is not recoverable as Coua is not the true recipient of the supply.			
	Total =	43,100				