The Chartered Institute of Taxation

Application and Professional Skills

VAT and Other Indirect Taxes

May 2026

Suggested answer

Report for Darius Azimi Considering Investment Options

1. Introduction

This Report has been prepared for Darius Azimi ("you") to consider the key tax and commercial issues arising in your email dated 29 April 2026, with attachments.

In that email we were asked to consider two Options:

- **Option 1**: You would set up a chain of "fitness hubs", beginning with a site you have identified in Maynard Keats. You would sell your share in the land to help finance this plan

- **Option 2**: Iskander wants to bring the land into the partnership, and for you to work with him in using it to develop "build-to-rent" new housing. This plan would require external finance, as the land would be retained

This Report is prepared solely for the use of Darius Azimi and is based on information provided and on information held in our files. Accordingly it should not be passed to any third party without our previous express permission. 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

Recommendation

We recommend that you pursue Option 2. We set out below our reasons for this recommendation, drawing on a comparison of the two Options.

Comparison of Options 1 and 2

1) In the first three years, Option 2 is expected to generate almost £1 million more in profit than Option 1. Moreover, in the same period, the predicted pre-tax net profit margin earned on Option 2 (70.72%) significantly exceeds that on Option 1 (20.93%). This makes Option 2 commercially both more certain and more attractive than Option 1.
2) The precise impact of CT and VAT cannot be accurately calculated given the uncertainty of the position. However, the pre-tax three-year return on investment using the unadjusted estimates is much higher for Option 2 (34.33%) than for Option 1 (21.99%).
3) Against this must be set the fact that any profits earned in Option 1 would not have to be shared, although a right to 100% of the profits in a business which made losses is not a valuable right.
4) Option 1 will potentially face some irrecoverable VAT due to the planned activities. A special use based partial exemption method may reduce this cost (see section 3). Under Option 2, the use of a wholly owned connected company ("Propco") needs to be considered further, including the direct tax issues for you, as it would avoid significant levels of otherwise irrecoverable VAT (see section 5).
5) Option 1 offers the prospects of significant capital allowances which, together with relief for early losses, would reduce the Corporation Tax ("CT") cost once the Hub became profitable (see section 4). Option 2's profits will face CT in Propco, with much less scope for capital allowances than in Option 1 (see section 6).
6) Iskander and/or ZRID Construction will need to take on debt to fund the purchase from you under Option 1.
7) You have very limited experience of the areas of business in Option 1, which makes it riskier than Option 2, where the plans are closely related to the firm's existing activities. Moreover, Iskander already has direct experience of the build-to-rent sector.

8) In addition to this point, the potential resale value of the assets in Option 2 is higher than it would be if Option 1 was unsuccessful. It would also be much easier and quicker to sell newly-completed apartments than a bespoke fitness hub.
9) Overall, therefore, Option 2 is clearly the better approach from a commercial perspective. It is also likely to be less risky, and even if it should not be successful, it would still be possible to sell the completed apartments at a good price to recover the investment in that way. That is not true for Option 1. The potential CT benefits of Option 1 therefore do not outweigh the cost of irrecoverable VAT or the less attractive commercial position.
10) It should also be added that Option 2 is much less disruptive to your family, which is a major concern for you.

<u>Detailed Considerations</u>

3. Option 1: VAT

We recommend registering for VAT as an intending trader to maximise the cashflow from VAT refunds. Monthly VAT returns make receiving refunds faster and can be requested on registration. We will be happy to assist in this process.

The construction of the Hub is likely to give rise to input VAT of £276,100 (**EXHIBIT B**, excluding the contingency). This assumes that the purchase of the Maynard Keats site is exempt from VAT.

The planned uses of the Hub will not permit full recovery of the VAT. This is because the business under Option 1 would include sources of exempt income, discussed further below, and would therefore be a partially exempt business.

Partial exemption requires an affected business to apportion its input VAT between those items which are directly attributable to taxable supplies; those which are directly attributable to exempt supplies; and those which cannot be directly attributed. Unattributable VAT is known as “residual” input VAT, and, under the “standard method”, can be reclaimed based on the proportion of the business’s sales which are taxable. Note, however, that businesses can apply for a “special method”, or indeed HMRC can impose one, where the standard method does not produce an accurate result. In the first year of VAT registration a use based method can be applied without prior approval from HMRC and this could well be beneficial.

