Answer-to-Question-_1_

Memo to board of German Kitchen Ltd

This memo will cover a wide range of topics regarding German Kitchen Ltd's ("GKL") financing including UK tax deducibility of interest payable, UK corporation tax treatment of the Irish permanent establishment ("PE") and the UK WHT implications of the payments made to group companies.

1. *Interest deducibility*

GKL will have two interest payments to make as part of its new financing, £1.68m to the UK bank each year (4.2% of £40m) and £4.2m to Deutsche Kitchen Financing Ltd ("DKF").

As the group exceeds the size limits for small and medium enterprises, transfer pricing rules and thin capitalisation rules will apply. These are anti-avoidance measures in place to ensure that there are tax advantages taken to create excess deductions in high-tax countries and excessive income in low-tax countries. As Deutsche Kitchen GmBH is the head parent of both GKL and DKF, they will be connected for transfer pricing and thin capitalisation rules (participation condition).

Based on the information provided, the £100m loan from DKF will need to be at arm's length, this includes the interest rates, the amount of the loan as well as other loan arrangements. From the comparison with the UK bank loan of £40m, although the interest rate seems to be at arm's length (both 4.2%), the amount of the loan provided by DKF seems excessive (£40m v £100m).

Benchmarking studies and functional analysis should be undertaken to ensure that the interest rates and loan arrangements are at an arm's length basis.

As such the thin capitalisation rules are applicable. This is where two group companies are involved in a loaning arrangement and may provide loans at a discounted or less favourable arrangement as a result of being connected compared to third party. This is particularly applicable

-

when the debt capacity exceeds the equity of a company.

Therefore, it is likely that the £100m interest payable will be restricted as a result of thin capitalisation rules and therefore it would be prudent to restrict the interest payable to DKF from £4.2m to £1.68m so £2.52m should be disallowable deductions within the tax computation of GKL.

Furthermore, CIR rules should be considered. These are also a form of anti-avoidance provisions within the UK which are used to reduce excessive tax deductions from being made as a result of interest payments. This includes both external loans as well as intergroup companies loans.

CIR restricts the interest deducibility available based on the UK EBITDA (earnings before interest tax depreciation and amortisation). There is a de minimis of £2m for the UK net interest expense. Based on the above thin capitalisation rules (thin capitalisation rules must be considered before CIR), the net interest expense for GKL is £3.36m and therefore GKL will be applicable to CIR rules.

This can either be through the fixed ratio or the group ratio. The fixed ratio will restrict the interest allowance to 30% of the UK group's tax EBITDA and will compare this to the aggregate net interest expense ("ANTIE"). The group ratio can offer greater deducibility as this considers the global interest deducibility position of the group and the % will be higher than 30%. This requires the worldwide group tax EBITDA as well as the group ANTIE.

There is currently insufficient information to provide the actual interest disallowance for CIR as there is no EBITDA information but this must be considered by your tax compliance provider ahead of drafting the tax computation for GKL.

Furthermore, there may be further restrictions as a result of anti-hybrid rules, another anti-avoidance provision. This will need to be considered further once the Maltese treatment of the loan interest received by DKF is more clear. This looks at eliminating double deductions or deductions/ non-inclusions which could be the case here where GKL takes a deduction for the interest paid but DKF does not pay tax on the interest income received. Further consideration and information will be required to have a better understanding of the applicability of the anti-hybrid rules.

2. *Irish PE*

The Irish PE will be subject to UK tax as all UK tax resident companies are subject to corporation tax on their worldwide income (which includes any global PEs). As such, the Irish PE may also be chargeable to Irish corporation tax on its Irish activities.

Assuming that the Irish-UK DTT follows that of the OECD Model, then Article 5 will detail how the PE should be taxed. There will be double tax credit from the Irish taxes suffered when calculating the UK tax equivalent of the Irish activities in Ireland. The UK equivalent tax will be calculated as if the Irish PE is a UK tax resident entity and all of the regular UK tax rules apply, i.e. deductions for expenses, capital allowances etc.

The tax credit will be the lower of the Irish tax suffered against the UK equivalent tax (i.e. 15% vs 25%). As the Irish tax rates are lower, this will be the cap of the double tax credit available in the UK.

