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

Event **NA**

Exam Mode **OPEN LAPTOP + NETWORK**

Exam ID

Count(s)	Word(s)	Char(s)	Char(s) (WS)
Section 1	**4533**	**22680**	**26984**
Total	**4533**	**22680**	**26984**

Answer-to-Question-_1_

To: Joanne Grey, Global Tax Director of Norwal Inc

From: Stephens LLP

Subject: Report on recommendations for the proposed restructuring of the Norwal Inc Group

Date: 14 November 2024

This Report is in response to Joanne Grey's email on 1 November 2024, in respect of the requested advice on UK tax in regards to the expansion and restructure of the Norwal Inc group's global operations, with a particular focus in Europe.

This Report is soley for the benefit of the Norwal Inc group and Stephens LLP will not take any responsibility for third parties' reliance on this Report.

The tax law in this Report applies at the time of writing.

This report will be structured as follows:

Section A: The UK tax implications of purchasing shares in Macduff Ltd
Section B: Funding the potential purchase of Macduff Ltd's shares
Section C: Consequences of Macduff Ltd being the holding company to Norwal Inc's current permanent establishments
Section D: Consequences of keeping the overseas branches as they are or incorporating them in their respective jurisdictions

Stephens LLP
Tolley Academy Building

Bristol

BS1 1AB

Executive Summary

- Purchasing the shares of Macduff Ltd will mean that there are further UK tax administrative obligations. The threshold for these administrative obligations may be met once the transfer of the UK branches' trade and assets is completed.
- Norwal Inc will be subject to stamp duty of 0.5% in respect of the price of the shares on acquisition of Macduff Ltd, and VAT is exempt in regards to share sales
- The share acquisition may be funded by either debt, equity or qualifying corporate bonds, or a mixture. However if the share purchase were to be funded by equity, there will be no deduction in the UK, and the dividend from the UK company will be subject to 5% tax.
- The transfer of the trade and assets of the UK branch will be treated as a succession as Norwal Inc will hold the entire shareholding of Macduff Ltd. This means that assets will be transferred at tax written down value and stock can be transferred at the higher of cost or price paid if an election is made.
- Stamp duty is payable on any transfer of land or property, and should there be a transfer of going concern, no VAT will be charged
- Overseas permanent establishments under a UK company can claim double tax relief, and any losses from the overseas permanent establishment can be relieved against UK profits
- The Czech republic and Lithuanian branch losses in the first few years can be relieved against the UK's taxable profits
- Future profits of the Czech Republic and Lithuanian Branches are subject to double tax but can claim double tax relief
- There is a permanent exemption election that exempts profits of an overseas branch from being taxed in the UK (unless the income is specifically derived from the UK). This

will cover all permanent establishments and is irrevocable. If an overseas branch has losses in the current year and the last 6 years, this will defer the election.
- A streamline election in respect of the permanent exemption election can be made to enable certain jurisdictions to claim the election first (where they have profits only)
- The permanent establishment exemption election can not be elected for financial year 2025 as the election should have been made before the start of the accounting period (i.e. before 1 July 2024).
- Subsidiaries are only taxed in the jurisdiction they are resident in
- Incorporating subsidiaries will give rise to chargeable gains but elections can be put in place to defer these gains as well as payment plans

Recommendations
- It is recommended that both Macduff Ltd and Norwal Inc complete their own due diligence prior to the share acquisition. Norwal Inc should ensure any warranties and indemnities are included within the share purchase agreement.
- It is recommended that the share acquisition is funded by both qualifying corporate bonds, debt or an amalgamation of both on the basis that interest from loan stock is deductible in the UK. Advice will need to be sought from the Ruritanian tax advisors on whether or not interest is deductible in Ruritania. If so, then debt is also an available route.
- It is recommended that Ruritanian advice is sought in respect of transferring the existing permanent establishments from Norwal Inc to Macduff Ltd
- It is recommended that from 2026, the permanent exemption election applies as this will save approximately £155k of tax (Appendix 2).
- It is recommended that the Portuguese and Polish branches are incorporated, and because they are from the EU and are EEA, they can defer their chargeable gains
- Once the Czech Republic and Lithuanian overseas permanent establishments are profit making (and once their losses are offset by subsequent profits), then they can also be incorporated

- Opting for the permanent establishment exemption election prior to incorporating an overseas branch will prevent a chargeable gain from arising. We therefore recommend doing so before incorporating an overseas branch.
- We recommend the acquisition of Macduff Ltd, the transfer of the UK branch's trade and assets, the transfer of the overseas branches and recommended actions above to be done before the Ruritanian tax increases (so within 2 years).

