The Chartered Institute of Taxation

Application and Professional Skills

VAT and Other Indirect Taxes

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Suggested answer

FAO: Sam Ferrers, Tax Partner, BFR Tax LLP

Report to the Board, Coua Ltd (DRAFT)

1. Introduction

This Report has been prepared for the Board of Coua Ltd, to consider the key tax and commercial issues arising in a letter from Manny Singh, CFO of Coua Ltd, dated 7 May 2025, with enclosures.

Coua Ltd, the parent company of a small corporate group, and representative member of the VAT group, is in the process of selling its shares in Eggton Ltd for an agreed price of £35 million. Coua Ltd has two options for reinvesting the proceeds of the sale in the group's activities:

Option 1: Coua Ltd will use the funds to construct and operate a new factory and lab in Windleshire via one of the group companies, Norrisco Ltd.

Option 2: Coua Ltd will use the funds to diversify its business, by acquiring the shares in a UK-established trading company, Unumiota Ltd, which operates in the clothing sector.

This Report is prepared solely for the use of the Board of Coua Ltd and is based on information provided and on information held in our files. We have applied the tax law and practice in force at today's date. If there is a delay in undertaking the transactions, a significant fiscal event (such as a Budget), or a change in circumstances, confirmation should be sought as to whether this affects our advice.

2. Executive Summary

Sale of Eggton Ltd: VAT

a) VAT of £65,000 will be incurred on the legal and accountancy fees of selling Eggton Ltd. However, other disposal costs will not be liable to VAT.

b) Under either Option, it seems likely that £13,000 of the above input VAT will be recoverable as being directly attributable to the sale of 20% of the shares to overseas buyers. We recommend that the use of the inputs for a specified supply is carefully evidenced to support a claim and to meet the requirements of the rules for input VAT deduction. Under either Option, we also recommend obtaining and preserving objective evidence of a direct and immediate link with taxable activities to support input VAT deduction.

c) No further VAT on the disposal costs will be recoverable if Option 2 is chosen. Depending on the outcome of an impending Supreme Court decision, an additional proportion of this VAT may be deductible provided both that it forms a cost component of the overheads of the VAT group's taxable business and Option 1 is chosen. We recommend that the position is reviewed following this decision. Otherwise, there is little difference between the Options with respect to VAT, and overall that difference is not commercially significant.

d) HMRC must be notified of the exit of Eggton Ltd from the VAT group. This will require an amendment of the VAT group registration details. Under Option 1, Coua Ltd, as representative member, is responsible for the VAT accounting of the group. Under Option 2 Unumiota Ltd will be responsible for its own VAT accounting. Its existing VAT registration will continue unless of course it is currently a member of a VAT group (in which case we advise that it immediately VAT-registers in its own name).

Sale of Eggton Ltd: CT

e) Coua Ltd faces a CT charge of £8.75 million on its gain on the disposal of Eggton Ltd. However, the substantial shareholding exemption ("SSE") will apply to reduce that liability to nil. As it is exempt there will be no relief for associated expenses. These expenses are capital and cannot therefore be deducted from trading profits.

Revised Proceeds of Sale

f) The revised proceeds of sale come to £34,085,000. This ignores the small VAT element.

Option 1 v Option 2: VAT

g) Under Option 1, we recommend carefully checking the validity of the seller's option to tax the land. Given the value, HMRC are likely to scrutinise the claim to input VAT on the land purchase and may request than an option to tax is made to evidence an intention to make taxable supplies. We do not believe this is technically correct, but in practice HMRC will often insist. If so, we can assess the impact of such a request at that time. We advise that expenditure on the new factory will require compliance with the capital goods scheme ("CGS") for the adjustment of input VAT over time We recommend procedures are put in place deferring the payment of customs duty and VAT on imported goods.

h) Similarly, in Option 2, virtually all the input VAT on acquisition will be recoverable provided different directors are appointed to Unumiota Ltd and formal management charges are agreed. The input VAT incurred by the financiers, however, will not be recoverable.