As both the UK and Irish operations of GKL are expected to be profit-making from the start, it is expected that they will be paying taxes going forward. Therefore, it is recommended that a PE exemption election is made to exempt all PEs of GKL to come within charge of UK CT.

This will be applicable to all PEs of GKL (even future ones) and will be irrevocable. This must be made before the start of an accoutring period in order to be valid and must be written to HMRC. This means that the Irish PE will only be taxable in Ireland and will no longer come to charge to UK CT.

3. *WHT*

There is no WHT on the bank loan to the UK company.

Assuming that the loan to DKF is longer than 12 months, then this will be applicable to WHT. The standard UK WHT on interest is 20% but this can be reduced according to the DTT available. Assuming that the UK-Malta follows the OECD Model Treaty then Article 11 must be considered. This states that the interest rate can be reduced to 10% so there will be £420,000 of WHT to pay on the £4.2m interest payable.

Royalty payments in the UK also have a standard 20% WHT rate which can be reduced further according to the DTT available. The UK-Switzerland DTT (assuming it follows the OECD Model) will include within Article 12, paragraph 1 that it will only be taxable in Switzerland and therefore no royalty WHT is applicable.

Dividend payment to Deutsche Kitchen GbmH have a standard WHT of 0% in the UK as they tend to be exempt for UK tax purposes. However, based on the UK-German DTT, the WHT rate will either be 5% if owned by at least 25% or 15% if owned by less than 25%. As Deutsche Kitchen GmBH is 100% parent of GKL, the lower rate of 5% is applicable. The tax on the dividend payment must be withheld by GKL ahead of making the dividend payment to Deutsche Kitchen GmbH.

The payment for the kitchen units does not fall within the definition for interest, royalty or divident payment and therefore there will be no WHT implications. However, this will come within transfer pricing applications and therefore the Group must ensure that this payment is made at arm's length as if it would be made to a third independent party rather than to a connected group company.

We are happy to discuss any of the points made above if anything is unclear.

---------DO-NOT-EDIT-THIS-DIVIDER----------

Answer-to-Question-2

Letter to Luis

Dear Luis,

I am writing in respect of your UK tax position for the 2024/25 tax year below.

1. *UK tax resident position for 2024/25 tax year*

Residence position in the UK is determined by the statutory residence test ("SRT") which has 3 parts and they are hierarchal which means that the automatic overseas test comes first, followed by the automatic UK test and then by the sufficient ties test.

As you have never been in the UK before, you are considered to be an "arriver" for UK tax purposes. The first automatic overseas test is applicable to leavers and therefore not applicable for our case here.

The second automatic overseas test looks at if you were not a UK tax resident for the past 3 years and you spend less than 46 days in the UK in the current tax year. This is not applicable as you will only spend 95 days in the 2024/25 tax year (from 1 January 2025 to 5 April 2025).

The third automatic overseas test looks at if you worked full time overseas and spend less than 91 days in the UK, have no significant breaks from overseas work and work less than 31 days in the UK for full time. This again is not applicable as you spend more than 91 days in the UK.

We must then look at the automatic UK tests. The first test looks at whether you spend 183 days or more in the UK which is not applicable as you will only be spending 95 days. The second test looks at whether you will have a UK home for 91 consecutive days and spend at least 30 days at any time and had no overseas home or spend less than 30 days in the overseas home within the tax year.

Although you will have a UK home for more than 90 days, you will have an overseas home for more than 30 days, assuming that the days before 1 Jan

2025 will all be spent in your Brazilian home which you will be retaining so this test is not applicable.

The final automatic UK test is if you work full time in the UK and more than 75% (274 days) within a 365 day period are in the UK and one day falls within the 365 day period and tax year. This is the case here as you will be working full time in the UK and no longer working overseas. Since this is a three-year secondment, I understand that you will be working in the UK from 1 January 2025 to 31 December 2027 and therefore you will meet the second and third condition of this test. Therefore you will be a UK tax resident for the tax year 2024/25.

This will be a split year as you will be Brazilian tax resident for parts of this period as well. Therefore, cases 4-8 must be considered. Case 5 of when you start full time work in the UK will be applicable, therefore you will be UK tax resident from 1 January 2025 for the tax year 2024/25 and Brazilian tax resident for the period prior to that.