SECTION A: THE UK TAX IMPLICATIONS OF PURCHASING SHARES IN MACDUFF LTD

Section 1A: Introduction

This section of the Report will cover the UK tax implications of purchasing shares in Macduff Ltd and the consequences of doing so, including any administrative obligations that the Norwal Inc group should be aware of.

Section 2A: Consequences of purchasing shares in a UK company

Norwal Inc is considering purchasing the entire shareholding of Macduff Ltd, a UK trading company.

When purchasing the shares of a UK company, the buyer will inherit the history of the company, and therefore it is recommended that some due diligence takes place prior to the purchase.

The due diligence analysis will cover aspects of the company such as but not limited to, whether there are any open enquiries with HMRC, late returns or penalties that have yet to be paid.

Further research into potential de-grouping charges may be considered in the case that Macduff Ltd is within a capital gains group. We recommend Macduff Ltd completing their own due diligence as well.

To ensure the Norwal Inc group is covered and will not be liable to any potential liabilities not forewarned by the shareholders of Macduff Ltd, it is recommended that warranties and indeminities are put within place in the purchase agreement to cover such risks.

Section 3A: Administrative obligations

When dealing with companies in the UK such as Macduff Ltd, some consideration needs to be taken into account.

For example, when there is a change in ownership during of a company, there are anti-avoidance rules in place to ensure companies are not just bought for the purposes of relieving their losses against other group companies. In Macduff's case, further information will need to be provided for any potential brought forward losses, however as per the financial information provided for the period ended 30 June 2024, it is unlikely there are any.

Macduff Ltd will have been paying its corporation tax in quarterly instalments all within the year. This is because it is considered "very large" under the quarterly instalment payments regime (i.e. more than £20 million augmented profits). Care will be needed to ensure Macduff Ltd's corporation tax is paid however as the UK branch has had revenue of over £20 million we assume that you are fully aware of the regime. We are able to further advise you on this if the purchase takes place, as necessary.

There are further anti-avoidance rules in the UK such as the corporate interest restriction regime whereby if the net interest expense of the group is more than £2 million, some of the interest in the year is disallowed. There is further commentary on this in section B.

There are also a few other UK administrative obligations worth mentioning whereby a UK company or group will be subject to on the basis that they meet the conditions (i.e. over £200 million in group turnover, or £2 billion in group net assets):
- The Corporate Criminal Offence Regime - ensuring necessary precautions in regards to the potential faciliation of tax evasion
- Senior Accounting Officer - A reporting officer (that is nominated) will be responsible for ensuring there are appropriate tax accounting arrangements in place for the accounting period
- Tax Strategy - A company or group is obligated to publicly showcase their tax strategy every year on their website, and update this accordingly year on year

Currently, Macduff Ltd does not meet these conditions, however with the potential restructuring and expansion of the group, this threshold may be breached and it is best to remain pro-active. We are happy to provide further advice on the above if and when necessary.

Section 4A: UK indirect taxes

On the purchase of UK shares, there is a 0.5% stamp duty reserves tax on the purchase price of the shares. The purchase price of the shares will mostly include the net asset value of the company, including goodwill. This should be discussed between you and Macduff Ltd.

VAT on the purchase of shares is exempt.

Section 5A: Other

For completion, any potential future sale of Macduff Ltd will require Ruritanian advice.

SECTION B: FUNDING THE POTENTIAL PURCHASE OF MACDUFF LTD'S SHARES

Section 1B: Introduction

This section of the Report will cover the different types of ways in which the share purchase can be funded.

Section 2B: Funded by debt

The purchase of Macduff Ltd's shareholding may be funded by either an internal or external loan.

We recommend seeking further advice from your Ruritanian advisors if there are any reliefs available when taking out a loan and paying interest on the loan. In the UK, interest payments on loans are deductible and if this is the same within Ruritania, this may be an attractive route.

- Loan, either external or internal
- Potential CIR consequences
- Arms length, APA?

- Deductible in the UK, as long as taxable in Ruritania, eitherwise non-deduction/non-inclusion rules apply (and not deductible in the UK and tax mismatch)

Section 3B: Funded by equity

The purchase of Macduff Ltd's shareholding may be funded through equity, as it has been confirmed that Norwal Inc has enough cash reserves to pay for the shares.

Dividends paid in the UK are non-deductible, which means that there will be no deduction to the UK taxable profits when it pays out dividends to Norwal Inc.

It has also been confirmed that a 5% tax is applied to dividend income received from a UK subsidiary, so there is essentially a tax mismatch (i.e. non-deductible in one jurisdiction, and then taxable in another jurisdiction).

This may not be the most attractive route.

