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VAT on transfers of a business as a going concern

Speed read

A sale of assets as part of a transfer of a business as a going concern (TOGC) is not treated as a supply of goods or services for VAT purposes, and so is outside the scope of VAT. The treatment is mandatory if the conditions are met. If VAT is charged in error, it would not be recoverable by the transferee as input tax. The business or part of a business that is transferred must be capable of separate operation, and the transferee must carry on the same kind of business as that carried on by the transferor. Special conditions apply to land and buildings in respect of which a sale would have given rise to a standard-rated supply.

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Overview

Special rules provide that the sale of assets as part of a TOGC is not treated as a supply of goods or services for VAT purposes (VATA 1994 s 49; the Value Added Tax (Special Provisions) Order 1995, SI 1995/1268, article 5; the VAT Regulations, SI 1995/2518, reg 6).

The TOGC provisions have two main purposes:

- to relieve the buyer of a business from the burden of funding any VAT on the purchase, helping businesses by improving their cash flow and avoiding the need to separately value assets which may be liable to VAT at different rates, or are exempt, and which have been sold as a whole; and
- to protect government revenue by removing a charge to tax and entitlement to input tax where the output tax may not be paid to HMRC.

In *VAT Notice 700/9*, HMRC states that 'business' means any continuing activity which is mainly concerned with making supplies to other persons for a consideration. The activity must have a degree of frequency and scale, and be continued over a period of time. Isolated transactions are not normally a business for VAT purposes. HMRC considers that if a business has not yet made taxable supplies, a transfer might not qualify as a TOGC but, where enough preparatory work has been undertaken prior to making taxable supplies, there will be a business capable of being transferred as a TOGC.

If the conditions for a TOGC are met, the transfer will not be treated as a supply for VAT purposes, and no claim is required – the treatment is mandatory.

It should be noted that the transfer of the share capital of a company cannot in itself constitute a TOGC, as the assets still belong to the company, and there is no supply for the purposes of the TOGC provisions.

Conditions

The conditions are set out in SI 1995/1268, article 5:

- The transferred assets must be used by the transferee in carrying on the same kind of business (whether or not as part of any existing business) as that carried on by the transferor (note that case law indicates that the business to be carried on need not be *exactly* the same)
- Where the transferor is a taxable person (i.e. registered or registerable for VAT), the transferee must already be a taxable person, or must immediately become a taxable person as a result of the transfer
- A transfer of part of a business as a going concern must be capable of separate operation.

In *VAT Notice 700/9*, HMRC summarises the following additional conditions which must also be met:

- the assets, such as stock-in-trade, machinery, goodwill, premises, and fixtures and fittings, must be sold as part of the TOGC;
- in respect of land or buildings which would be standard-rated if supplied (for example, commercial buildings that are less than three years old; unfinished commercial buildings; civil engineering works; or land that has been opted to tax by the transferor), the transferee must notify HMRC that they have opted to tax the land by the 'relevant date' (usually the date of completion of the transfer, but it could be the earlier receipt of a deposit or issue of a VAT invoice by the transferor where this crystallises a tax point) and must notify the transferor that their option has not been disapplied by the same date (this would usually be incorporated into the contract for the transfer); and
- there must not be a series of immediately consecutive transfers of the business – this expands on the condition above that the transferred assets must be used by the transferee in carrying on the same kind of business.

There is no minimum period for which the business must be carried on after a TOGC, and each case must be considered by reference to its own fact pattern. HMRC states in its *VAT Transfer of a Going Concern Manual* (at VTOGC3550): 'It is not possible to set out hard and fast minimum periods that automatically define how long a business must be maintained by a purchaser for it to be regarded as a "continuing business", as to do so could lead to contrived TOGCs. Instead, a "continuing business" should always depend upon the nature of the business carried on and the intention of the purchaser.' However, in the *Brian Oliver Jones* case (MAN/90/136), the purchase of a nightclub with a view to turning it into a restaurant, running it for just one week as a night club, was held to have been a TOGC for VAT purposes. The intentions of the transferee are key in ascertaining whether there is a TOGC.

HMRC states (at para 2.2.7 in *VAT Notice 700/9*) that:

- there must be no significant break in the normal trading

pattern before or immediately after the transfer;
- where a 'seasonal' business has closed for the 'off-season' as normal at the time of sale, this does not necessarily constitute a break in trade; and
- a short period of closure that does not significantly disrupt the existing trading pattern, such as for redecoration, will not prevent the business from being transferred as a TOGC.

In the *Montrose DIY Ltd* case (EDN/87/98), it was held that a two-month break before the new owner began trading was not significant and did not prevent TOGC treatment from applying.

