Institution **CIOT - CTA**
Course **APS Taxation of Larger Companies**

Event **NA**

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Answer-to-Question-_1_

**REPORT**

To : Joanne Gray (Norwal Inc)

From : Peter Jones (Stephens LLP)

Date : 1 Novemeber 2024

**Background and Scope**

The following report has been drafted in response to your email dated 1 November 2024.

The report is in has been preared inline with current tax legislation and is covered by our engagement letter dates 1 November 2024.

This report has been prepared for the board of directors of Norwal Inc and should not be shared with any third parties.

No advice contained in this report should be deemed to be agressive tax planning and therefore HMRC should not raise any concerns with the plans set out.

Due to the nature of the group strucutre local advice should be sought in each territory the group operates in.

**Executiv Summary**

It is important that each new company is incorporated locally and centrally management and controlled from its local territory.

The UK branch should be transfered to a Newco which is a subsidary of Macduff, this

would allows the two companies to be in a gains group and income group. It would also ensure the profits are taxed at 25% rather than 35%. Stamp duty will be payable on the purchase of the land and buildings, however capital allowances will be avaible on the cost of the plant and machinery transfered to the UK Newco.

Establishing overseas locally incorporated and manged companies would allow the group to shelter the profits made in lower tax juristcitions from UK CT. These profits could then be distributed to MacDuff by way of an exempt diviend, giving no rise to UK CT. If overseas PEs are established in MacDuff then any profits will remain attributable to Macduff and within the charge of UK CT, however MacDuff will be able to benefit from the losses generated by Spain aswell as losses in the opening years for Czech Republic and Lithania. An examption could be made to exempt all profits and losses, this would allow profits in Portugal and Poland to remain outside of UK CT but would also elemimate the loss releif from Spain, Czech Republic and Lithuaian PEs.

It is our recomendation that the Portugal and Polish braches be transfered to locally incoported and managed subsidaries of Macduff. This will allow their pofits to be sheltered from UK CT entirely. The spanish PE should emains as such, as the tax rates are the same as the UK and should it become profitable there will be no charge to repatriate profits. The Czech Republican and Lithuanian PEs should be established as PEs of Norwall until such time as they become profitable, when they will be then trnasfered to local subsidaries of Macduff. In doing so there is a potential tax saving, over the next two years, of £1,450,000.

The new strucutre should be funded by way of equity funding. This is preferable as the disparity of tax rates between the UK and Riritania will mean that any interest will be taxed at 35% in ruritania but only receive releif at 25% in the UK. This will likey outweigh the cost to repatriate profits to Ruritania by a dividend incurring 5% tax there.

Additionally by funding the restrucutre by way of equity you also negate any potential for thin capialisation rules to apply or for the group to consider the CIR requirements, which could in turn result in a disallowace of UK interest.

**Section A : Residency**

It is firsly important to note and establish where residency would lie for each company or branch. Residency is impacted by two factors, place or incorporation and place of central management and control. The OECD treaty rules that residency is located where the place of effectiive management (PEOM)is, this is often where key decisions are made and where the board sits. In the event that POEM can't be estalished there is a tie braker cluase which states that the relevant competent authorities should come to an agreement where the company is resident. To this effect if the group dicided to set up locally incorporated companies in any overseas territories it should ensure that each entity is centrally managed and controled from that territory.

**Section B : Restructure**

As detailed in your letter, Ruritania does not levy exit charges on the ownership of assets being transfered outside Ruritania. Therefore this will not cause any adverse tax liabilties to arise.

It should be noted that on the purchase of MacDuff Norwall will need to pay UK Stamp duty at a rate of 0.5% of total consdieration.

Current UK Branch

It would make sense to transfer the UK branch to a new UK subsidary, of either MacDuff or Norwall, this will avoid any profits being taxed in Ruritania (@35%) and will also allow the group to form a UK income and gains group. This will give the group flexability in the future should any assets need to be transfered around the group or any future losses be incurred.

It should be noted that the NewCo will incurr stamp duty on any land and building it aquires from Norwall Inc, this will be calcuated on the VAT inclusive consideration. In this case you can confirmed that consideration will be market value (MV), however a they are connected parties MV must be used.

Any fixed assets will be purchased by Newco at MV and will be elligible for capital allowances, unfortunately NewCo will not be able to claim first year allowances (FYA) as they will not be new and unsed and will not be able to claim AIA as they are from a conncected party. Tax releif will be given at either 8%/6% per annum.