The business must carry out an “annual adjustment” to ensure that its input VAT recovery is accurate. Partial exemption therefore imposes considerable compliance and accounting requirements on affected businesses and you will need to ensure that your internal bookkeeping is sufficiently strong to manage these obligations.

Turning to the sources of exempt income, the figures for physiotherapy income from the employed physiotherapists is very likely to be exempt (assuming the normal conditions for medical exemption are met), with the result that ca. 16.7% of projected earnings in the first three years (£380,000/£2,270,000) will be exempt. This would imply a restriction of 16.7% or so of the input VAT incurred, or ca. £46,110

The lettings to personal trainers and self-employed physiotherapists are also potentially exempt, depending on the nature of supply. If a supply of land was being made, then this would be exempt, subject to the option to tax. This could be addressed by opting to tax the Hub, though for reasons explained below we would not recommend this.

If the supplies are more by way of a bundle of services (e.g.: access to equipment, client bookings, etc), then VAT is virtually certain to arise.

In either case, VAT is likely to be a cost to the personal trainers or physiotherapists, because many of them will not be VAT-registered. This is either because of a low turnover, or because they are supplying exempt services of some kind. Either way, they will not want to pay VAT, hence opting to tax is likely to be commercially unattractive.

Accordingly, taking all of these points together, the set-up costs for the Hub will need to include irrecoverable VAT. We cannot assess the level of this irrecoverable VAT with any accuracy at this stage, since it will be a function of the mixture of actual taxable and exempt supplies made by the business. As stated above we consider a special use based method of partial exemption may be advantageous and we recommend reviewing this when the numbers become more certain.

A further important point should be made. As the building cost is more than £250,000 plus VAT, you will need to monitor the use of the Hub over the ten years after "first use", in line with the capital goods scheme (CGS). Where exempt use increases, a payment will be made to HMRC, and vice versa. As the future mix of use is uncertain, we cannot accurately quantify the irrecoverable VAT at this time. Note that the CGS recovery percentage will reflect the residual percentage calculated in each year under the partial exemption annual adjustment. CGS adjustments are carried out in the second VAT return after the end of the "VAT year", i.e.: either 31 March, 30 April or 31 May.

Food and Café Sales

While many food products are zero-rated, VAT will arise on some goods (e.g.: sports nutrition drinks). We will be happy to advise further on this complex matter.

Café sales will be standard-rated, except for cold food sold for consumption off the premises. Modern tills and proper "point of sale" software is vital to ensure these sales are handled correctly. If assistance is needed in setting up the tills, please let us know.

Note that, for both the shop and the café, VAT on ongoing costs will be recoverable in full.

4. Option 1: Other

A sale of the development site will trigger CGT on any gain in value since you inherited it.

Under HMRC's SP/D12, however, a change in your fractional share in ZRID Construction would not give rise to a CGT charge.

To protect personal assets, such as your house, and your share in ZRID Construction from the risks involved in the Hub business, you should consider incorporating it and limiting your liability.

The tax consequences of this would be relatively straightforward:

i. CT loss relief would arise in the first year, which could be carried forward from year 1.

ii. Capital allowances would also be available to be set off against profits. This would increase the loss relief to be carried forward and so improve the cash position once the Hub was profitable.

iii. SBA at 3% of the value of the land and buildings would be available, as would first year allowances at 100% of eligible expenditure. A detailed capital allowances report should be obtained to support a claim in the face of HMRC challenge. Note that leasing equipment to personal trainers may prevent 100% relief under "full expensing": care is required here.

iv. Once loss relief had been utilised, CT would arise at 25%, with relief at the marginal rate.

All employees will be subject to PAYE. Care is required with arrangements with self-employed personal trainers and physiotherapists to avoid employment status disputes.

5. Option 2: VAT

Subcontractors will not charge VAT on their services as construction of new dwellings is zero-rated. Accordingly, the VAT cost of the building work should be reduced by £60,000 in your figures (**EXHIBIT C**).