Section 4B: Funded by loan stock (qualifying corporate bonds)

Another way for the purchase to be funded is through qualifying corporate bonds.

Ruritania could instead fund the purchase of the shareholding through qualifying corporate bonds. There are no immediate tax consequences, and any gains that take place are essentially frozen until the loan stock is sold or impaired.

Any interest paid from Macduff Ltd to Norwal Inc in respect of the loan stock will be deductible in the UK, and therefore may be a favourable route to funding the shares.

Section 5B: Mixture of different types of funding

The funding of the acquisition of the shares does not necessarily have to be done through one method. It can be completed through different types of avenues to ensure the most tax efficient way of funding the shares.

A combination of funding the shares through qualifying corporate bonds and debt may be attractive as there will be a deduction on the interest paid in respect of the loan stock, and on the basis that Ruritania allows for relief against interest paid, there will also be a deduction in Norwal Inc. This is however subject to the appropriate tax advice provided by your Ruritanian tax advisors.

We would not recommend funding the share acquisition using equity as there will not be a deduction in the UK for the dividends paid, and the dividends will also be taxed in Ruritania.

SECTION C: CONSEQUENCES OF MACDUFF LTD BEING THE HOLDING COMPANY TO NORWAL INC'S PERMANENT ESTABLISHMENTS

Section 1C: Introduction

This section of the Report will cover the UK tax consequences of Macduff Ltd being the holding company to Norwal Inc's permanent establishments, including the potential expansion into new territories (the Czech Republic and Lithuania).

Section 2C: UK tax implications of the transfer of the trade and assets of the UK branch

As confirmed, there are no exit charges in Ruritania on a change of ownership of the trade

and assets, unless an asset is phyically located in Ruritania. We recommend seeking further advice to ensure this is accurate, but on the basis that it is the correct treatment, the transfer of the trade and assets of the UK branch to Macduff Ltd should not have any Ruritanian tax implications.

Because Norwal Inc will hold more than 75% of the shareholding within Macduff Ltd on acquisition, and permanent establishments are prima facie treated as one entity with its parent company, the transfer of the trade and assets to Macduff Ltd from the UK branch will be treated as a succession.

This means that any losses within the UK permanent establishment will be transferred into Macduff Ltd (however due to the information provided, there are no losses in the UK branch so this is not relevant).

Any assets that claim capital allowances will be transferred at tax written down value, intangible fixed assets are transferred at net book value, loan relationships and derivatives are transferred at fair value.

There is an election to treat stock at the higher of cost or price paid and this election must be made within 2 years of the end of the accounting period.

There will be stamp duty payable on the transfer of land or property and the rates depend on the value of the asset.

As long as there is a transfer of going concern (i.e. the assets will be sold as part of a going concern, Macduff Ltd intends to use the assets to carry out the same kind of business as the UK permanent establishment, the UK permanent establishment is a taxable person and they have opted to tax the freehold properties it owns), then no supply

takes place for VAT purposes and no VAT is chargeable.

Section 3C: Implications of the transfer of the existing branches from Norwal Inc to Macduff Ltd

In respect of the Ruritanian tax implications of transering the existing Portuguese, Polish and Spanish branch, it best to seek Ruritanian advice.

Permanent establishments held by a UK company will be taxed on both the UK and overseas tax (in the territory it resides in).

Double tax relief can be claimed when calculating the UK taxable profits, which will be the lower of the UK and overseas tax paid.

Losses in overseas permanent establishments are available to be relieved against UK taxable profits.

Section 4C: Implications of setting up permanent establishments in the Czech Republic and Lithuania

Setting up permanent establishments in the Czech Republic and Lithuania, where the corporate taxes are 19% and 15% respectively, which are expected to create losses in the early years of trading, will be able to offset their losses against the UK's taxable trading profits.

In the future however, any profit will be subject to tax in both the jurisdiction the permanent establishment resides in, and because the UK has a higher tax rate, it is most likely that the overseas tax will be credited from the UK tax liability.

SECTION D: CONSEQUENCES OF KEEPING THE OVERSEAS BRANCHES AS THEY ARE OR INCORPORATING THEM IN THEIR RESPECTIVE JURISDICTIONS

Section 1D: Introduction

This section of the Report will cover the UK tax consequences of either keeping the permanent establishments as they are, or incorporating them.

Section 2D: Consequences of keeping the overseas branches as permanent establishments

Overseas permanent establishment losses are available to be relieved against UK taxable profits, and therefore if there are any overseas branches with losses, these can be relieved against Macduff's taxable profits to reduce the UK tax liability.

