

TAXREP 62/05

VAT: TRANSFER OF A GOING CONCERN

Memorandum submitted in November 2005 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a summary of responses issued in August 2005 by HMRC

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VAT: TRANSFER OF A GOING CONCERN

INTRODUCTION

1. We welcome the opportunity to express views on the matters on which comments were invited in the Summary of Responses announced in Business Brief 15/05 dated 9 August 2005 and published by HMRC at http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageMySite_ShowContent&propertyType=document&columns=1&id=HMCE_PROD1_024503#P230_43166. We responded to Customs' consultation of 28 September 2000 in TAXREP 41/00 submitted on 21 December 2000 (<http://www.icaew.co.uk/publicassets/00/00/04/41/0000044152.DOC>).
2. The headings below are as in HMRC's paper. Points on which HMRC seek views are reproduced [thus](#).
3. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A.

KEY POINT SUMMARY AND RECOMMENDATIONS

4. The key issue to remember is that VAT is a self-assessed tax. As a self-assessed tax, taxable persons should be able to administer it without the need for written rulings. It is inequitable that a measure that was originally intended as an anti-avoidance measure to prevent a vendor absconding with the tax on the sale of a business should potentially lead to tax being recovered from a purchaser business that did not know or could not have known all the facts. Any adjustments to the TOGC regime should ensure that this does not happen and should be consistent with our Ten Tenets for a Better Tax System (summarised in Annex B).
5. As the present rules do not make it easy for traders to determine their tax liability, there should be a statutory rulings procedure with deadlines imposed on HMRC.

COMMENTS ON ISSUES RAISED IN HMRC'S PAPER

Consultation responses – general

1. Routine pre-transaction rulings for all TOGCs on request

6. The real answer to the questions on rulings is that the rules should be simplified. Indeed, we consider that the *Zita Modes* case (C-497/01) was saying that if a business is transferred, member states that apply the option set out in Article 5(8) of the Sixth VAT Directive must not levy tax. As regards the condition that member states may take measures to prevent distortion of competition, it is perhaps interesting to note that this does not say (as with other provisions of the Sixth Directive) that member states may impose conditions, only that they 'may take the necessary measures'. The distinctiveness of the wording suggests that it is aimed at administrative measures such as how member states ensure the proper application of the capital items legislation that are the target here.

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7. If it is not possible to simplify the legislation, then there is no answer to a requirement that in the interests of legal certainty - a fundamental concept of EU law - the tax authorities must provide proper assurances to taxable persons who act in good faith based on the knowledge that they actually have (at the time of the exercise of a decision). Further, it is no answer to say that HMRC will not impose penalties in certain cases. Taxable persons have a right to legal certainty and if the legislation does not provide it, then there must be clear administrative measures, eg a statutory rulings procedure, that do.
8. Turning to the UK situation as it is now and the matters raised in HRMC's paper, whilst we note that HMRC do give rulings as outlined in [VAT Notice 700/6](#) VAT Rulings, there is obviously still some uncertainty outside HMRC that such a facility exists, hence the number of responses. This seems to suggest that more publicity is needed – perhaps as an item in VAT Notes?
9. We now turn to the questions raised by HMRC.

Would a list of factors considered 'unusual' be helpful? What should be 'unusual' factors?

10. A list of factors could clearly help, so long as it is not considered exhaustive. In particular, it might be worth seeing if there could be commentary on vertical integration/divestment, where someone takes over the business of a supplier or outsources an internal function (where, in both cases, one would not expect to see a TOGC); also on the situation such as where businesses leave a VAT group where the customers of the business were VAT group members.

Would a 'joint application' procedure for a single ruling be helpful or practical?

11. A joint application for a single ruling would certainly be helpful inasmuch as it would/could put both sides on notice of their respective obligations.

2. Clarify condition that assets are to be used in new business

12. The UK measures go further than *Zita Modes* intended. The test as regards property transfers was considered in the VAT and Duties tribunal case of *Hallborough Properties* (1992) MAN/92/877 (10849). That case concluded that where a property was transferred by a developer to a person who intended to exploit a property by renting it, there was a continuance of the same business. In our view, the term 'carrying on of the business or part of the undertaking transferred' requires a very broad approach. Indeed, the fact that the judgment compares continuation of the business with the liquidation of the business emphasises the point. The judgment in fact suggests that *Dearwood* [1986] STC 327 may have been wrong because in that case there was an intention to liquidate the business as it was insolvent.
13. As regards property therefore the imposition of a condition that both transferor and transferee must opt to tax appears to be a condition that has no foundation. Operating a property that is opted is no different to operating one that is not. It is still carrying

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out the same business. The conditions imposed by UK law usurp the function of the capital items scheme which is the correct way to deal with a transfer from someone who operates a property on a taxable basis to one who does not. It will also be noted that in fact there is a lacuna in UK law when a business that has not had to register because it was exempt transfers a property to someone who is going to use the building for taxable persons. The capital items rule should operate to allow any remaining VAT adjustment to be made.