Assuming that you will be purchasing the materials directly, VAT of £400,000 will arise, as none will qualify for zero-rating.

VAT of £27,000 will arise on architects' and other professional services.

Only the holiday lettings will be subject to output VAT, with the residential lettings being exempt. Accordingly, potentially large amounts of input VAT will be irrecoverable.

You could explore whether a design and build contract with a third party builder was commercially viable as this would mean that the builder's supply to you would be zero-rated and consequently you would have no irrecoverable VAT.

However, HMRC's Business Brief 101/09 states that the first grant of a major interest in a new dwelling to a connected company will not be regarded as abusive.

If a design and build contract is not commercially viable, you could consider selling the three blocks of flats to a connected company ("Propco"). Propco should be wholly owned by the partners, but should not form a VAT group with the firm. The shares in Propco should be held in the same proportions as the partnership shares in the firm.

Such a zero-rated supply to Propco would secure 100% input VAT recovery.

Propco will need to register for VAT if, as **EXHIBIT C** suggests, its holiday lettings turnover exceeds the £90,000 registration threshold within 12 months. Propco will thus have to charge VAT on its holiday lettings income, but will have 100% input VAT recovery on costs related to the holiday letting. Lettings exceeding 28 days can benefit from an effective VAT rate of 4%.

Propco will, however, be likely to be partially exempt in respect of its ongoing costs due the residential letting of the remaining units. As such it will be required to carry out an annual adjustment, etc., as explained in section 2 for Option 1 above. The amounts involved however are likely to be fairly minor.

Propco will not apply the capital goods scheme to the blocks of flats, because the purchase will be zero-rated.

6. Option 2: Other

A transfer of the land by you and Iskander to ZRID Construction, a partnership, is not a disposal for CGT purposes.

As a property developer, it is likely that the growth in value beyond costs to the point of transfer to Propco would be a trading profit. If the work was to construct an investment asset for retention, a disposal may be subject to CGT. Incorporation Relief would avoid an upfront CGT charge on the sale of the apartments to Propco and would reduce Propco's base cost for any sale to a third-party purchaser. However, it would only be available if there was a business being transferred, i.e. at least the holiday lettings business would need to have started before the sale to Propco. This should involve advertising the apartments and having at least some bookings in advance of the transfer.

However, note that residential lettings should not commence until after the sale to Propco. This is because residential lettings are exempt, and such a use of the inputs would lead to input VAT restrictions and possibly complex calculations. This may well restrict or prevent incorporation relief.

CIS applies to subcontract labour in the construction industry and will also apply in this project. PAYE will continue to apply to employed labour. This will be familiar to you.

The domestic reverse charge ("DRC") will not apply to these zero-rated works.

Bank debt repayments over a ten-year period can be met from the projected income. Moreover, Option 2 is expected to make significant profits over the three-year period outlined in **EXHIBIT C**, starting immediately.

Rental profits will accrue to Propco, as holder of the property, rather than the firm directly. This means that CT at 25%, rather than Income Tax at 45% plus NICs at 2%, will be due on the profits. Personal taxes will arise on value extracted from Propco.

Note also that Annual Tax on Enveloped Dwellings ("ATED") should be considered if the value of one or more of the apartments exceeds £500,000 each. If let, relief should be available.

7. Options 1 and 2: Stamp Duty Land Tax ("SDLT")

For Option 1, SDLT would arise on the purchase of the site, coming to £27,000 (**EXHIBIT B**).

For Option 2, 100% relief from SDLT arises under FA 2003, Sch 18, on the transfer of the land to the partnership and any transfer to Propco because the ownership shares are the same throughout.

No change to the ownership of the blocks should take place for at least three years after the transfer, to avoid an anti-avoidance charge, which would apply SDLT on the sale to Propco on the market value of the blocks of flats transferred. under FA 2003, s 75A. We would therefore strongly recommend that the shares in Propco continue in the same ownership for at least three years.

8. Comparison of Options 1 and 2: VAT

Under Option 1, the cost figures will need to reflect irrecoverable VAT. The Hub's use should be monitored over the 10-year CGS period, with adjustments in favour of HMRC or you depending on the change in the level of taxable and exempt income after "first use".

