The Chartered Institute of Taxation

Application and Professional Skills

Taxation of Larger Companies and Groups

May 2025

Suggested answer

Introduction

This report has been prepared for the Board of Corline plc. It identifies the direct tax issues arising from the proposed lending to, or investment in, Corline plc and gives advice on how best to deal with these. 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 Lady Caroline Longly, Chair of Corline plc in her letter of 1 May 2025 to Sir Alistair Bentwood, Senior Partner at Garland & Moore LLP. That information included a minute of a meeting of the Corline plc Board on 28 April 2025.

This report is based on our current understanding of the Corporate Tax regime in the UK. We have not commented further on the tax situation in Sealand, as we understand that those matters have been resolved to your satisfaction, as advised by our sister firm Garland & Moore Sealand.

Before you implement our advice, we recommend that we are asked to advise on changes to UK tax legislation that could impact on our advice.

K O'Driscoll
Garland & Moore LLP
May 2025

Executive summary

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

1) Financing structures.
2) Cost of equity investment or borrowing.
3) Acquire assets of or shares in Batteries Nord Srl.
4) Restrictions on tax relief for interest.
5) Change of ownership of Corline plc and restriction of losses.

There are two proposals for raising the required £3,000 million to fund the proposed factory conversions and the Belgian battery manufacturing business acquisition, and to pay the overdue taxes due in Sealand. Either the Hunter family can subscribe for new preference shares or the group can borrow the amount required from UK banks and the Hunter family. Under each option the money would be repayable after 10 years. At that point alternative funding arrangements could be considered if necessary.

Share or asset purchase

The Belgian business can be acquired by way of a share or asset acquisition. As the company remains Belgian tax-resident, or the assets are acquired by a Belgian tax-resident company, only Belgian corporate income tax will be payable on the profits of the Belgian business. Belgian tax advice should be taken to establish whether either route results in a lower Belgian tax charge.

There are no UK direct tax differences between owning the original or a new company.

Financing options

The money raised can be made available to the operating or holding company by way of equity or loan. Where equity has been raised by Corline plc, any onward lending of the funds to other companies in the group will generate broadly equal and opposite interest deductions and receipts, with no net impact on group interest payable. Where loan finance is raised, the net impact will be increased deductions within the group. Those additional deductions could be taken wholly in the UK or, partly in France, Belgium and Sealand.

The annual cost of preference shares at £165 million is lower than the pre-tax cost of interest, at £210 million. However, several tax issues can affect the after-tax cost of both options.

Debt finance

Tax relief is not given for interest expense in Sealand on the borrowing for the Sealand tax settlement, Furthermore, we have concluded that, under the unallowable purpose rules, relief for that interest would also not be available in the UK.

The corporate interest restriction rules will further restrict the availability of interest relief in the UK to £102 million per annum.

However, the overall position can be enhanced by pushing debt down to the French and Belgian companies, if full tax deductions are available in those countries for the interest arising.

That would increase the amount of interest relief available to the group to £126 million per annum. On the basis that French and Belgium corporate tax rates are similar to those in the UK, the after-tax cost of the overall £210 million annual interest expense would be £178.5 million.

Equity finance

No tax relief is available for the payment of dividends, including preference dividends. However, the effective cost of preference dividends is likely to increase because the issue of the preference shares causes a change of ownership of Corline plc and its subsidiary companies. The trade of Corline Cars (No 2) Ltd is likely to be regarded as having undergone a major alteration (from making and selling luxury petrol/diesel cars to making and selling mass-produced electric cars). In consequence, its losses would be prevented from being carried forward for relief. You have estimated the annual cost of that at £20 million over the 10-year period before the preference shares are to be redeemed, thus increasing the effective annual cost of equity finance from £165 million to £185 million.

Furthermore, the preference share route clearly has a non-tax consequence in that Corline plc would become controlled by the Hunter family. As a listed company, Corline plc needs to check any regulatory and other Stock Exchange requirements in relation to such a transaction.