2. *Salary and benefits tax*

If you were to be tax resident from 1 January 2025 then your salary will be subject to UK income tax, including the £60,000 bonus.

The cost of return flights to Brazil will only be deducted if this is the first flight to the UK and the last flight back to Brazil (s.373 ITEPA 2003). Any flights taken in between and within the 3 year secondment will be a taxable benefit. Conditions A and B must be met where Condition A is that the journey ends on or during the period of 5 years beginning with the arrival date (this is met as the secondment is only 3 year long) and Condition B is that the other country is where the employee normally lives which is outside the UK.

Furthermore, the costs for his family are also deductible under s.375 ITEPA 2003 where Conditions A- C are met (Condition A being the same as Conditions A and B above). Condition B states that you must be in the UK for a continuous period of 60 days which is met and Condition C states that the spouse and child accompany you in from the beginning of the period, visit you or return back with you which is met. Therefore, only

£6,000 is deductible, with the remaining amounts being taxable on the years that they a

The temporary accommodation of £12,000 is also deductible under s.364.

Therefore, for the tax year 2024/25, you will pay the following UK taxes:

Cost of return flights, £6,000 are deductible for the first and final flight but the four periods per year are taxable benefits as and when they arise so the net cost would be £18,000.

			£
Salary			120,000
Bonus			60,000
Cost of return flights			18,000
Temporar accommodationon			(12,000)
Subtotal			186,000

As you are a UK tax resident, you will have personal allowance of £12,570.

		£	£
Subtotal		186,000	
0%		(12,570)	0
20%		(25,130)	5,026
40% 45%		(87,440) (60,860)	34,976 27,387

Total tax liability: £67,389.

I trust the above makes sense but please let me know if you have any questions.

Kind regards,

Tax Advisor

---------DO-NOT-EDIT-THIS-DIVIDER----------

Answer-to-Question-3

Memo to the board of Garden Innovation Ltd ("GI")

This memo will consider the corporate residency status of Garden Innovation Ltd as a result of the planned changes as well as explore the UK Corporation Tax consequences if the resideny of GI were to change.

1. *Corporate residency status of GI*

Companies are UK tax resident if they are either incorporated in the UK or if the central management and control ("CMC") is based in the UK. Here GI is incorporated in the UK which makes this a UK tax resident company. Therefore, its resident will only change if the CMC is deemed to be at another juridiscition and that jurisdiction claims that it is resident in their country (i.e. Netherlands).

Central management and control is loosely defined as where the strategic decisions of the company are made and is separate from where the day-to-day operations take place. This tends to be where the board meetings take place but this is not the only factor.

Based on the planned changes, it is clear that the CMC will shift from the UK to the Netherlands ("NL") as the headquarters are shifting in 2026 and it is expected that all board meetings will be held in the NL and that all strategic decisions will be made in the NL as well.

It is possible that the company will be considered to be dual resident during the period of transition but the OECD model states according to Article 4(3) that the competent tax authorities of both jurisdictions will determine the residency of the company by mutual agreement procedure ("MAP"). This is where they will consider the place of effective management ("POEM") as well as where it is incorporated and other factors to determine the resideny of the company. The POEM tends to be a tier below the CMC and looks at the day-to-day operations of the company.

Based on the facts, the company will also shift its product manufacturing from the UK to the NL in 2028. However, it is stated that the UK personnel will manage the day-to-day operations of the UK manufacturing plant so some of the POEM will still be in the UK till 2028 when the factory closes.

It could be argued that the manufacturing are preparatory and auxiliary in character and therefore won't create a PE however these activities do not fall within the definition of auxiliary (use of facilities for the purpose of storage, display or delivery of goods, maintenance of goods/ merchandsise or purchasing goods/merchandise or collecting information).

However, even though its POEM seems to remain in the UK and its incorporation is in the UK, the MAP will also consider other factors including where the board meetings and strategic decisions take place. Although the board members are UK nationals, they will travel to NL for the board meetings. Therefore, it is highly that the outcome of the MAP will be that GI is NL tax resident from 1 January 2026 when it shifts its headquarters, board meetings and strategic decisions to the NL from the UK. Therefore it will instead form a UK PE with a NL residency from 1 Jan 2026 to 2028 until it closes its UK factory and then only be NL tax resident from then onwards.