The tests of continuity and the same type of business were highlighted in the recent First-tier Tribunal (FTT) case of *Haymarket Media Group v HMRC* [2022] UKFTT 168 (TC). The appellant argued that the sale of land to a property development group constituted a TOGC, on the basis that the vendor carried on a business of property development and property letting. However, the FTT found that there was no property development business; the vendor's main business activities were publishing and media-related activities, and its intention had simply been to sell the site with the benefit of planning permission.

Input tax on expenses related to a TOGC

Input tax on expenses related to a TOGC (for example, solicitors' fees and estate agents' costs) can be recovered, despite the fact that a TOGC does not involve a supply for VAT purposes. The position is as follows:

Transferor: The costs are treated as a general business overhead of the part of the business being transferred. Where that part of the business makes:
- only taxable supplies, the input tax is fully recoverable;
- only exempt supplies, the input tax is wholly non-recoverable; or
- both taxable and exempt supplies, the input tax is residual and recoverable in accordance with the partial exemption method in place.

Transferee: If the assets of the acquired business are to be used:
- exclusively to make taxable supplies, the VAT incurred on the cost of acquiring those assets can be attributed to those taxable supplies, and recovered in full;
- exclusively to make exempt supplies, the input tax on the cost of acquiring those assets is wholly non-recoverable; or
- in making both taxable and exempt supplies, any input tax incurred is residual input tax and must be apportioned in accordance with the transferee's VAT partial exemption method.

Land and buildings

The transferor is responsible for ensuring correct VAT treatment, including satisfying itself that the transferee's option to tax (if required) is in place and notified to HMRC by the relevant date.

If the transferor transfers zero-rated or exempt land or buildings, ie where a supply of the land or buildings would not have given rise to a supply that would have been standard-rated, there is no requirement for the transferee to opt to tax or notify that the option has not been disapplied.

In *VAT Notice 700/9*, HMRC confirms that a property business can be transferred as a TOGC if the transferor owns any of the following:
- the freehold of a property which is let to a tenant, and the freehold is sold with the benefit of the existing lease, even if the property is only partly tenanted;
- the lease of a property (which is subject to a sub-lease) and the lease is assigned with the benefit of the sub-lease;
- a building with a contract to pay rent in the future, but where the tenants are enjoying an initial rent-free period, even if the building is sold during the rent-free period;
- a property with a prospective tenant who has not entered into a lease agreement when the freehold is transferred to a third party (with the benefit of a contractual agreement for a lease but before the lease has been signed); or
- a number of let freehold properties: the sale of a single let or partly let property can be a TOGC of a property rental business.

The following situations will also be capable of being a TOGC:
- The grant of a lease of the property, retaining an interest with a value of no more than 1% of the value of the land or property immediately before the transfer (disregarding any mortgage or charge).
- A tenant of a building who has sub-let part of that building surrendering the lease to the landlord with the benefit of the subleases.
- A property developer selling a site as a package (to a single buyer) which is a mixture of let and unlet, finished or unfinished properties, and the sale of the site would otherwise have been standard-rated.
- A business owning land with the intention of constructing buildings for sale (and these supplies would be taxable supplies), performing work on the land such as widening roads and installing utilities, if a part of this partially developed land is then sold to a property developer who intends to complete the development and sell the newly constructed buildings.
- The transfer of a partially-let building which is capable of being a property rental business, provided that the letting constitutes economic activity. Such cases should be considered on their facts – HMRC would not see a TOGC if the letting element of the transaction was so small as to be negligible.
- The purchase of a freehold and leasehold of a property from separate sellers without the interests merging and without the lease being extinguished, providing the owner continues to exploit the asset by receiving rent from the tenant.

HMRC considers that the following would not constitute a TOGC:
- The transfer of a building by a property developer who has allowed someone to occupy it temporarily (without any right to occupy after any proposed sale), or who is 'actively marketing' it in search of a tenant – there is no property rental business being carried on.
- The grant of a lease retaining an interest that has a value of more than 1% of the value of the property immediately before the transfer (disregarding any mortgage or charge). Where more than one property is transferred at one time, this test should be applied on a property-by-property basis, rather than for the entire portfolio.
- The sale of a property freehold to the existing tenant who then leases the whole premises to the transferor – this cannot be a TOGC, as the property rental business is not transferred to the tenant.

In the *Haymarket Media Group v HMRC* case referred to above, the appellant's secondary argument was that there had been a TOGC of a property lettings business. However, the FTT found that a key feature of the sale of the site was that of a sale of the freehold with vacant possession, and the grant of leases shortly before the sale was an attempt to characterise the sale as a TOGC.

If any property assets transferred as part of a TOGC are subject to the VAT capital goods scheme (CGS), the responsibility to make any remaining CGS adjustments will pass to the transferee. In summary, the CGS applies where the value of VAT-able (other than zero-rated) supplies received in connection with the acquisition, creation, refurbishment or fitting out of a property is £250,000 or more. The CGS requires that adjustments are made to the VAT reclaimed in relation to a 'capital item' if, within a period of ten successive intervals (each interval normally corresponds with a 'VAT year'), there is a change in the extent to which the capital item is used to make VAT-able supplies. Therefore, the transferee would be required to adjust input tax that had been reclaimed by the transferor.