<u>Recommendations</u>

The after-tax cost of the equity route will be greater than that of the optimum debt route (£185 million per annum against £178.5 million per annum) insofar as interest relief can be obtained in full by pushing debt down to France and Belgium. Therefore, if interest relief is available in those countries, we recommend that you proceed with the borrowing route and push debt down to Belgium (via a new Belgian company) and to France.

If interest relief is not available, in part, in those countries, you could take interest deductions in the UK of up to £102 million without any UK restrictions, and achieve the same overall result, so long as the remainder of the interest were relievable in France and Belgium.

If only £102 million of interest were relievable overall, the annual after-tax cost increases to £184.5 million. However, any additional interest relief available in France or Belgium will reduce the annual after-tax cost towards the best figure of £178.5 million.

The borrowings from the Hunter family can be taken out in the UK or in Sealand. Under either option, no tax relief is available.

If no interest can be relieved in France and Belgium, you should instead consider the equity route, the annual cost of which, at £185 million, is almost identical to the after-tax interest cost, whilst recognising the non-tax consequences of Corline plc becoming controlled by the Hunter family.

The decision to buy shares or assets in Belgium will depend on advice on Belgian corporate income tax. The decision might be influenced by any other incidental acquisition and compliance costs.

We recommend that advice is taken in France and Belgium on interest deductions and in Belgium on any differential costs of buying assets or shares.

1. Financing Structures

The equity or borrowings raised can be provided to the operating companies, or to an existing holding company or a new company created to acquire the Belgian business or company, as either debt or equity.

Interest on loans will need to be computed on an arm's length basis to comply with transfer pricing requirements in each country. Leaving aside any small margins arising between borrowing and lending rates, any inter-company loans will produce an interest deduction that is matched by an equal and opposite interest receipt.

Therefore:

a) under the equity proposal there will be no net interest deduction or receipt arising across the group. However, it is possible to generate an interest receipt within the UK and a deduction in an overseas company.
b) under the borrowings proposal there will always be one net interest deduction. It is possible to structure the inter-company debts/equity so that the net deduction arises either in the UK or in an overseas company (or partly in each).

We have considered each of these financing options below.

2. After-tax cost of equity investment or borrowing

Under the terms of the proposed equity investment, an annual preference dividend at 5.5% would be payable (that is £165 million). There is no tax relief for the payment of dividends, so that the annual net cost is therefore £165 million.

Interest on borrowings of £3,000 million by Corline plc, at 7% per annum, would be £210 million for each of the 10 years of the loan. Subject to possible disallowances of interest expenses, and capacity to absorb the deduction (discussed below) if the interest were tax-relieved in the UK at 25%, the after-tax cost to the group would be £157.5 million per year. The net cost would be the same if some or all of the debt and interest were pushed down to France and Belgium, and relieved in those countries at 25%.

Alternatively, if the Hunter loan was made directly to Corline Sealand Ltd, only £126 million (£1,800 million at 7%) would be potentially relievable to the group in the UK, France and Belgium. The interest paid by Corline Sealand Ltd would not attract any tax relief. The overall after-tax cost would therefore be £126 million at 75% (that is, £94.5 million), plus £84 million (interest on the Sealand debt); that is, £178.5 million per year in total.

In summary, if all borrowings were in the UK, France and Belgium the after-tax cost of interest would be less expensive than the payment of preference dividends, subject to any interest disallowances. If £1,200 million of borrowings were in Sealand, however, the after-tax cost would be higher than the cost of dividends.

3. Acquire assets of or shares in Batteries Nord Srl

The Corline group can either purchase all the share capital of the Belgian company or all of its net assets. In each case the consideration payable will be £1,000 million.

As you have ruled out the possibly of moving the tax residence of any company or business, we have not considered moving the Belgian company's tax residence, for example by a change of central management and control. As instructed, we have also not addressed an asset acquisition by a company incorporated outside Belgium.

Purchasing the shares would mean that the Corline group would own a Belgian tax-resident company. That company would be liable to corporate taxes in Belgium. As it apparently has no UK income source and is not tax-resident in the UK, it would have no UK corporate tax liabilities. As a manufacturing company based in a country that does not have a low rate of tax, its profits would not be subject to the controlled foreign company (CFC) regime in the UK which can deem overseas profits to be liable to UK tax in certain circumstances.