However, if there are profits within the overseas permanent establishments, then these profits may be double taxed in both the UK and the country the branch resides in.

There is a permanent exemption election that exempts the profits of an overseas branch from being taxed in the UK and will only be taxed in the jurisdiction it resides in. This election is irrevocable and covers all the permanent establishments.

Under the transitional rules, there will be a delay in claiming the election where there are losses (also called the total opening negative amount) in a permanent establishment. The election will only take place once all the current year losses (and the losses in the past 6 years) have been relieved against subsequent profits.

There is another election which allows certain jurisdictions to claim the election first, which essentially "streamlines" the election to enable the company to exempt any overseas taxable profits sooner.

The election must be made before the start of the accounting period in which it is due to apply to. This can be revoked any time before the start of that specific accounting period.

As per Appendix 1, the total amount of tax that would be saved in respect of the Portuguese and Polish branch (not the Spanish branch as it has losses and it is assumed that the streamlined election has also been elected), would be £170,000.

The permanent establishment exemption election can not be elected for financial year 2025 as the election should have been made before the start of the accounting period (i.e. before 1 July 2024).

In respect of financial year 2026, as per Appendix 2, the amount of overseas tax saved in respect of the Portuguese and Polish branch if the permanent establishment exemption election were to be claimed would be £240,000, and if the exemption were to not be claimed, there will be an extra £115,000 liability.

Therefore it is recommended that the permanent establishment exemption election be claimed for financial year 2026 going forward.

However, the potential Czech Republic and Lithuanian permanent establishments would need to be considered as it has been confirmed that there are anticipated losses in the early years of trading.

We recommend that you draft a budget for the next 5 plus years to showcase the amount of losses per year. This will enable us to further analyse whether or not the permanent establishment exemption election will be beneficial in 2026 or if it is best to wait until the Czech Republic and Lithuanian permanent establishments are profitable.

Section 3D: Consequences of incorporating the permanent establishments

There are a few consequences when incorporating permanent establishments.

Firstly, this report has been completed on the basis that the UK branch will have its trade and assets transferred into Macduff, instead of incorporating a UK subsidiary under Macduff Ltd. If this is not the case, we can provide further advice on the tax implications of doing so.

When incorporating overseas permanent establishments (on the basis that all the branches are now under Macduff at this point), there are a few considerations that need to be accounted for.

Incorporating an overseas permanent establishment is treated as a chargeable disposal for UK tax purposes and will be subject to UK tax on the deemed release and immediate acquisition of the overseas branches' assets.

This chargeable gain can be deferred for 6 years as long as the trade, together with the assets of the company used for the purposes of its trade is transferred outside of the UK, the trade is transferred wholly through shares and Macduff will own at least 25% of the shareholding. This chargeable gain will crystallise within the 6 years if the shareholding is sold.

Overseas branches in the EU can reduce their notional tax with any chargeable gains that arise.

An exit charge payment plan may also be available by EEA residents as well to defer any full payment of the gain.

Overseas subsidiaries are unable to relieve any of their losses against their UK parent, as opposed to overseas permanent establishments. However, overseas subsidiaries will only be taxed in the resident they reside in, unless any income comes from the UK.

One way to approach incorporating an overseas permanent establishment would be to elect the overseas permanent establishment exemption treaty for accounting period 2026, and then incorporate the year after. When the exemption has been elected, any chargeable gain arising from an incorporation of an overseas branch is also exempt. This would however would again mean that all overseas branches will be privy to the election, and any losses would no longer be relievable in the UK.

Section 4D: Other

When incorporating overseas permanent establishments and creating overseas subsidiaries, it is mindful to be aware of the UK anti-avoidance schemes which may come to light.

Firstly, there are anti-avoidance rules called "controlled foreign companies" where an non-UK resident company is controlled by a UK resident company, and there is a potential tax charge if the gateways and exemptions are passed through.

On the basis that in respect of the gateways, there are no profits attributable specially to

the UK, there are no non-trading and trading finance profits, the company isn't a captive insurance business, no overseas subsidiary profits should be subject to UK tax.

The exemptions are whether or not the controlled foreign company is resident in an excluded territory, the company is covered by the low profit exemption, the company is covered by the tax exemption, the company is covered by the low profit exemption. Further analysis will need to be done to confirm that subsidiaries once incorporated will not be caught by the controlled foreign companies rules but from a quick analysis, they shouldn't.

Another anti-avoidance rule worth mentioning is the "diverted profits tax" anti-avoidance scheme. This is where there is a transaction designed to secure a tax reduction and tax mismatch outcome. This should not be the case, but further analysis can be done in the future if an incorporation of the overseas permanent establishments occurs.