Option 1 v Option 2: CT and Other Taxes

i) Option 1 offers the possibility of an R&D credit of up to £4.2 million, after tax, which Option 2 does not. Option 1 therefore offers a significant cashflow advantage over Option 2. Moreover, Option 1 is also likely to offer capital allowances in respect of the fitting-out of the factory. We strongly recommend that both the R&D claim and any capital allowance claims are prepared with specialist assistance and are made as robust as possible to HMRC challenge, which is now an increased risk.

j) Option 1 involves an SDLT liability of £469,500 and customs duty on imported goods, but no liability to Stamp Duty. Option 2 does not involve SDLT, but Stamp Duty of £205,000 will be payable on the share purchase.

Option 1 v Option 2: Commercial

k) We have revised the expected cash returns on investment to reflect our tax advice. For Option 1 it is 42.8% and for Option 2, 27.92%. We also advise that, whereas Option 1 is estimated to be cash negative in years 1 to 3, Option 2 is expected to be cash positive throughout.

l) Nonetheless, the cash return in both absolute and percentage terms is much greater with Option 1. Moreover, once details of capital allowances have been obtained, it is likely to deliver an even greater cash return.

m) Whilst the significant risks of Option 1 in terms of new and unproven technology must be borne in mind, the potential for a very good return on investment leads us to recommend Option 1.

Detailed Considerations

We consider first the tax issues raised by the disposal. Next, we compare the tax and projected commercial outcomes for each Option.

3. Costs on disposal of Eggton Ltd

The disposal of the shares in Eggton Ltd raises issues for VAT and CT. Each is addressed in turn.

VAT issues on share sale

A disposal of shares may fall into one of the following categories:

a) "non-business", because the seller held the shares as a pure investment activity; or

b) VAT exempt, if the shares are sold to a UK-established purchaser and form part of an economic activity (e.g.: where the seller is a holding company providing management services); or
c) as b) above, but the shares are sold to a non-UK purchaser. This effectively makes the sale zero-rated.

In any event therefore no VAT is chargeable on the transfer of shares. The type of share sale, however, may affect the entitlement to deduct VAT on related costs.

HMRC must be advised that Eggton Ltd has left the VAT group by submitting forms VAT50 and VAT51.

VAT on related costs

Legal and accountancy services supplied by UK providers are generally liable to VAT at 20%. This VAT totals approximately £65,000.

The treatment of intermediary services, however, depends on two factors, namely the place of establishment of the purchaser and of the intermediary. Melanie Honeyford is UK-established and is arranging the sale of 80% of the shares to UK purchasers. Therefore, her services are VAT-exempt. Teddy Wu Associates are established outside the UK. In principle, their services would attract VAT under the reverse charge as an imported service. However, where (as here) 20% of the shares will be sold to non-UK buyers, intermediary services follow the same VAT treatment and are outside the scope of UK VAT.

Accordingly, the only VAT at stake on disposal costs will be approximately £65,000. We now examine its deductibility.

VAT deductibility

Input VAT must always be apportioned between non-business/ business activities first, and then between exempt activities and those which give rise to a right to deduct. This must be determined according to objective evidence. Input VAT will only be deductible where there is a “direct and immediate link” to onward taxable activities, whether directly, or by reference to the whole of the entity’s economic activity. The whole economic activity may only be referred to where the costs incurred form part of overheads and thus contribute to the price of the entity’s outputs.

We apply these principles to the proposed transactions. As Coua Ltd was making realistic management charges to Eggton Ltd prior to disposal, the older case law (*BLP*, recently reaffirmed by the Court of Appeal in *Hotel La Tour Ltd*), establishes that the sale of the shares is itself an economic activity. Where that activity is exempt, then VAT on associated costs will not be recoverable. This is because the exempt supply of the shares “breaks the chain” between inputs and onward taxable supplies by the taxpayer.

However, more recent case law, in particular *SKF* and *Frank A Smart & Sons Ltd*, has suggested that even where costs relate to an exempt supply of shares, it is legitimate to consider whether they may *also* be related to the overall activities of the taxpayer. Where these activities are fully-taxable, VAT on associated costs may be recovered in full.

Whichever Option is pursued, a fair and reasonable basis of apportionment could be the ratio 20:80 (to reflect the split between non-UK and UK purchasers of the shares). We can advise further if a link with overall activities of the group can be shown; but, for the purposes of this Report, a safe assumption would be that £65,000 x 20% is deductible, i.e. £13,000.

