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Answer-to-Question-_1_

To: Norwal Inc, Joanne Grey, Global tax director

From: Stephens LLP, Peter Jones

Date: 14 November 2024

Title: Regarding the proposed restructure of group

Introduction

This report is to provide our response to the items raised in Joanne Grey's email dated 1 November 2024 on the proposed acquisition of Macduff Ltd and the expansion plans in the UK.

This report is for the sole purpose of Norwal Inc and its oversea branches. We will not accept any responsibility for any reliance placed on this report by third parties.

This report is based on tax law in place in the UK at the time

Executive summary and Recommendations

1. Acquisition of Macduff Ltd

Tax implication of the purchase onf Macduff will be the stamp duty liability £7.685m of based on the net asset value of £1,537m.

We recommend that further due diligence to be performed on Macduff to determine the value of the shares. It could be beneficial to seek HMRC clearance on the value of the shares in Macduff.

In addition to this, purchase of the shares in Macduff means Norwal is taking on all the

histories of Macduff so would be worth drafting warranties or indemnities to mitigate any liabilities arising on historic transaction by Macduff.

We advise that the current directors of Macduff to seek separate tax and legal advise.

2. Funding option for the expansion and restructure

Where equity funding is provided from Norwal, dividend payable from the UK will not receive any tax relief, nor will it attract any WHT. However, on receipt in Ruritania, the dividend will be subject to Ruritanian tax at 5%.

Debt funding have been considered for two option. One option being in the form of an external bank loan in the UK. The second option being in the form of intercompany loan from Norwal. Interest expense incurred in the UK will have immediate tax relief by interest expense being deductible in Macduff, on the provision that the interest expense is deductible under CIR rules.

We understand there is currently low level of borrowing in existing Norwal's UK branch. CIR impact should be considered for the finance expense incurred in Macduff. Should the long term creditors be refinaned during the acquisition of the Macduff, there should be scope for deduction of finance interest in the UK.

Debt financing from Norwal was considered but this is not advised due to the 20% WHT applied by the UK on interest payable from a UK company to an oversesas company that is not within the carge to UK corporation tax.

We therefore advise that external loan from a UK bank is used to finance the overseas expansion as well as the restructuring. We recommend further interest deductibility analysis is conducted prior to proceeding with this as well as receiving overseas tax

implication of the treatment of interest expenes in the overseas jurisdiction.

3.restructuring the overseas entities

We have discussed the different UK tax implication on the implication of Macduff holding overseas PE or holding shares in overseas subsidiaries.

Based on the tax impact projected for the next three years, incorporation of the profitable overseas trade will result in total tax saving of £610k achieved by utilising lower overseas CT tax rate. This is as a result of incorporating the profitable overseas trade in Portugal and Spain.

For the loss making region, Spain and the two new jurisdiction, trade loss that arose in those regions have the potential tax benefit of £1,275k pa based on the releivable profit expected in the UK based on FY24 results. Once incorporated, the overseas losses are not available to be used in the UK. Therefore, we recommend that for the loss making jurisdictions, Macduff should hold the overseas trade as an overseas PE and consider incorporation once each jurisdiction becomes profitable.

We recommend that tax advise and legal adivse to be sought in each jurisdiction surrounding the incorporation and any tax implication.

General comment

Our advise provided does not include any tax advice that may be considered as aggressive tax planning by HMRC.

1. Acquisition of Macduff Ltd shares

We understand that you are considering the purchase of shares in Macduff Ltd using cash

reserves from Norwal Inc.

On acqusition of Shares UK company, there is a stamp tax payable by Norwal of 0.5% on the value of shares purchased. We understand it is the management's decision to use the market value of assets to be purchase so based on the net book value of net assets provided in the Exhibit B for Macduff Ltd as at 30 June 2024, we expect the value of shares purchased will be £1,537m. Therefore, there will be a stamp duty liability of £7.685m(1,537m*0.5%).

