

**The Chartered Institute of Taxation**

**Application and Professional Skills**

**Taxation of Owner-Managed Businesses**

**November 2025**

**Suggested answer**

**Report to Michael and Suvil Blatt, Jo Peskal and Fran Bowler (“the investors”) on the most tax efficient structure for their proposed acquisition of the business of RS Ltd.**

**Introduction**

The objective of this report is to advise the investors on the most tax efficient way of acquiring and operating the business of RS Ltd.

This will include:

- a) Whether to acquire the shares or trade and assets of RS Ltd
- b) The most efficient operating structure
- c) Funding by share capital or loans
- d) Direct personal or company investment by Fran

This report is based on the information provided by the investors and reflects legislation in force on today’s date. If there is a delay in implementing our recommendations, a significant fiscal event (such as a Budget), or a change in circumstances, confirmation should be sought as to whether this affects the conclusions and recommendations in this report.

This report is prepared under instruction from the investors. No other party may rely on the advice and recommendations given.

**Executive Summary**

We make the following recommendations:

- 1) Press for a purchase of trade and assets rather than the purchase of the shares of RS Ltd. This will avoid the risk of adopting substantial historic liabilities (in particular on the HMRC enquiry), it will be cheaper and quicker as less due diligence will be needed and it will enable you to maximise tax relief on the majority of the assets of the business. You will need to register for VAT in advance of the purchase to ensure that no VAT is charged and to minimise the SDLT on the property. You should also be aware of the impact of the TUPE regulations in relation to the existing employees and discuss this with your lawyer.
- 2) In terms of the recommended vehicle for the acquisition, you should not use a general partnership due to the unlimited personal liability for the partners. You should therefore use a limited company or a limited liability partnership, which will limit personal liability to the capital invested and the assets within the entity. If sufficient tax relief can be secured on the purchase of trade and assets to offset the loss of brought forward trading losses then make the acquisition through a newly formed limited company. Unlike a LLP, where profits are subject to Income Tax and National Insurance on the partners whether or not drawn, a company allows profits to be retained in the company in order to invest and grow at a relatively low tax rate and potentially extracted in the future on a sale of the company as a capital gain.
- 3) Keep the issued share capital to a minimum; possibly just four £1 Ordinary shares, one held by each investor. Any additional funding should be provided by way of loans.

## **Acquisition of shares or trade and assets**

The owners of RS Ltd have not indicated whether they wish to sell the shares of their company or the trade and assets.

If you acquire the shares of RS Ltd then you will receive no tax relief for the investment.

RS Ltd has substantial brought forward trading losses. If you acquire the shares then these losses will be available to carry forward and offset against future trading profits. In order to secure this carry forward, it is essential that there is no major change in the nature of the business undertaken within five years beginning no more than three years prior to the change in ownership. As you intend to continue to operate as a restaurant then this restriction is unlikely to apply.

The purchase price of the shares will attract a Stamp Duty charge of 0.5% payable within 14 days of completion.

Any liabilities or claims in RS Ltd will remain. This could be very problematic, as you are aware of an on-going HMRC enquiry and have already identified concerns of over the operation of PAYE on the company's employees.

Alternatively, if you acquire the trade and assets of RS Ltd then you will not be impacted by any historic liabilities of the company. You will also reduce the need for extensive due diligence and warranties on acquisition. However, you will need to consider with your lawyer the impact of the "TUPE" regulations in relation to the employees of the business and you will also need to ensure that part-time and casual staff are correctly treated as regards their employment status, National Minimum Wage and the operation of PAYE (including on tips).

By purchasing the trade and assets, you will be able to select what assets you acquire, however this will mean that the brought forward losses cannot be acquired.

In addition, you should be able to claim tax relief on the cost of at least some of the assets acquired.

The key assets to consider are outlined below:

### Freehold Property

The building is likely to include a substantial element of embedded plant and machinery on which Capital Allowances could be claimed. The current owners incurred renovation and fitout costs in 2019 which probably included items such as heating and air conditioning systems, sanitary ware, water and electricity supply etc. It is essential that they can demonstrate that they have either already claimed Capital Allowances or that they are willing to submit a claim prior to sale of the property. It will then be open to you and the vendors to agree how much of these allowances may be passed to you through a joint election which will fix the disposal proceeds of the qualifying assets. The elected value can be between £1 and the original cost of the assets. A high value is better for you to maximise future tax relief whereas usually the vendor would prefer a low value in order to avoid a claw-back of relief. In the case of RS Ltd, the vendors would be less concerned with securing a low value because the taxable profit resulting from a low value election would be covered by brought forward trading losses.

The purchase of the property will result in a Stamp Duty Land Tax charge. The first £150,000 will be at 0%, the next £100,000 at 2% and the excess at 5%.