The Supreme Court is still to hear the taxpayer’s appeal in *Hotel La Tour Ltd*, and will decide between the older and the more recent case law. If *BLP* is again reaffirmed, then no input VAT could be recovered on the exempt element of the sale of Eggton Ltd’s shares.

However, if *SKF* is confirmed, then the balance of £52,000 may be available under Option 1.

Option 2 would not use the funds to support the VAT group’s wider taxable supplies and so would preclude recovery of the £52,000 balance even if the *SKF* approach is confirmed by the Supreme Court.

CT

You are concerned about a large capital gain and CT liability on the sale, given that the base cost of the shares was only £1,000. Where a company sells shares and:

1) The company being sold is a trading company; and
2) The selling company is its majority shareholder, and
3) The shares have been owned for more than 12 months

the "substantial shareholding exemption" ("SSE") can apply. This completely exempts the gain. Fortunately, all of these conditions are clearly satisfied and so there should be no CT liability on the sale of the shares of Eggton Ltd. No claim need be made in respect of SSE, as it applies automatically where the conditions are met. Note that no CT relief is ever available for associated costs of a capital nature.

We now consider the tax issues arising under each Option

4. VAT issues: Option 1 vs Option 2

Option 1

Under Option 1 Norrisco Ltd will incur costs on purchasing the land, developing the site, fitting-out the new factory and on research and development ("R&D"). The VAT considerations are dealt with here, with the other tax heads dealt with in the next section.

Land purchase

VAT at 20% i.e., £1,600,000 will be added to the purchase price because the purchaser has opted to tax. This should be confirmed. Norrisco Ltd, although currently dormant, is part of the VAT group registration. Provided the land is used, or intended to be used, to make taxable supplies, this VAT should be fully deductible. All input VAT claims are made by Coua Ltd as representative member of the VAT group. We anticipate HMRC will wish to see compelling evidence of the intention to make taxable supplies, which may include a demand for an option to tax. Legally, this is not strictly necessary, but HMRC often insist.

Developing the site and fitting-out

Provided the costs are to be used for making taxable supplies, VAT incurred on development costs and fitting-out is fully deductible. As the factory will be a new commercial building costing more than £250,000 the Capital Goods Scheme ("CGS") will apply. The CGS requires that input VAT initially deducted is adjusted each year if, over a 10-year period, there is any change in the extent to which the building is used to make taxable supplies.

We note that some of the factory equipment will be sourced from Sayonara. Depending on tariff classification, these goods will be liable on importation to customs duty and import VAT (which is charged and collected as if it were customs duty). Payment of import VAT can be deferred under the postponed accounting scheme, but should then be fully deductible under the principles described above. Payment of customs duty can also be deferred or, if the goods are placed into a customs warehouse or other permitted regime, suspended. Ultimately, however, when the goods are brought into use, duty is payable and is a cost.

If no taxable supplies are made, for instance because the project fails, the case of *Ghent Coal Terminal NV* supports full recovery of VAT on abortive costs, provided there was a genuine intention to make taxable supplies at the time of deduction. Norrisco Ltd would have to de-register if its intention to make taxable supplies ceased. This may lead to a VAT exit charge on business assets remaining on hand, as well as a CGS disposal adjustment.

Option 2

Unlike Norrisco Ltd, Unumiota Ltd is an active and profitable trading company. We assume it is registered for VAT and able to recover input VAT in full. Subject to undertaking due diligence, we proceed on the assumption that, going forward, its VAT and CT treatment should be straightforward. Some tax issues arising from the acquisition, however, should be considered. The purchase negotiations should also address warranties and indemnities to cover the historical risks on acquisition.

Professional costs

Coua Ltd will incur costs of around £750,000 relating to the acquisition. Depending on their nature, VAT is potentially £150,000.

Unless Coua Ltd is proposing to make management charges, HMRC will likely argue there is no direct and immediate link with any taxable transactions by Coua Ltd, since Unumiota Ltd will not be part of its VAT group.

Accordingly, this VAT could be recoverable if Coua Ltd did arrange to make realistic management charges to Unumiota Ltd. This can only be achieved where the directors of the two companies are different.