Under an asset acquisition, the acquiring company would be liable to Belgian corporate taxes. The asset and liabilities acquired might be stepped up, or down, to the price attributed to them under Belgian tax law. It is possible that some tax reliefs or charges might arise from those changes in value so that the taxable profits in Belgium might be different from those under a share acquisition.

Advice should be taken in Belgium to identify the tax difference between a share and an asset acquisition.

From a UK perspective, owning shares in the existing company, or in a new company that acquires the assets, is unlikely to be of future tax relevance. In either event, any future disposal of a trading company, so long as held for at least 12 months, will be exempt from tax on capital gains in the UK.

4. <u>Restrictions on tax relief for interest</u>

<u>Unallowable purpose</u>

Interest expenses are not allowable in the UK if they are incurred on borrowings for an unallowable purpose. If borrowings are for mixed purposes, the interest is apportioned accordingly. Unallowable purposes include

a) cases where any part of a company's activities are not within the charge to Corporation Tax, or
b) cases where tax avoidance is a main purpose for the borrowing (i.e. the purpose of the loan is to secure a tax advantage).

Borrowing by a UK company for the purposes of investment in a subsidiary company is regarded as part of the borrowing company's activities within the charge to Corporation Tax, and is thus not caught by the first test. Furthermore, where the investment has a commercial purpose, HMRC generally accept that tax avoidance is not a main purpose.

Therefore, interest deductions in the UK for the purposes of investment in the UK and French factories, and to acquire the Belgian battery company will be for an allowable purpose.

However, borrowings in the UK to invest in Corline Sealand Ltd might be regarded as being for an unallowable purpose because:

a) No tax relief would be available on the interest payable in Sealand, as Sealand does not give tax relief for interest. By taking the interest deduction in the UK instead, tax relief would potentially be available. The purpose of generating UK interest on such a UK loan would appear to give rise to a UK tax advantage.
b) The loan is being made by the Hunter family that has significant other business interests which rely on the continuing activities of Corline Sealand Ltd. Its purpose is perhaps therefore to obtain benefit for the Hunter family's other business interests.

It appears therefore that undertaking this borrowing in the UK could fail both tests and the interest might therefore be disallowed as being in relation to a loan taken out for an unallowable purpose. On balance, we consider it likely that the interest would be so disallowed.

Accordingly, the annual after-tax relief interest costs would be as follows:

Project	Borrowing £ millions	Interest at 7%	(Tax relief at 25%)	Net cost
a) UK factory	400	28	(7)	21
b) French factory	400	28	(7)	21

c) Belgian company	1,000	70	(17.5)	52.5
d) Sealand tax settlement	1,200	84	0	84
Totals	3,000	210	(31.5)	178.5

Corporate interest restriction (CIR)

A further restriction, CIR, exists whereby the tax deduction for interest in the UK that would otherwise be allowable (for example, after any unallowable purpose disallowance) is limited to a proportion of adjusted UK taxable profits.

The group's maximum UK tax deduction for interest costs before the impact of CIR will be £126 million per annum (i.e. £1,800 million x 7%). The interest on the investment of £1,200 million in Corline Sealand Ltd will be disallowed under the unallowable purpose rule as discussed above.

The calculation of allowable interest under CIR is the interest payable (after other disallowances) or, if less, the greater of:

a) 30% of UK taxable profits before interest and capital allowances (the fixed ratio method); and
b) the ratio of the group worldwide external interest expense to the group's earnings before interest, tax, depreciation and amortisation (EBITDA) multiplied by the group's UK taxable profits (adjusted as above) (the group ratio method).

We have assumed that pre-tax profits of the existing group, before interest, stay at similar levels as for 2024, and that the Belgian company will add about £100 million per annum. Therefore, future annual global profits will be £642 million (£542 million last year plus £100 million).

All interest expense taken in UK

UK taxable profits of existing group companies before interest and capital allowances for 2025 are likely to be about £340 million. This is made up of £290 million taxable profits of Corline Cars UK Ltd plus £20 million capital allowances, and £30 million taxable profits of Corline Cars (No 2) Ltd, totalling £340 million.