2. UK CT implications of change in residency

Based on the above, GI will no longer be taxed on its worldwide income in the UK from 1 Jan 2026 onwards as it will no longer be a UK tax resident. Instead, it will be taxed on its UK activities which consists mainly of the UK manufacturing plants until 2028.

Therefore, it will still need to submit UK tax returns but these will only be on the manufacturing plant in the UK. It will no longer need to produce accounts and tag them according to iXBRL but instead GI will need to produce separate management accounts for just the UK activities and file these with the UK tax returns instead.

GI will need to let HMRC know in writing that it will cease to be a UK tax resident and also pay the exit charges within 3 months of 1 Jan 2026.

A change in residency means a migration for UK tax purposes. This means that it will consider all of its plant and machinery to be disposed as at the date of migration (i.e. 1 January 2026) using the market value date on 1 January 2026. This means that it will also have a balacing charge or a capital allowance credit on its plant and machinery. It will lose its flexibility in its losses.

This will create a large gain which is payable to HMRC. There is the option to enter into an exit charge payment plan ("ECPP") with HMRC which means that these chargeable gains can be paid in instalments rather than in one sum (s.59FA TMA 1970).

This means that the ECPP will be due in 6 equal instalments with the first instalment due on the first day after the peiod of 9 months immediately after the migration period starts i.e. by 1 October 2026 and the other 5 instalments are due on each of the first 5 anniversaries of that day.

Please let me know if you require any further detail on the topics covered by the memo above or if any of the facts change as this will impact the result of the analysis.

---------DO-NOT-EDIT-THIS-DIVIDER----------

Answer-to-Question-5

1. *Digital Services Tax*

The Digital Services Tax ("DST") came into place recently and aims at taxing digital services revenue arising in the UK . Digital service activities fall within one of three categories: social media service, internet search engine or an online market place.

An online market place is defined as facilitating the sale by users of particular things or enabling users to sell particular things to other users or to advertise/ offer particular things for sale to other users.

There are threshold conditions for DST so these rules are only applicable if the total amount of digital service revenues arising within a period to members of the Group to exceed £500m and that the total amount of UK digital service revenues exceeds £25m.

If the thresholds are met, the DST charge is calculated by taking the total amount of UK digital service revenues, deducting £25m which acts as an allowance and then calculating 2% of this amount. This is due and payable on the day following the end of 9 months from the end of an accounting period.

The liability to DST in respect of an accounting period is the appropriate proportion of the group's amount.

A DST return must be filed and notification to HMRC must be given within 90 days beginning with the day on which the DST charge applies.

A payment notice may be issued by HMRC which must be paid within 30 days of the notice.

2. *Statement conclusion*

The statement states that the DST looks at taxing in the county in which the business creates value.

This is partially true as some of the cases listed within s.41 of FA 2020 look at where the value is created. Case 1, 3, 4 and 5 all include a condition of the UK user. This means that the consumers of the of the digital services must be in the UK. Arguably, value is created where the consumers/ customers are so this means that the DST does tax where the value is created.

Case 2 follows a similar concept where it taxes based on the location of the accommodation and land. This means that if it is facilitating the use of hotels based in the UK, it will be taxed on that which makes sense as the value would be where the location of the land is which agrees with the statement.

However, it could be argued that the value would be created where the founders of the online market place/ social media service is based, rather than the users/ consumers. For example, if the founders are based in France and have created the ideas and design of their brand and website to faciliate this, then they shouldn't be taxed in the UK for having UK customers as France would already be taxing the company for this. The UK would be unfairly taxing the company for having a large UK customer base.

Therefore, this argument suggests that DST instead acts as a form of tax which looks at taxing the consumers and users of the digital service, rather than the value created.

This can be compared to the gateway of profits allocated to UK profits for the CFC rules where DST is trying to tax profits which are allocated to its UK equivalent.

The thresholds for the worldwide digital services are so large (£500m) that only the top businesses would be affected by this regime. As this is applicable to these large businesses, the value they create from each sale is pretty significant and therefore it could be argued that the DST is not unfair and truly does tax where the value is created (i.e. the user).