The financier requires Coua Ltd to bear its costs, estimated at £1 million plus VAT of £200,000. VAT is non-deductible as Coua Ltd is not the recipient of these services.

Summary

It should be possible to recover all of the input VAT under either Option provided our advice is followed, with the exception of the input VAT on the financiers' costs. This VAT is not sufficient on its own to decide between the two Options.

5. Other Tax issues: Option 1 vs Option 2

Option 1: Land Acquisition and Fitting-Out

The total sale consideration of £9,600,000 will be subject to SDLT. This is calculated as follows:

Purchase Price Bands	SDLT Rate Applicable	SDLT Due
£		£
Up to 150,000	0%	0
Above 150,000 and up to 250,000	2%	2,000
Above 250,000	5%	467,500
TOTAL		**£469,500**

SDLT is due on completion and Norrisco Ltd will be required to make an SDLT return to HMRC.

Note that for CT purposes, the land purchase will be capitalised and so will not give rise to a deduction

In principle, expenses of a revenue nature (as distinct from capital expenditure) are allowable for CT purposes. Expenditure on fitting-out and plant and machinery may instead qualify for capital allowances, depending on its nature. These could be substantial with plant and machinery allowances likely to be available on a significant part of the equipment fit out costs and structures and buildings allowance on much of the construction costs. We can advise further on these matters once details of the proposed expenditure are available. Based on the projections provided, Option 1 is likely to generate losses initially (potentially enhanced for tax purposes by capital allowances), which should be available for group loss relief at the main CT rate of 25%.

R&D

Additional CT relief is available for qualifying R&D. Qualifying R&D is where the project seeks an advance in science or technology. This appears to be the case with Option 1, but this should be reviewed in detail. Assuming the R&D undertaken qualifies, relief is available for qualifying costs, which include employee salaries and NI. There is a credit of 20% of the expenditure so on £28 million it would be £5.6 million. This is subject to CT giving a net benefit of £4.2 million

Option 2: Other Taxes on Acquisition of Unumiota Ltd

No deduction will be allowed for CT on the costs of acquisition, as it is capital in nature.

If Unumiota Ltd makes trading losses, these may be eligible for group relief against the profits of other group companies even if, as suggested, the acquired company is "siloed". Obviously, the same applies to any profits which may be used to absorb any future group losses.

Stamp Duty on the share purchase at the rate of 0.5%, i.e., £205,000, which is non-deductible, should not be ignored.

Summary

The SDLT cost under Option 1 is ca. £269,500 higher than the Stamp Duty due under Option.

However, Option 1 offers significant and valuable potential CT benefits when compared to Option 2.

6. Comparison of Figures Provided

Revised Proceeds of Sale

Likely proceeds of sale of Eggton Ltd will be:

	£
Sale of Shares	35,000,000
Less professional fees (including VAT)	(915,000)
Revised Net Proceeds	**£34,085,000**

The potential input VAT deduction of between £13,000 and £65,000, is ignored in the calculations below.

The costs of each Option are estimated as follows:

a) Option 1: £45,500,000
b) Option 2: £42,750,000

Based on this, we have revised the figures as follows:

Option1

	£
Outlay per **EXHIBIT C**	45,500,000
Add SDLT	469,500
Revised Outlay	**£45,969,500**

Revised Cash Return:

	£
Cash Return per **EXHIBIT C**	15,475,000
Add R & D Tax Credits	4,200,000
Revised Cash Return	**£19,675,000**

Revised Cash Return on Investment: 42.8%

Option 2

	£
Outlay per **EXHIBIT C**	42,750,000
Add VAT on Financiers' Costs	200,000
Add Stamp Duty on Shares	205,000
Revised Outlay	**£43,155,000**

Revised Cash Return:

	£
Cash Return per EXHIBIT C	**£12,050,000**

Revised Cash Return on Investment: 27.92%

We would recommend choosing Option 1, given that it clearly delivers a much greater net cash return, both in absolute terms and as a percentage of the initial investment. Moreover, when the capital allowances report is obtained, even higher cash values may result. Against this return must be weighed a greater risk of the project failing due to the unproven nature of the technology.

We trust the foregoing is clear and should be pleased to advise further if required.

BFR Tax LLP
8 May 2025