### Loose fixtures and fittings

Similarly it is open to both sides to agree how much is attributable to the acquisition of loose fixtures and fittings. Again the vendors may be willing to effectively transfer maximum value to you as the tax cost to them will be covered by brought forward losses.

### Goodwill

Generally amounts paid in excess of the value of the tangible assets of the business is classified as goodwill. Tax relief for such expenditure is highly restricted and will not be available in this case.

### VAT

It is likely that the acquisition of the trade and assets will be treated as a Transfer of a Going Concern (TOGC) which means no VAT is charged. The treatment is mandatory if:

- a) The assets, stock, premises fixtures etc are being acquired. You are acquiring all the assets needed to run the business.
- b) You will be continuing the same or a similar business. You will be operating a restaurant.
- c) The vendor and the purchaser must be VAT registered. RS Ltd is registered and with the level of turnover you are expecting, you will need to register for VAT anyway within 2 months of starting so may as well get the registration in place ready for the acquisition.

Therefore, RS Ltd will not charge VAT. This will aid cash flow for yourselves and also has the advantage that SDLT will be calculated on the VAT exclusive value.

The conversion works will cost over £250,000 and may therefore be within the “Capital Goods Scheme” which potentially requires adjustments to the VAT recovery over a 10-year period. As all the supplies the business makes are likely to be standard rated (the supply of meals in a restaurant), this will have no practical impact unless there is a change to provide exempt supplies. One example would be a sale of the property as this would be an exempt supply unless an option to tax is made. You should discuss with us any changes to the business model or plans to sell the property in advance.

### **Recommendation**

Our recommendation would be to press for a trade and asset purchase. This is particularly relevant in view of the potential historic liabilities.

### **Possible operating structure**

There are three operating structures through which you could make the acquisition of the trade and assets of RS Ltd, being:

- 1) General partnership.
- 2) Limited Liability Partnership (LLP).
- 3) Limited Company.

We have compared the relative advantages and disadvantages of these structures below.

## **General partnership**

A general partnership has the attraction of simplicity and flexibility. It would be necessary to register the partnership with HMRC. You would file annual returns with HMRC but there is no requirement to publicly disclose annual accounting information.

The partnership would acquire the trade and assets of RS Ltd and operate the business through the partnership.

You would have significant flexibility over how profits and losses are allocated between the individual partners on an annual basis. This could be in any combination of fixed salary, variable profit share, interest on capital etc.

The financial forecasts indicate that the business is likely to generate trading losses in the early years. As a partnership, the partners can elect to offset these losses against any other income, known as sideways loss relief. Usually this is limited to the year of the loss or the previous tax year. Losses generated in the first four years of trading can be carried back up to three years to offset against general income, offsetting against the earliest year first.

The maximum loss that an individual can offset against general income in any year is subject to restrictions. The maximum offset is limited to the greater of:

- a) £50,000
- b) 25% of total income in the year of offset

Where a partner spends less than 10 hours per week in the business, there is a further restriction on the amount of sideways loss relief that can be claimed. This may be relevant for Fran in the first four years of trading. This restriction limits the offset to the amount of capital contributed to the partnership or £25,000 if lower. Thereafter the sideways loss offset is restricted to £25,000 per annum.

Any unused losses will be carried forward by the partners to offset against future profits from the same trade.

The principal disadvantage of a general partnership is unlimited personal liability for the partners. This liability is joint and several.

The general partnership is tax transparent so individual partners are subject to income tax and national insurance on all profits as they arise regardless of what is drawn from the business. This can be problematic where there is a desire to retain profits within the business for future growth.

A future sale of the business will allow the individual partners to realise personal capital gains. Provided they have been partners for at least the two years prior to sale, it is likely they would benefit from Business Asset Disposal Relief (BADR). As such the first £1 million of gains would be taxed at 10% rather than the usual 20%.

Fran has fully utilised her lifetime BADR entitlement. As such, her gain would be taxed at 20%.

## **LLP**

There are additional administration responsibilities over and above that of a normal partnership. Principally, the requirement to file accounts and returns at Companies House.

The tax treatment of an LLP is essentially the same as a general partnership. The individual members are subject to income tax and NIC on profits as they arise regardless of drawings.

The principal advantage of an LLP is that, in the absence of any personal guarantees, any liability is limited to the capital invested and profits retained within the partnership.

The use of sideways loss relief for an LLP member is subject to an additional restriction. The sideways relief is limited to the total capital contribution of the individual member plus any un-drawn profits.

## **Limited Company**

In this case, you would each subscribe for shares in a newly formed company (Newco).

One of the key advantages of a limited company is that the potential financial risk for the shareholders is limited to the funds that they have invested either as shares or loans.

Profits arising to Newco will be subject to Corporation Tax at between 19% and 25%, depending on the level of profits.