Under Option 2, the use of Propco to acquire and hold the blocks of flats can avoid the irrecoverable VAT in full (save for any non-building materials specifically covered by the input VAT block, e.g.: white goods, etc).

Nonetheless, Propco will need to carry out the normal partial exemption calculations, since its income will be a mixture of taxable holiday lettings and exempt residential lettings. The CGS should not apply.

9. Comparison of Options 1 and 2: Direct Tax

Option 1 offers potential reliefs in the form of capital allowances on expenditure, whereas Option 2 does not. As noted above, there may be an income tax charge on the partners on any uplift in value on a transfer to Propco. Depending on the circumstances, it may be possible for Incorporation Relief to apply.

Ongoing profits in both cases will be subject to CT initially (assuming Propco is used for Option 2), with income tax arising on any dividends withdrawn at your marginal tax rate. Salary, too, could be considered, but overall levels of income will affect the tax rate.

SDLT is a relatively minor cost with Option 1, and will not arise under Option 2 as currently outlined, nor if Propco is used for VAT planning purposes.

10. Comparison of Options 1 and 2: Other Matters

Your family are concerned about Option 1 and would prefer you to pursue Option 2. While you have assumed that the debt of at least £2.8 million in Option 2 is risky, your family's concerns are justified:

i. As well as personal training, Option 1 involves a wide range of different businesses which are likely to be new to you, such as:

   - Letting of facilities
   - Physiotherapy services
   - Operation of a retail outlet
   - Operation of a café

ii. By contrast, Option 2 is closely-connected to ZRID Construction's existing activities. Moreover, Iskander has significant experience in this field.

iii. Option 1 is also expected to be loss-making initially, potentially more than has been estimated. This could lead to greater demands on your cash and possibly funding issues. Option 2, however, is expected to generate profits in the first year.

However, if you did pursue Option 1 you could reduce the negative impact on your family as follows:

- First, Option 1 could be financed by way of borrowing in your own name, using your share of the land as security. This would match the debt against the expected income stream and would mean that Iskander would not need to incur debt. It would also avoid a CGT charge if the land has increased in value.
- Finally, Option 1 can be deferred. Option 2 offers a good return on the inheritance. It would allow you to revisit Option 1 in a few years' time. You could then also discuss your plans with your family. Moreover, Beth would be better-placed to help out with Option 1 when she has completed her physiotherapy training.

Success in Option 2 could make the family better disposed to Option 1 in the future.

In terms of the commercial returns, it is impossible to accurately calculate the impact of VAT and CT for reasons set out above.

However, the estimated figures suggest an additional £1 million of pre-tax profits in Option 2 in the first three years.

Moreover, comparing the three-year expected pre-tax return on investment, we find the following figures:

- Option 1: £475,000/£2,160,500 = 21.99%. Note that this figure overstates the real return, as irrecoverable VAT will need to be added to the outlays
- Option 2: £1,436,537/£4,185,000 = 34.33%

Option 2 therefore offers a much better pre-tax return on investment in the first three years, even before irrecoverable VAT is added to the outlay for Option 1.

Likewise, the pre-tax net profit margin is much more attractive for Option 2:

- Option 1: £475,000/£2,270,000 = 20.93%
- Option 2: £1,436,537/£2,031,245 = 70.72%

One further important point should be made. If either Option is unsuccessful, the obvious course of action to recoup the investment made would be to attempt to sell on the assets constructed. It is clear that the newly-built apartments in Option 2 would be much easier to sell on the open market. Demand for such properties is strong, the market is liquid and the price achievable is likely to be attractive.

By contrast, the bespoke Hub in Option 1 would be much harder to sell, and its value would be low where there was no ongoing business to be sold together with the asset, with promising future returns showing up in an extensive list of members.

This means that "cutting your losses" is much more realistic and much more easily achieved in Option 2 than in Option 1.

In summary, we recommend pursuing Option 2, with plans to revisit Option 1 in the future.

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

Austen & Austin Tax Advisers

30 April 2026