3. Cases of doubt - protecting a position

14. Regarding HMRC's first comment, we think that it is wrong to encourage businesses to protect their position by charging VAT where there is doubt as to whether VAT is properly chargeable. In the HMRC Summary of Responses it says that, where the seller treats a transaction as a supply and pays HMRC the output tax, HMRC do not seek to cancel the transaction. But we would suggest that the 'VAT' in this case is not input tax in which case the transferee has not right to deduct. If the seller does not account for the VAT, it is one thing for HMRC to say they could assess the seller. However, if the seller has disappeared, then HMRC will presumably go for the transferee, who could be in a materially worse position if this so called VAT had been paid over as part of the price and the input tax deduction is later denied. Such action by HMRC seems to conflict with the original intention of the provision, which is supposed to be an anti-avoidance measure to ensure that by not bringing such transactions into VAT, such situations, ie sellers absconding with the VAT and purchasers paying sums called VAT which later prove non-deductible, do not occur.
15. Any party who has acted in good faith must be able to rely on being protected from the fiscal consequences of the other's default. Keeping a TOGC VAT-free must be the best way to do this. This is likely to necessitate improving the clearance procedure.
16. Regarding HMRC's second comment, we question HMRC's comments on not revealing confidential information about other businesses. A TOGC is, in effect a tri-partite arrangement with HMRC in the middle and it ought to be a matter of accepted routine that the information is available if requested to the parties to the transaction as it is fundamental to the contractual position.
17. In particular, it is difficult to see how a person's VAT registration number can be regarded as confidential. It is required to be included on all stationery and of course on invoices of the business. It follows that where a business claims to be registered and provides a VAT registration number it must always be permissible for HMRC to confirm that fact.
18. Where the seller needs confirmation that the purchaser of a business is a taxable person or will become one, a problem arises because what the current legislation is doing is requiring the transferor to make a decision based on an event that has yet to take place. That cannot comply with the principle of legal certainty. (There will of course be some cases where the condition will obviously be met but that is not always the case.)

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19. Because the seller cannot enforce any condition but runs the risk of paying VAT on the assets transferred, it would seem that the legislation needs amendment to simply require the seller to make a declaration that he is treating the business as a TOGC based on undertakings made by the transferee. That allows HMRC to ensure that the transferee does not escape with tax-free assets while protecting the seller.

4. Introduce a TOGC purchaser's declaration/ certificate

20. This can only be helpful. HMRC may wish to waive such a requirement in cases where:

- Both parties are already registered and are mainly taxable; and
- Fixed property is not the major asset of the business or the value of fixed property is insignificant in relation to the total value of assets transferred.

Should such a system be compulsory or optional?

21. We do not favour such a system being compulsory, but the existence of the possibility of using such a system would help to tighten up the contractual situation generally.

Would sellers unduly influence purchasers to sign a certificate?

22. Sellers already tend to ask for warranties or indemnities on this in contracts and we have seen cases where a purchaser was influenced to act to his detriment. This would be likely to be more of a problem if the declarations were compulsory.

As information on the purchaser's future use of the business might be commercially sensitive, might he mislead the seller?

23. This is always possible, but it could be made clear that detailed, commercially-sensitive, information was not needed.

Would there be sufficient distinction between the parties' private contractual obligations and statements for VAT law purposes?

24. There is a cross-over here and we think that it would be inadvisable to infer that the interests can be distinguished.

If a purchaser did not fulfil his stated intentions immediately following the transfer, what sort of penalty should arise?

25. If the default were on the part of the purchaser in a VAT-free TOGC, the sanction could be to require him to account for VAT on the same lines as in section 44 VAT Act 1994 (Supplies to Groups) by making the buyer have a self-supply.

Should there be a separate, punitive, penalty for false declarations?

26. If the scheme is voluntary, no – unless the action resulted in an existing VAT offence, for which there are already penalties.