You do need to incorporate all the overseas branches. It is recommended that the overseas branches that have a profit are incorporated (as long as they are expected to continue being profit making), on the basis that they will fully only be taxed in the jurisdiction they are resident in. This will be the Portuguese and Polish branch, and they will not be subject to tax in both the UK and their respective jurisdictions. They also have a lower tax rate than the UK, and so less tax will be payable year on year.

Appendix

Appendix 1 - Available credit in foreign permanent establishments where no permanent establishment exemption has been elected for 2025

	Portuguese branch	Polish branch	Spanish Branch	
	£	£	£	
Projected profit/(loss) - 2025	2,000,000	1,500,000	(1,500,000) (N2)	
UK Tax - 25%	500,000	375,000	nil	
Local tax - 21%/19%/25%	420,000	285,000	nil	
Tax credit (lower of UK or lower tax) (N1)	420,000	285,000	nil	
Total relief (N3)				£205,000

(N1) - This will be credited against the Macduff's total UK tax liability
(N2) - This loss will reduce the UK's total taxable profits
(N3) - The total relief has been calculated as follows:

Portugese branch UK tax = £500,000 - £420,000 = £80,000
Polish branch UK tax = £375,000 - £285,000 = £90,000
Loss available = £1,500,000 x 25% = £375,000
Total relief = £375,000 - £90,000 - £80,000 = £205,000

<u>Appendix 2 - Available credit in foreign permanent establishments where no permanent establishment exemption has been elected for 2026</u>

	Portuguese branch	Polish branch	Spanish branch	
	£	£	£	
Projected profit/(loss) 2026	3,000,000	2,000,000	(500,000)	
UK Tax - 25%	750,000	500,000	nil	
Local tax - 21%/19%/25%	630,000	380,000	nil	

Tax credit (lower of UK or lower tax) (N4)	630,000	380,000	nil	

(N1) - This will be credited against the Macduff's total UK tax liability
(N2) - This loss will reduce the UK's total taxable profits
(N3) - The total relief has been calculated as follows:

Portugese branch UK tax = £750,000 - £630,000 = £120,000
Polish branch UK tax = £500,000 - £380,000 = £120,000
Loss available = £500,000 x 25% = £125,000
Total further payable UK tax = £125,000 - £120,000 - £120,000 = -£115,000

Notes:
- Prepare a report for Joanne Grey - proposed acquisition of a UK company, Macduff Ltd
- Prepare report for Joanne making recommendations for the proposed restructuring of the group (given the acquisition)
- Needs UK tax advice - look to expand and restructure global operations
- Purchase all the shares in Macduff Ltd - principal supplier in the UK
- Can be funded from Norwal Inc's cash reserves
- Also considering expanding into new territories - Czech Republic and Lithuania (CT rates are 19% and 15%). Anticipate losses will arise in the early years - but operations in those two new territories should become profitable within 5 years (they're EU companies)
- Tax rate in Ruritania expected to rise from 20% to 35%
- UK investment company?

Ruritania tax rate expected to rise in 2 years, so needs to be done before then
- Identify tax benefits of permanent establishment or incorporating sub. PE exemption election?
- Can use losses to reduce taxable profits (but can't do that with overseas subsidiaries)
- Transfer of trade and assets from UK company or create subsidiary?

- Dividends received by the UK are taxable at 5% in Ruritania
- Fully by debt or by equity

Need to:
- Recommendations on proposed restructuring
- Consideration on most appropriate finance options (shares, QCB, loan - internal or external)

Macduff Ltd:
- Incorporated and is tax resident in the UK
- Trading
- Finance expense is £1.8 mil (CIR?)

Think about:
- SDLT
- VAT
- DPT
- CFC?
- PE, double tax treaty
- PE, exemption (streamline), then incorporate (make use of losses)
- TP, all arms length (because of the market value point)

What are the main things?
- Board wants to purchase all shares in Macduff Ltd, how can this be funded? Either debt or equity? Think about potential CIR disallowances. Debt, equity, QCB's? They want the UK to be a holding company
- They consider that Macduff Ltd would be ideal in being the holding company for the permanent establishments
- They want to consider whether the overseas branches should remain as branches or incorporated into overseas subsidiaries (wholly owned by the UK company)

Sections to potentially be split as follows:
- Purchasing shares, consequences of purchasing shares?
- Purchasing shares, how is this funded?
- Consequences of Macduff being the holding company (also speak about Czech Republic and Lithuania)
- Consequences of keeping overseas branch or incorporating overseas subsidiaries (talk about Czech Republic and Lithuania)

Potential calculations:
- Calculation to see if PE is better or subs are better