VAT will be charged on teh sale of the UK property to NewCo, Newco will need to register for VAT and reclaim this VAT however this could casue timing and cashflow implications that need to be considered. It should be noted that the UK PE and Newco could enter a VAT group to mitigate this issue. I can put you in contact with a memeber of our VAT team to discuss this issue in more detail.

<u>Overseas PEs</u>

There are a number of ways of running the overseas PEs, which will be owned by Macduff. These are to incorporate local companies in each territory (as subs of Macduff) and then transfer the trade and assets to each of them, or to transfer trade and assets to MacDuff and run each territory as a PE. We have detailed the consieration of both below.

Seperately incorporated companies

If each PE is incorporated as a local subsidary of MacDuff then these companies would not fall within the charge of UK corporation tax, provided central management and control is local also (as discussed above)

Overseas subsidaries subsidaries can come into the UK CT charge if they are caught be the Controled Foreign Companies (CFC) rules. The new group is unlieky to be caught by these rules as no overseas profits arise from the UK, therefore it is unlikely that any profits would pass through a gateway.

It is worth noting that any overseas losses generated by these seperaty entities will not be releivable in the UK. Therefore the UK group (being Macduff and Newco discussed above) could not benefit from the losses generated by the spanish sub. You will need to seek local tax advice to confirm treatment, however it is likeley that these profits could be used against future profits.

Similarly the losses generated in the opening years of teh Czech and Lithunian subsidaries would not be able to obtain UK CT releif.

Should the new local subsidaries want to distribute profits to Macduff they would not be taxable in the UK as they would meet the participation condition. You would need to seek local advice as there may be witholding tax on the dividends locally.

Local trades remaining as PEs but of Macduff

If the group were to transfer the trade and assets of each PE to MacDuff there would be no exit charge(as discussed above). Macduff would need to pay stamp duty on the purchase of any land and buildings from Norwall however as they are not within a UK gains group.

similarly MacDuff would be able to claim capital allowance on the purchase of plant and machinery from Norwall.

The profits and losses for each PE would be attribuited to the UK company and charged to UK CT, however double taxation releif would be given for any oversea ta suffered locally be the PE on its profits. As all PEs have an equal or lower tax rate than the UK,all would effectly be taxed at 25%. It is possible to make an election to exempt PE profits and losses, this is discussed below.

Losses generated by Spain, Chzech and Lithuania should be considered also, these would be directly attributed to the Macduff and releif given at 25%.

PE Eemption

The group could elect to exempt all PE profits and losses from UK CT. This election applies to all PEs and is irrovocable, therefore due consideration should be given to the long term planning of the group. If you would like to use the election it should be made in advance of the start of the accounting period you wish for it to become active in.

This exemption allows for local PE profits to be only taxed in the territory in which the PE resides, as Portugal, Polnd, Czech Republic and Lithuania have lower tax rates than the UK, this would present a tax saving the group.

However as importand as lower tax on profits is, we should also consider the implications on losses. These will be exempt from UK CT and therefore there will be no UK releif gained for these losses. As the Spanish, Czech Republican and Lithuanian PE are expected to be losse making in the next few years releif for these should be retained wherever possible.

You have mentioned that there is no b/fwd losses in the group so i will assume that each PE has been profitable in the past. If there were b/fwd losses for the PE's this could impact the timeframe the exemption takes to come into effect. If this is not the case then we could consider streaming the total opening negative amounts to allow the profits from Portual and Poland to become exempt sooner.

Other Considerations

As the group is considered large for transfer pricing rules it would need to ensure that any intercompany trasnactions are at market rate. This is often done by useing fuctional analysis, such as benchmarking, to esatblish the fair market rate. Additionally the group will need to keep all the transfer pricing documentation required by law. The group will need to elect a reporting entiry which will hold a master file containing a summary of all transfer pricing decisions, a local file containing details of material transactions and will also need to undertake country by country reporting to create risk assesments for transfer pricing. This could increase the admin burden on teh group.

Also associated companies would need to be considered for Macduff and the New UK Newco (former UK branch of Norwall) previosly Macduff appears to be large for CT (assuming taxable profits are similar to accoutning profits) however with the addition of a new group strucure the Macduff would likely be treated as very large, requiring QIPs to be paid sooner that previosly, consideration should be given for the cashflow impacts of this.

**Section C : Tax liabilties**

Following on from the above structues we though it would be useful to demonstrate the potential future tax liabiles which may arise under each strucure. These are detailed

below.

All the below options assume that the UK branch will be transfered to a NewCo underneath Macduff.