Would the objective be achieved more effectively by better-drafted contracts?

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27. Partly, but this does not directly address the issue and a voluntary declaration would help crystalise the parties' minds.

Could the current position be improved more effectively by improving HMRC's guidance on what corrective action we might take?

28. There is always scope for more and better guidance.

5. TOGC Elections

29. We are not in favour of making any system like this voluntary as this reduces certainty. Regarding the suggestion that HMRC refuse to allow TOGC treatment unless both vendor and purchaser provide a written joint election to treat it as such, this could work to the detriment of the buyer in some situations. It is fairer and better to make the application of the rules automatic.

6. HMRC to confirm that an option to tax land or buildings was never made

30. We particularly support the point that HMRC should confirm whether an option to tax has been made or not where the transferor does not know. HMRC's saying that they cannot disclose confidential information about a business in this situation is not good enough. Any person in receipt of a supply on which VAT could be charged should be entitled to find out if that charge is justified. Otherwise there is a potentially a breach of fundamental human rights.

7. Possession of business records

31. On the basis of the list in the Summary of Responses, respondents omitted the main reason why records should not pass from transferor to transferee - Companies Act and Insolvency legislation provides for the retention of records as a measure to protect creditors and shareholders. We consider that it is totally wrong to require that the records be transferred for tax reasons whether or not the VAT registration number (an administrative measure) is taken over and we would like to see the law changed.
32. If it is important for the buyer to acquire records, then the law could either provide that the seller undertakes to provide reasonable access or that certain specific documents (within a reasonably limited range) should be copied and given to the purchaser. A purchaser accepting such in good faith should then be at no risk of sanctions.

8. Operation of the business by the purchaser

33. This is a 'how long is a piece of string?' question. We agree that it does not lend itself to a set timespan, because 'continuation of a business' can vary between different types of activity. If an attempt were made to fix a time, this would open the way to avoidance.

9. Break in trading

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Is it the length of time or the reason for closure that are important?

34. Normally it is a combination of both but we consider that reason is the more important. If there is no indication that the closure is permanent (insolvency or non-viability, perhaps) then the length of the break could be flexible, with a sanction on the transferee (a self-supply charge, say) if the business is not, in the event, continued after a reasonable period.
35. The true test should be whether there is a transfer of the undertaking. That should be a practical test of whether the transfer would ordinarily be regarded as a TOGC under normal accounting and insolvency rules and not any artificial tax rules.

10. Transfer of a business - no external supplies

36. We now look at the points cited in HMRC's paper.

Where the internal activities of a business or VAT group are transferred to a third party, who will use them to make supplies for VAT purposes.

37. If the business gives rise to supplies between one group member and another, TOGC treatment should be allowed. If a mere internal function of one company is transferred, as in outsourcing an accounts department, it should not.

Where a business making supplies is transferred to a business that will use it only in internal activities.

38. This should not be a TOGC unless it comes within the sort of situation covered by S 44 (see above)

Specifically under b), where assets are transferred back in-house from an outsourcer on termination of the contract, where the business continues the functions of the outsourcer internally.

39. This should be capable of being a TOGC, so that double taxation does not occur.
40. The key question is whether the activity is capable of being carried on separately from the seller's other activities.

12. Harmonising TOGC and TUPE regulations

41. TUPE is based on wholly different legislation having a purpose totally different from the VAT rules. There should be no attempt to harmonise.

13. TOGC and partly exempt businesses

42. One quirk that needs to be eliminated is that although the transfer of a business or part of a business which makes only exempt supplies can be a TOGC, if the transferor happens to be a taxable person (because of other activities not being transferred), TOGC treatment is only afforded by Article 5 of VAT (Special Provisions) Order SI

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1995/1268 if the transferee happens to be a taxable person too: see Art 5(1)(a)(ii) and 5(1)(b)(iii).

43. This is illogical, and potentially distortive, because if the transferee is not a taxable person (because he is only making exempt supplies) he will not be able to recover any VAT charged on the assets of the business transferred. Article 5(8) of the Sixth VAT Directive gives Member States power to 'take the necessary measures to prevent distortion of competition in cases where the recipient is not wholly liable to tax', but the provision in Article 5 of the Order seems to create distortion.

14. VAT registration of purchaser

44. In respect of the point that the purchaser may be unable to register for VAT before the transfer takes place due to the speed with which the deal is concluded, we suggest that the solution would be to allow provisional TOGC treatment so long as the transferee applies for retrospective registration to the date of transfer within, say, 30 days.