Groups

Following the Upper Tribunal's ruling in *Intelligent Managed Services Ltd v HMRC* [2015] UKUT 341 (TCC), HMRC accepts that:

- The initial transfer of a business, or part of a business capable of separate operation, to a company in a VAT group is a TOGC if that company both (i) intends to continue to use the transferred assets to operate the same kind of business, and (ii) will provide supplies of that business to other group members, and those other group members use or intend to use them to make supplies outside the group.
- This is also the case if, after the initial transfer into the group, the business is transferred between group members, provided that ultimately the services that it provides are made to a group member that makes or intends to make services outside the group.
- If the buyer uses the assets to make supplies directly outside the VAT group, this would also be a TOGC.

It should be noted that the transfer of certain assets by way of TOGC to the member of a partly exempt VAT group may give rise to a 'self-supply' whereby the representative member of the VAT group must account for output tax on those assets. The VAT on the self-supply can be treated as input tax in the same period, so it would be recoverable by reference to the use of the relevant asset. For example, if the relevant asset would be used for 95% VAT-able purposes, output tax at 20% would be accounted for on the self-supply by reference to the market value of the assets, and 95% of this amount would be reclaimed as input tax. This provision typically applies in respect of assets that were acquired by the transferor within the period of three years before the TOGC where VAT recovery was available in full on the purchase.

Transfer of VAT number

The transferor's VAT number can be reallocated to the transferee, if both parties agree to the consequences, which include:

- the transfer of any VAT liability to the transferee, including VAT on any stocks and assets kept by the transferor;
- loss of entitlement by the transferor to any repayments of VAT or unclaimed input tax, both in relation to periods before or after the transfer; and
- transfer of entitlement to unclaimed VAT bad debt relief.

The transferee also becomes liable to repay input tax claimed by the transferor on supplies that remain unpaid after six months.

It is therefore unusual for the VAT number to be reallocated, as the transferee will normally not wish to risk exposure to additional VAT liabilities. In such cases, the transferor will need to deregister, unless they are continuing to trade in another capacity.

The transferee may still be able to claim input tax on goods and services supplied to the transferor, without the VAT number having been transferred, depending on the terms of the business purchase agreement (*The NT Advisors Partnership v HMRC* [2017] UKFTT 625 (TC)).

Practical issues

A number of factors should be taken into account when determining whether a transfer qualifies as a TOGC. The effect of the transfer must be to put the transferee in possession of a business that it can carry on as a going concern with minimal interruption.

As HMRC notes (at VTOGC4100), there is no requirement for the transfer of all of a business's assets to take place at once for the TOGC provisions to apply, provided that the effect of the transfers is to put the purchaser in possession of a business. However, it is generally the case that the closer together that the transfers take place, the more likely it is that they are in essence part of the same transaction.

If the transferor charges VAT on a TOGC in error, the transferee will not be entitled to reclaim this amount as input tax. The transferor would have to cancel the tax invoice, issue a credit note, and refund the VAT charged.

The transferor retains the business records, unless the VAT registration number is transferred, but must provide information the transferee needs in order to comply with their duties.

Following a TOGC, the transferee may need to apply for customs authorisations and approvals, as registrations for other duties or taxes will not have been transferred as part of the TOGC.

In recent years, HMRC has become increasingly reluctant to provide written VAT rulings, particularly in respect of whether a transfer qualifies as a TOGC. If there is genuine uncertainty, a potential transferor can make a written request for guidance or clarification, setting out all relevant facts and information, and giving a clear indication of what aspects of the arrangement give rise to doubt or uncertainty. Alternatively, if VAT has been charged where the transferee considers that TOGC treatment is available, one option is to submit a voluntary disclosure to HMRC (rather than claiming the input tax on a VAT return), and HMRC would be obliged to provide a decision on whether the input tax is recoverable.

It is vital that the parties are suitably protected in the event that HMRC considers that TOGC treatment does not apply. For example, the transferor should ensure that the purchase price is VAT-exclusive to allow it to charge VAT in addition to the purchase price. Furthermore, it may be appropriate for the transferor to seek a provision in the contractual documentation for the transferee to indemnify the transferor against any penalty or interest charged by HMRC that may be due if the transfer is not a TOGC because of something that the transferee has done or failed to do. The contractual wording is key and should include suitable warranties with a view to ensuring that the conditions for TOGC treatment are met. ■

For related reading visit www.taxjournal.com

- VAT groups: an 'Intelligent' solution to TOGC issues? (P Mason, 5.8.15)
- Cases: *Haymarket Media Group Ltd v HMRC* (15.6.22)
- VAT and TOGCs: lessons from *Haymarket* (J de Wilton, 22.6.22)