If no changes are made and all the PEs reamin PEs of norwal inc then all profit and losses will be taxed/releied at 35%. This will generate a tax liabilty for 2025 and 2026 of £1,575,000 and £2,265,000 respectivly, with an overal tax libailty for the whole period of £3,840,000. Please see appendix 1 for detailed calcuations.

In order to benefit from the sheltering of profits in Portugal an Poland if we incorporate these branches and left spain as a PE of MacDuff then the tax liability for 2025 and 2026 of £995,000 and 1,635,000 respectivly, with an overall tax libailty for the whole period of £2,630,000. Please see appendix 2 for detailed calcuations.

Consideration should be given for the fact that Ruritania has a tax rate greater than than of the UK, being 35% compared to our 25%. Therefore additional tax releif could be gained by leaving the loss making PEs as PEs of Norwall, attracting releif at 35%. If instead it were the case that Portuguese and Polish PEs were incorporated as subs of Macduff but the spanish PE remained a PE of Norwall then the laibilties of 2025 and 2026 would be £805,000 and 1,585,000, with an overall tax libailty for the whole period of £2,390,000. See appendix 3 for detailed calcuations. If the spanish branch becomes profitable it should remain a PE of Norwall as spanish tax is 25%, the same as the UK, so there would be no tax saving in making is a sub of Macduff. instead there would actually be a tax loss as any dividends from Macduff to Norwal will be taxed at 5% in ruritania.

A similar technique could be applied to the Czech and Luthuanian PEs, whereby they remain as PEs of Norwall, so that any losses are releived at 35%, then once profitable

they are transfered to locally incorporated and manged subsidaries of Macduff. This would allow  for efficent and fast use of any losses generated.

Therefore it is our recomendation that the Portugal and Polish braches be transfered to locally incoported and managed subsidaries of Macduff,while the spanish PE remains as such.The Czech Republican and Lithuanian PEs should remain PEs of Norwall until such time as they become profitable, when they will be then trnasfered to local subsidaries of Macduff. The above figures demonstrate a potential tax saving of £1,450,000.

**Section D :  Finance**

As requested we have explored two finacning options, debt and equity. The following options are based on the purchase of the UK branch (as a new UK sub, the Portugese branch and the polish branch. As discussed aboce the spanish branch should remain as PE of Norwall. This will come at a total cost of £36m.

Equity financing

If Macduff issues new shares to Norwall then no UK stamp duty will need to be paid on the cost of these shares. The price paid would form the base cost for a future disposal.

Any profits from UK subsidaries would be distributed to Macduff as exempt divideds, these would not attract a UK CT charge. You will need to ensure your local advice considers any withild tax that may be held on divideds from Portugal and Poland.

Consiquesntly any profits from Macduff will be distributed and repatriated by way of a divided to Norwall. The UK does not levy any witholding taxes on dividends. However Ruritania does tax dividend income at a rate of 5%. For demonstrative purposes if we say Macduff's profits for 2025 are the same as in 2024, and all 2025 profits from Macduff,

UK NewCo, Portugese Newco, Polish Newco are distibuted (£9m) then the tax suffered in Ruritania for this would be £450K which is outweighted by the benfit of £770K seen in 2025 under the above proposed strucutre.

For the avoidance of doubt there would be no VAT arrising on a share issue.

Debt financing

Transfer pricing rules would require that a market rate of interest is charged on any intercompany loan. (TP requirement have been discussed above). This would further increae group admin as TP reporting would need to be done.

The group would also need to consider if MacDuff had become thinly capitalised. Thin cap rules apply where a company has excessive debt and the rules seek to disallow any interest on debt that is excessive. This is usually calcuated by looking at the amount of debt, and rate of interest a company could get without group support. If a disallowance is made then no corresponding adjustment is given in the other territory.

MacDuff would be able to claim a tax deduction for the non trade loan relationship debits (interest) arising on the loan, however this would also mean that the income would likey be taxable in Ruritania. This would cause a net tax charge for the group as the interest would be taxed at 35% but only releived at 25%.

Due to the level of debt the group will also need to condsider teh implication if this additional interest in the groups Corporate Interest Restriction (CIR) requirements for those companies with the charge ti UK CT, being Macduff and UK Brach Newco.

Macduff already has interst costs of £1.8m, whihc means that upon aquiring it the UK entites will already by near the £2m threshold for CIR. Any additional intersst from the

loan would likey push them over the threshold.