15. Identifying turnover

45. We have no comment on this.

16. Self-supply charge - section 44 VATA 1994

46. Some commentators say that this section is ultra vires. We also question whether it is proportional. Its effect is that a transferee who is a single company or an individual avoids 'new' VAT but a group that acquires a business does not. In any event, we would suggest that the proper way to deal with the mischief targeted by this section is via the Capital Items Scheme.

17. Impact of land and property VAT legislation and policy

47. We support fully the point that the use in the legislation and guidance of 'grant' and 'supply' is very confusing and needs to be rectified.

18. Manner of changes

48. We agree with the suggestion that changes should be made by changing the law to make it clear.

Consultation responses - land and property issues

49. As a general point on this section, it is arguable that you either treat a business as a TOGC or you do not. We question whether it is possible to exclude part of it as the UK's anti-avoidance rules provide. As noted above, they do not appear to be justified either under the same business rule or as a measure to prevent distortion of competition. Indeed, providing for 'new' VAT to apply to a property on a transfer of a going concern is in itself potentially distortive.

1. Same kind of business

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50. See the comments under ‘Consultation responses – general’ item 2: ‘Clarify condition that assets need to be used in new business’.

Surrenders

51. We agree with the respondent who asked HMRC to reconsider [VAT Notice 700/9](#) Transfer of a going concern Section 7.3, 3rd bullet point.

Leasing assets

52. We have no comment here.

Grant of a long leases rather than the freehold

53. We have no comments here.

Merged interests in land

54. We consider that HMRC are probably wrong in their view on this.

Tenant acquiring the freehold

55. We have no comments here.

Transfer of unoccupied property

56. We suggest that this depends on the facts and whether there is just a temporary break in a property rental business.

Consecutive transfers of property

[Can consecutive transfers of rented property be TOGCs? Kwik Save Group plc says no, reflected in section 2.3.3 of \[Notice 700/9\]\(#\).](#)

57. We have no objection to the way the principles are being interpreted here – ie where the purchaser makes an immediate onward supply. It appears that the purchaser cannot satisfy the pre-conditions for TOGC treatment. Businesses make decisions about how they want to do things and should have to live with the consequences as one of the facts of life. However, the solution in this situation is often to VAT-group the purchaser and the transferee before the intra-group transfer.
58. However, having said this, we do see a problem if the law in Scotland is different in this respect in relation to property lettings and we feel that some accommodation should be considered to give equality of treatment.

[Could HMRC allow TOGC treatment where the business purchased is immediately transferred to another member of a purchaser's corporate group.](#)

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59. As noted just now, the solution in this situation is often to VAT-group the purchaser and the transferee before the intra-group transfer. If companies choose not to group, then we suggest that they must live with the consequences?

Purchase of shares

60. No comment.

2. Transfer of a single property - TOGC?

61. No comment.

HMRC comment

Currently, we accept that any single, (partly) let, property is capable of being a TOGC of a property rental business. We are willing to reconsider this policy, particularly as the above comments came exclusively from outside HMRC.

62. It would be regrettable if HMRC were to retract from this favourable policy. We consider that the facts of the particular case should matter, not size.

3. Option to tax notification procedure

63. As with the comment on registration earlier, we consider that there should be a facility to allow the transferee to opt to tax retrospectively within a short period of time, say 30 days from the time of supply. We see no reason to change the time of supply rule regarding the deposit.

64. If it is necessary to protect the seller's position, would it be practicable, for example, to allow the seller to provisionally charge VAT and for this to be paid by the buyer, not to the seller, but to HMRC as stakeholder on the basis that it will be refunded when the option to tax/registration is dealt with?

Should there be notification within a time limit?

65. Yes.

If so, what should the time limit be?

66. 30 days.

What must a purchaser do between a purchase in principle and completion?

67. The purchaser should decide whether to opt to tax and register.

4. Minimum occupation

68. No comment.

5. Portfolios

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69. No comment.

6. Peppercorn rents

70. No comment.

7. Property development and leasing

71. No comment.

Consultation responses - specific changes to VAT notices

VAT Notice 700/9 Transfer of a business as a going concern

Notice – general

72. We can understand the comments as Notices can often be improved. HMRC's suggested solution to have one larger TOGC Notice with two distinct parts is a sensible way forward.

PCB
17.11.05

ICAEW AND THE TAX FACULTY: WHO WE ARE

The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at tdtf@icaew.co.uk or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99; see http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160.