---------DO-NOT-EDIT-THIS-DIVIDER----------

Answer-to-Question-6

1. *<u>UK Transfer Pricing ("TP") rules</u>*

Toys UK Ltd is assumed to be a large company under the TP rules as its parent Toy plc falls under the CbCR rules. Therefore, we assume that it has more than 250 employees and a turnover of greater than £50m.

Transfer pricing rules are applicable to arrangements between group companies which are connected and therefore may try to obtain UK tax advantages through these arrangements. TP rules are applicable to both global arrangements (i.e. between a UK and international group company) as well as UK to UK group companies.

Purchasing the components and materials from Toys (Shenzhen) Ltd will fall within the TP rules as this company is a Chinese resident group company. Toys plc will need to ensure that Toys (Shenzhen) is remunerated appropriately at arm's length principles for its components and materials by Toys UK Ltd as it is were with an independent third party provider.

There should be an intercompany agreement with benchmarking studies and functional analysis in order to obtain the right transfer pricing method of choosing the arm's length price. This document should be recorded and filed in case of an enquiry.

The sales ato the independent UK retailers and individual customers do not fall within the UK TP rules. However, these act as good comparisons when looking at the sales made to group companies. Clearly the 5% gross profit margin ("GPM") sale is not at arm's length as a gross profit margin of 20% and 15% is obtained with independent parties. This is a TP risk and the group must revisit this GPM to make it more appropriate and increase it accordingly.

An Advance Pricing Arrangement may alleviate some of this risk. This is pricing which is agreed with HMRC in advance of the arragement to ensure that HMRC agrees that this is at arm's length and hence provides certainty and security over the intergroup arragements.

As Toys UK Ltd only holds 5% of the shares of Factoryparts (China) Ltd, it will not fall within the TP rules as Toys UK Ltd and Factoryparts (China) Ltd are not connected for TP purposes.

Providing routine IT support services to other group companies also falls within the TP rules. This also needs to be at arm's length provision. A benchmarking study or functional analysis can be performed to understand whether this mark-up is at arm's length and to understand which TP method is the most appropriate for working this out.

The loan with the bank again does not fall within TP rules as this is with an independent bank. However, this forms a good comparison for the loan with Toys (Germany) of £20m which is interest free.

The loan with the German group company will fall within TP rules and particularly thin capitalisation rules as the UK company will not receive any interest income from this lending which results in a UK tax advantage. It is expected that the interest rate should be 7% or lower and this therefore poses a transfer pricing risk. An Advance Thin Capitalisation Agreement (ATCA) can be used to provide clarity and certainty of the loan arrangement and reduce the TP risk.

2. *UK TP documentation*

The UK has a 3-tier documentation requirement consisting of CbCR (country by country reporting) containing certain information relating to the global allocation of the Group's income and taxes, Master File containing standardised information for all group members and Local File containing specific information material to the transactions involved with the local companies.

From the information provided, the parent UK group Toys plc is already filing CbCR returns. This will mainly consist of the group's global income, taxes paid, employees, group structure and general strategy and TP policies. The CbCR will allow global tax authorities to exchange information and create a global image of the Group's tax profile using Local and Master Files available. Please refer to Annex III for a model template within the OECD Guidelines which includes in a lot of detail what should be included with the CbCR return and how this should be presented.

The Master File will include the nature of the global business operations, overall transfer pricing policiies, global allocation of income and economic activities. This provides a high level overview of the Group's TP policies within an economic, legal, financial and tax context. The Master file will need to contain the group#s organisation structure, description of group's business, intangibles, intercompany financial activities and group's financial and tax position.

The Local File is more specific to the country and specific intercompany transactions. This will need to include loan agreements, intercompany matrix/ agreements and individual company information such as local organisation chart, key competitors and financial accounts. It will also need to include information regarding the chosen transfer pricing methodology chosen including analysis where possible and any APAs available.

The Group does not need to file the Master File and Local File with HMRC but should keep them in case of enquiries. They should be kept in file for 5 years and annually updated.

CbCR returns will have penalties of £300 for failing to comply with regulations,£3,000 for each return with inaccurate information and default £60 per day if a return has not been made.