Cash consideration to the four current directors of Macduff Ltd will be charged capital gains tax on the gain arising. This may qualify for business asset disposal relief where they will be tax at 10% up to a life time limited of £1m chargeable gain. Otherwise, they will be taxed at 20%. We adivse that the directors receive separate tax and legal advice on the disposal of their shares.

We understand there is sufficient cash reserves in Norwal for this acquisition but should this be required for the other expansion and restructuring, there are options of paying for the considerations in other forms than cash.

Consideration could be in the form of shares in Norwal Inc. With 90% holding of shares by a private equity group, we expect this option will not be accepted as this will lead to dilution of shares by the current shareholders. However, as Norwal is not charge to UK tax, this will not constitue a share for share exchange provision.

Another option would be to issue qualifying corporate bond in the form of loan note to the current shareholders of Macduff. This would be beneficial for the current shareholders as gais will be frozen until the eventual disposal of the corporate bond. However interest expense will arise for Norwal and therefore this is not recommneded.

Purchase of shares is exempt from VAT so no VAT implication on the acquisition of Macduff.

2.Expansion into Czech Republic and Lithuania

THis section considers how the expansion should be funded. In line with the further restructruing we understand the expansion into Czech Republic and Lithuania will be structured by either establishing a PE of a UK company(Macduff Ltd) in each jurisdiction or setting up a new subsidiary under Macduff Ltd. This is discussed in the next section along with the other overseas branch

1. Fund expansion by equity with overseas PE

Equity funding can come from Norwal to Macduff Ltd. Macduff will then pay dividend to Norwal once there is sufficient distributable profits.

Dividend payments to parent entity will not be a dedutible expense in the UK.

There will be no withholding tax levied in the UK. From the new UK-Ruritania tax we understand dividend income will be taxed in Ruritania at 5%.

2. Fund expansion by equity with overseas subsidiary

Similarly to option 1, initially there will be requirement for equity funding from Norwal to Macduff which will then be passed down to the new subsidiary in Czech Republic or Lithuania. In this case dividend will be payable from Czech Republic or Lithuania to the UK and then from the UK to Ruritania. In the UK, Dividend received from its controlling subsidiaries is expemt from UK corporation tax. However based on OECD treaty, there is 5% withholding tax on dividned payments where dividend is paid to a company with

more than 25% share holding. We would need to confirm this with the specific UK double tax treaties with Czech Republic or Lithuania if there are any treaty clause to reduce the WHT of dividend further.

As neither Czech Republic or Lithuania are expecting to be profitable for the next 5 years, it would not be possible to extract any returns by dividend.

3. Funding expansion by debt from UK bank to Macduff Ltd

Interest expense will incurr in Macduff for the external bank loan. THis will fall under the UK loan relationship rule. THere is CIR provision in the UK which limit total UK net interest expense of a group to £2m or to the interest capacity determined based on 30% of tax EBITDA. Based on Macduff's FY24 income statement, it incurs finance expense of 1.8m therefore, any interest expense above 200k additional interest expense will risk the interest expense to be disallosed in the Macduff UK CT return. However, this disallowance is not permanent. Should there be any extra capacity in the future based on the future tax-EBIDA increasing in future years, the disallowed interest expense can be re-activated in the year where there are excess interest capacity.

If the overseas expansion is incorporated, there would be a further intercompany loan between the new overseas subsidiary and Macduff Ltd. Here we would need to consider the tax implication on deductibility of interest expense Czech Republic and Lithuania as well as any WHT leveied on interest payment.

From a UK persepective, loan relationship between related parties have a different treatment in which the credit and debits are not brought into tax. Therefore the interest received from the overseas subsidiary will not be taxable, therefore not impacting CIR but the interest payable to external bank will fall under the CIR provision.