Funds can be drawn by the shareholders from Newco in a variety of ways including salary and benefits in kind, dividends, interest and company pension contributions. Each will have different tax implications for Newco and the individual investors depending on their personal tax circumstances. We can advise on how best to structure this for each of you. Unlike a partnership or LLP, there is no personal tax on the shareholders unless profits are actually drawn from the company. This allows profits to be retained and for the company to grow in a relatively low tax environment.

A future sale of Newco will allow the individual shareholders to dispose of their shares and realise value directly. Provided they hold at least 5% of the share capital of the company and are employed by Newco in the two years prior to sale then it is likely they would benefit from BADR. This would mean that gains up to £1 million each would be taxed at just 10% rather than the usual 20%.

As noted above, Fran has already fully utilised her lifetime BADR entitlement so her gain would potentially be taxed at 20% but see the section on "Investors' Relief" below.

Any trading losses are ring fenced within Newco and can only be offset against company profits. There is no facility to allow the individual investors to use those losses.

Newco would be required to file annual accounts with Companies House. The information disclosed is limited but this information is in the public domain.

## **Recommendation**

On balance, we recommend a newly formed limited company (Newco) as the most appropriate vehicle for the acquisition and operation of the business. This will ring-fence any personal liability for the investors and allow the business to grow in a relatively low tax environment.

## **Funding**

You have indicated a need for funding of approximately £1.2m. You have secured provisional bank debt of £600,000 and have each undertaken to invest at least £50,000 into the business. This will give you each a one quarter interest in the company. Fran will provide the balance of any funding but this will not increase her equity stake.

Dealing firstly with your personal investments, you need to decide whether this will be all share capital or a mixture of share capital and debt. Again, there are advantages and disadvantages of each:

### **Share Capital**

It is often the case that third party lenders such as banks prefer to see the owners of the business invest funds by way of share capital. This will tend to strengthen the Balance Sheet and demonstrate long term commitment to the business.

The main disadvantage of share capital is that the funds are locked into the business. The most likely way of releasing these funds in the future would be through a sale of the shares.

In the event the business is unsuccessful then any capital loss on shares may be offset against general income in the year of loss or carried back to offset against income in the previous year. This relief applies where an individual subscribes for shares in a trading company and those funds have been used in the operation of the trade.

The amount of loss that may be offset in this way is subject to the same restrictions as outlined above for sideways loss relief.

### **Investor tax reliefs**

There are a number of tax reliefs available to individuals when subscribing for share capital in a trading company. These are principally Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS) and Investors' Relief (IR).

Unfortunately EIS and SEIS would not be relevant in this case. The reason being that you are considering the acquisition of an existing business. These reliefs are not available where the monies being raised are used to fund the acquisition of a longstanding business.

IR may be relevant for Fran. This relief is available where an individual subscribes for shares in an unquoted trading company and holds them for at least three years. Provided neither the individual or anyone connected with them is a "relevant employee", IR should be available. A relevant employee is an employee or paid director of the company during the first three years from initial subscription. As such, Fran could be an unpaid director and still qualify.

In the event IR qualifying shares are sold, any capital gain up to a lifetime limit of £10 million will be taxed at just 10% rather than the usual 20%.

### **Loan Capital**

The main advantage of funding principally by loan capital is that the loans can be easily repaid at any time subject to cash availability in the company.

You may consider charging interest on outstanding loans. Provided the rate charge is no more than would be charged by a third party, the interest paid would be a tax deductible expense for

the company. This is a very tax efficient method of funds extraction for the investors. This interest is taxable income in your hands but there is no National Insurance liability. If interest is paid then the company must withhold basic rate Income Tax and pay this over to HMRC.

If the business is unsuccessful and cannot repay the loans, this will be treated as a capital loss for the investors. Unlike losses on share capital, these losses cannot be offset against general income and can only be used against other capital gains in the year of loss or carried forward to future years.

### **Tax relief for Jo's borrowings**

Jo will need to borrow in order to fund her investment in Newco. Regardless of whether this is from a bank or an individual, she will be able to claim full Income Tax relief for interest paid on these borrowings. She should include a claim for relief on her self-assessment return.

### **Recommendation**

Unless your bank is insisting on a material investment in share capital then on balance, we recommend that the initial share capital investment should be kept to a minimum. This could be as little as one £1 ordinary share issued to each of you. The balance of any funding can be provided through loan capital. This includes any additional funding that will be provided by Fran.

The investor loans can be repaid whenever funds are available in the company. If Fran seeks to benefit from IR, she should be careful to make sure that none of her loans are repaid prior to the end of her three year qualifying investment period.

As noted above, you could consider charging a commercial rate of interest on outstanding loan balances.

### **OT Accounting**

**14 November 2025**