Applying the two tests above to these projected future years' results gives the following amounts:

a) Fixed ratio method - 30% of UK taxable profits of £340 million = £102 million

b) Group ratio method - £126 million (interest)/£642 (global profits) x £340 million = £66.7 million

Hence, £102 million of interest under the fixed ratio method is the maximum amount allowable after CIR restrictions. Therefore, the maximum available relief is restricted to £102 million under CIR, whether or not there is an unallowable purposes restriction.

The annual after-tax cost therefore becomes £210 million less tax relief of £25.5 million (25% of £102 million allowable interest) = £184.5 million

Interest expense taken in France and Belgium

If the interest deductions in respect of France and Belgium (totalling £98 million = 7% x £1,400 million) were pushed down to the respective companies in those countries, and if full deductions against taxable profits were available for the interest in those countries, the position in the UK would be as follows:

Additional taxable interest income of £98 million would be received in the UK, so that the allowable net interest expense in the UK, after the unallowable purpose restriction, becomes £28 million (£126 million - £98 million receivable from France and Belgium).

The fixed ratio CIR calculation in the UK would be 30% of £340 million = £102 million (as above). The group ratio method would be £126 million/£642 million x £340 million = £66.7 million (as above)

As both of these numbers are greater than £28 million of net deductible interest (after the unallowable purpose restriction), the £28 million would be deductible. Insofar as tax deductions in France and Belgium for interest expense of £98 million were available, total interest deductions available to the group would be £126 million (£28 million in UK and £96 million in France and Belgium).

The annual after-tax cost therefore becomes £210 million (total interest payable) less tax relief of £31.5 million (25% of £126 million) = £178.5 million

5. Change of ownership of Corline plc and restriction of losses

Where there is a change in the ownership of a company, its brought forward trade losses are restricted if there is a major alteration in the nature or conduct of its trade within the following five years.

Change of ownership

There is a change of ownership where more than half of a company's ordinary share capital changes hands. The ownership of a subsidiary company is deemed to change if there is a change of ownership of its parent company.

Shares held by connected persons are deemed for tax purposes to belong to a single person.

The proposed voting participating preference shares will be ordinary share capital, as the shares are entitled to company profits in addition to a dividend at a fixed rate.

Members of the Hunter family are likely to be connected persons. Therefore, it is likely that the ownership of the preference shares will be attributable to one person (e.g Michael Hunter) who will therefore own more that 50% of the ordinary share capital. This will represent a change of ownership of Corline plc and of its wholly owned subsidiary companies, including Corline Cars (No 2) Ltd.

Restriction of losses

The trading losses of Corline Cars (No 2) Ltd as at 31 March 2019 are prima facie available to carry forward for use:

a) against future taxable profits of that company, and
b) after five years, as group relief within the Corline group. They will first be available for group relief from the accounting period ended 31 December 2025.

However, the carry forward of losses will be restricted if, in a five-year period following a change of ownership of a company, there is a major alteration in the nature or conduct of its trade.

A major alteration in the nature or conduct of a trade includes a major change in the type of property dealt in the trade, or a major change in customers, outlets or markets of the trade.

While the acquisition of Corline Cars (No 2) Ltd by Corline plc on 31 December 2019 was a change of ownership of that company, there does not appear to have been any major alteration in the nature or conduct of its trade since then; so the carry forward of losses was not restricted.

The Hunter family's share subscription in Corline plc will represent another change of ownership of Corline Cars (No 2) Ltd. Stopping the production of luxury petrol/diesel cars and switching to electric cars might not be regarded as a major change in the type of product dealt in. However, the proposed change in the market at which products will be aimed, from the luxury car market to the mass market for electric vehicles, is likely to be regarded by HMRC as a major alteration in itself. Allied with the change in product, we consider it is very likely that HMRC will regard the changes in product and market as amounting to a major change in the nature or conduct of the company's trade.

Accordingly, the unrelieved trading losses of £800 million would be disallowed going forward. At the current Corporation Tax rate of 25%, those losses are worth £200 million. As these are projected to be used over the next 10 years (by carry forward and group relief) the annual cost of the disallowance would therefore be £20 million per year.