4. Funding expansion by debt from Norwal interecompay loan

This will depend on the level of cash reserves avaialable in Norwal. Assuming there is sufficient cash reserves, an intercompany loan agreement could be put in place between Norwal and UK Co.
Interest expense will once again be incurred in UK which is deductible expense if not caught by CIR provision. However, interest payable from a UK company to an overseas company is subject to withholding tax at 20% and therefore Norwal will receive the interst net of the 20% WHT.

If Norwal is required to seek external loan from a bank in Ruritania, the interest expense will be dealt in accordance with Ruritanian tax law but based on the level of long term creditor in Norwal this may be an option.

If the tax treatment in the UK interest paid and Ruritania interest income, there would be a hibrid mismatch risk.

Summary
Based on the above, it appears that the funding via debt is more beneficial due to the additional deduction available in the UK for interest expense. This is on the basis that with an increase profitable group, interest capacity will likely allow for the deduction in the future even if there are initial disallowance but we advise further analysis of the potential CIR impact.

Comparison of option 3 and 4, there is additional WHT implication if intercompany loan is provided from Norwal therefore it is advised that external debt is sourced in the UK.

The equity funding does not provide any immediate returns to Norwal as dividend will not be paid by the loss making overseas entities an if any dividend is paid, this will be subject to 5% tax in Ruritania.

B Restructing for UK to hold all overseas entities

We understand there is expected changes to corporation tax rates in Ruritanian and introduction of a new UK-RUritania double tax treaty. Based on this we understand you are considering moving the overseas branch from Ruritania to a UK company.

Continue as PE of UK company

Under UK tax, we consider overseas branches to have a permanement establishment (PE) where there is a fixed place of business or a permanent agent acting for the company on the overseas jurisdiction. As Norwal's overseas operation involve retail premises, we understand there is a fixed place of business in the key overseas branches.

Any PE profit of a UK company is subject to UK tax with a couple of reliefs available for tax suffered overseas. Double tax credit relief can be claimed at the lower of overseas tax suffered and UK tax on overseas profit subject to overseas profits. It is on the basis that the profit allocation to the overseas branch is at an arm's lengh basis and that no transfer pricing adjustment is required. (Credit relief is outlined in Appendix)

Where double tax credit relief is claimed the total tax liabiliy of the Portugal and poland PE is £1,750k and £1,375k respectively. (appendix)

There is another form of relief available for overseas tax is for the UK company to make a overseas PE exemption. This must be made prior to the commencement of the accounting period and will apply to all overseas PE. This is where all profits attributable to the overseas PE is exempt from UK corporation tax. THis mean for Portugal and Poland, the tax liability will only be incurring for the local tax. However, any losses incurred in the overseas PE will not be available to offset any taxable profits arising in the

UK.

We understand you wish for all overseas trade to be held directly by Macduff. If this was not the case, it may be worth incorporating a separete UK company which would hold the trade and asset of the loss making regions separately so that the overseas PE exemption can be applied to the profit making overseas PEs only.

For Spain where there is projeted loss for the next three years.
If it is held as an overseas PE of a UK company, the losses incurred in the spanish branch can be utilised to offset against the other UK profits incurred in the UK company providing expected UK corporation tax relief in the next three years of £1m(4m*0.25).

The similar point should be considered for the expansion into Czech and Lithuania. Any losses incurred in the overseas PE expected for the first five years would be available to be offset against UK profits. Based on Macduff's FY24 figures taxable profits of £2.6m and existing UK PE's taxable profits of £2.5m there is sufficient UK profits to claim the losses with maximum expected tax saving £1,275k((2.6+2.5)*25%).

<u>Continue as overseas subsidiaries of a UK company</u>
The profit attributable to an overseas subsidiaries are outside the scope for UK corporation tax. THerefore the local tax rate is applied. Based on the projected forcast, project tax liability is £1,470k for Portugal and £1,045k for Poland.