Assuming Macduff projects to have a similar year to 2024 and operating expenses are similar to tax EBITDA. The group would have an interest capacity of 2,490,000, as the group would already have UK interest expense of £1.8m it could afford another 690K of interest without a disallowance. Anything over this would be disallowed and no tax releif given in the year of charge. Note UK Newco (current UK branch) does increase in profitablily next year so tax EBITDA might increase and allow for the reactivation of dissallowed losses.

If a CIR restriction is needed the group would need to elect a reporting company who would submit an annual full CIR return, detailing the calcuations behind the disallowable amount and the allocation of the disallowable amount around the UK group.

When considering th repatriation of profits, having a loan would give greater flexibility as it would allow MacDuff to repatriate cash to Ruritania by way of a loan repayment. This would shelter this cash from the dividend tax of 5% in Ruritania.

The UK levies witholding tax of 20% on overseas interest payments (unless OECD model traty applies). Therfore the group would need to submit CT61s quartlery and pay over any tax deducted to HMRC. Local advice would need to be sought in ruritania to confirm if relief could be claimed there for this witholding tax.

For the avoidance of doubt there would be no VAT arrising on a share issue.

Becuase of the likely CIR resitrcion and the imbalance of tax rates, causing income to be taxed at a much higher rate than releif can be ontained, we would recomend that the aquistion of the UK branch, porugese PE and Polish PE is funded by an equity

investment into Macduff, which will then intrun make an equity investment into three locally incorporated NewCos.

It should be noted that if repatriation of profits was a concern of yours then you could do a loan, which gived interst of up to £690k per year, and then equity finance the balance. This would still be hindered by the disparity of tax rates between the UK and Ruritania and any saving on taxable divideds would lieky by erroded by the loan interest charges and deductions.

**Appendix 1**

| | UK Branch | Portuguese Branch | Polish Branch | Spanish Branch | Total |
|---|---|---|---|---|---|
| Profits 2025 | 2,500,000 | 2,000,000 | 1,500,000 | (1,500,000)N1 | 4,500,000 |
| CT @ 35% | 875,000 | 700,000 | 525,000 | (525,000) | 1,575,000 |
| | | | | | |
| Profits 2026 | 3,000,000 | 3,000,000 | 2,000,000 | (500,000) | 7,500,000 |
| CT @ 35% | 1,050,000 | 1,050,000 | 700,000 | (175,000) | 2,265,000 |

N1 - Assume losses are releiveable agsint ruritanian profits

**Appendix 2**

| | UK Sub | Portuguese Sub | Polish Sub | Spanish Branch of UK sub | Total |
|---|---|---|---|---|---|
| Profits 2025 | 2,500,000 | 2,000,000 | 1,500,000 | (1,500,000)N1 | 4,500,000 |
| CT @ 21% | | 420,000 | | | 420,000 |
| CT @ 19% | | | 285,000 | | 285,000 |

| CT @ 25% | 625,000 | | | (375,000) | 250,00 |
|---|---|---|---|---|---|
| | | | | | |
| Profits 2026 | 3,000,00 0 | 3,000,000 | 2,000,000 | (500,000) | 7,500,000 |
| CT @ 21% | | 630,000 | | | 630,000 |
| CT @ 19% | | | 380,000 | | 380,000 |
| CT @ 25% | 750,000 | | | (125,000) | 625,000 |

N1 - Releiveable against UK profits

**Appendix 3**

| | UK Sub | Portuguese Sub | Polish Sub | Spanish Branch of Ruritanian company | Total |
|---|---|---|---|---|---|
| Profits 2025 | 2,500,00 0 | 2,000,000 | 1,500,000 | (1,500,000)N1 | 4,500,000 |
| CT @ 21% | | 420,000 | | | 420,000 |
| CT @ 19% | | | 285,000 | | 285,000 |
| CT @ 25% | 625,000 | | | | 625,000 |
| CT @ 35% | | | | (525,000) | (525,000) |
| | | | | | |
| Profits 2026 | 3,000,00 0 | 3,000,000 | 2,000,000 | (500,000) | 7,500,000 |
| CT @ 21% | | 630,000 | | | 630,000 |
| CT @ 19% | | | 380,000 | | 380,000 |
| CT @ 25% | 750,000 | | | | 750,000 |
| CT @ 35% | | | | (175,000) | (175,000) |

Appendix 4

IC of UK Group for 2025

| | | | |
|---|---|---|---|
| EBTIDA of Macduff | 5,800,000 | | |
| EBITDA of UK NewCo | 2,500,000 | | |
| total EBITDA | 8,300,000 | | |
| 30% of total EBITDA | 2,490,000 | | |
| Current interest | (1,800,000) | | |
| IC headroom | 690,000 | | |
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