Losses are incurred in a Spanish incorporated subsidiary, losses will remain in the spanish entity and will be offset against future taxable profits incurred in the Spanish entity. Same would apply if the Czech and Lithuania expansion involve incorporation of overseas subsidiaries

The overseas subsidiaries will be considered as controlled foregin company (CFC) for the UK company (Macduff). This provision is to catch any profits artificially deverted out of the UK.

There are entity level expemption and if no exeption applies, a gateway test is applied to the profits arising in the CFCs and if any profit pass through these gateway tests, this will be charged to 25% UK corporation tax.
THe overseas subsidiaries are in EU member state and they are expected to fall under the excluded territories exemption therefore there should be no CFC impcat to Macduff.

Consideration of timing of incorporation of overseas PE
Under Ruritania tax we understand there is no exit charge that are levied in Ruritania on a change of ownership of an asset unless the asset is physically located in RUritania. Therefore, we understand there is no Ruritani tax impact if the trade and asset of the overseas trade is transferred from Norwal to the new UK co (Macduff) or whether the newly incorporate overseas shares are transferred from Norwal to Macduff.

However, in the UK there is an exit charge where an overses PE of a UK company is incorporated and therefore will become outside the scope of UK corporation tax. In this event, exit charge will arise as the disposal of chargeable assets, IFA etc at market value as at the date of incorporation. As the overseas entities are in the EU, there is a exit charge payment plan which allows for the spreading of exit charges across 6 years. This charge will arise if the trade and asset transferred from Norwal to the UK co is then incorporated. THerfore, for Portuguese and Polish branch, it would be advisable to

incorporate first under Norwal and then transfer the subsidiaries to a UK co.

Transfer of existing UK trade to UK company(Macduff)

Once Macduff is acquired, Macduff will be a wholly owned subsidiary of Norwal and therefore will form a loss group, capital gains group and IFA group. Therefore, transfer of trade and assets of the UK PE currently held by Norwal will be transferred to Macduff at a no gain no loss or tax neutral manner.

Transfer of the land and building would be exempt from SDLT as Norwal and Macduff (post acquistion) will form a SDLT group.

The freehold properties in the UK branch is opted to tax. Prior to the transfer Macduff should opt to tax these properties to no incur any VAT implication.

Summary

Based on on the calculation shown in appendix 1 for Portugal and Poland, total tax liability will be 280k and 330k lower in respective regions if the entities were incorporated. Therefore it is advised that the profitable overseas branch is incorporated first under Norwal, then to be transferred to Macduff to avoid any exit charge.

For the loss making regions, Spain, Czech and Lithuania, it would be advisable to retain them as an overses PE. THe trade and asset for each region should be transferred from Norwal to Macduff. As Macduff and Norwal will be in the same loss, gains and IFA group, there should be no tax impact on the transfer. Consideration for this should be funded by debt financed in the UK based on the considerations discussed in the previous section. Loan from a UK bank will allow deduction for the interest expense in Macduff and will not be subject to any WHT implication should the interest be payable to Norwal in Ruritania. Alternative equity funding will give rise to Ruritania tax on dividend

received at 5%.

Appendix

Appendix 1

Comparison of CT chargeable in UK - Portugal, polish spansh remainig as overseas branch vs incorporate

Portugal		Total	FY24	FY25	FY26
			£	£	£
projected profit			2m	2m	3m
local tax	21%	1,470k	420k	420k	630k
UK tax on branch profit	25%		500k	500k	750k
less DTR*			(420k)	(420k)	(630k)
UK tax		280k	80k	80k	120k
Total tax as overseas PE		1,750k	500k	500k	750k
tax as overseas sub			420k	420k	630k
Poland					
projected profit			2m	1.5m	2
local tax	19%	1,045k	380k	285k	380k
Total tax as oversea PE	25%	1,375k	500k	375k	500k
difference		330k	120k	90k	120k

Spain					
projected loss			(2m)	(1.5m)	(0.5m)
same tax rate in spain and UK					

*DTR based on lower of overseas tax or UK tax on overseas profit.