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# VAT or no VAT?

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*Peter Mason* looks at when a business sale amounts to a transfer of a going concern

## What is the issue?

Business sales can be for very high values, so it is important to identify accurately when these qualify for no VAT as a no-supply transfer of a going concern (TOGC). The case of *Intelligent Managed Services v HMRC* [2015] UKUT 341 (IMSL)in the Upper Tribunal has broadened the scope of TOGC treatment to cover wider business chains, whether fiscal or economic

## What does it mean to me?

It is essential that TOGC is applied correctly because paying large amounts of VAT on asset sales can affect cash flow. It can also lead to a hard tax cost if sales contracts state that the consideration is VAT-inclusive (as in IMSL) and VAT is due, or VAT is incorrectly charged in a TOGC and cannot be recovered

## What can I take away?

After IMSL, a TOGC occurs when a business, defined as an undertaking (or part thereof) that is capable carrying on an independent economic activity, is transferred from one VAT-registered person to another, and the buyer intends to carry on or exploit it. To ensure fiscal neutrality and non-arbitrary treatment, a business must be identified not from a fiscal or legal sense, but from an economic one

Have you ever watched *Deal or No Deal* hosted by Noel Edmonds? It is a television game show in which contestants have to guess which boxes contain high-value money prizes. They can either cut a deal with the banker or play to the end and win large or small amounts. Arguably, the application of TOGC rules has, at times, been a matter of chance as to whether the outcome is VAT or no VAT.

## Legal rule

Articles 19 and 29 of the Principal VAT Directive 2006/112/EC (PVD) set out the TOGC provisions in EU law for goods and services as follows:

> 'In the event of a transfer, whether for consideration or not as a contribution to a company, of a totality of assets or part thereof, member states may consider that no supply of goods has taken place, and that the person to whom the goods are transferred is to be treated as the successor to the transferee.'

These provisions were introduced into the EC Sixth VAT Directive (77/388/EEC) of 17 May 1977 and the explanatory memorandum to it states that its purpose was in the interests of simplicity and not to overburden the purchaser. The Court of Justice of the European Union (CJEU) has interpreted the provision in its case law, in particular *Zita Modes Sàrl* [2004] (Case C-497/01), *Finanzamt Lüdenscheid v Schriever* [2012] (Case C-444/10) and *Staatssecretaris van Financiën v X BV* [2013] (Case C-651/11). Importantly, the CJEU stated that a TOGC is an independent concept of EU law with its own autonomous meaning, and any measures taken to restrict its application strictly to the second sentence of what is now article 19 PVD. The advocate-general in *Zita Modes* also pointed out that the provision protects the tax administration in cases in which the vendor does not pay the final tax sum of tax due, for example due to insolvency.

In *X BV*, the CJEU summarised the case law as set out in *Zita Modes*, where the CJEU had held that TOGC treatment applied if a set of cumulative conditions arose. TOGC treatment covers the transfer of goods and services which together constitute an undertaking or part thereof, that is capable of carrying on an independent economic activity. But it does not cover the simple transfer of assets such as sale of stock of products. The transferee must intend to operate the business or part of the undertaking transferred and not simply liquidate the activity immediately. All of the elements transferred must together allow an independent economic activity to be carried out.

In *Schriever* the CJEU emphasised that there must be an overall assessment of the facts and there should be no arbitrary distinctions resulting.

## UK implementation

The UK has exercised the TOGC option and implemented the 'no supply' rule in secondary legislation. Article 5 of the UK Special Provisions Order (SI 1995/1268) states that business asset transfers amount to a non-supply where the transferee is VAT-registered and uses the assets to carry on the same kind of business as that of the transferor. A part transfer is also eligible for TOGC treatment when it is capable of separate operation.

## Interaction with VAT groups

The facts in *Intelligent Managed Services v HMRC* [2015] UKUT 341 (IMSL) were that, in 2010, IMSL sold its business of providing banking support services to retail banks and lenders to Virgin Money Management Services Limited (VMMSL), a member of the Virgin Money Group (VMG) VAT group, by way of a business asset transfer. Business hardware, developed software, staff, intellectual property (IP) rights and essential contracts were transferred.

A feature of the purchaser's side of the transaction over which IMSL had no control was that VMMSL operated as a separate company within the VMG VAT group. This provided banking processing services to another member of the VMG VAT group, Virgin Money Bank Ltd (VMBL), which itself provided retail banking services to customers. VMMSL undertook no transactions with third-party customers, which would have amounted to supplies for VAT purposes; it transacted internally only, within the VMG VAT group.

## HMRC policy

The problem for IMSL was that HMRC considered a business to be defined by reference to external third-party supplies for VAT purposes made by the member of the VAT group. In accordance with their policy, set out in Notice 700/9 of April 2008 titled ‘Transfer of a business as a going concern’:

> ‘4.3 Transfers made to a VAT group
>
> Where a business is sold and the purchaser is part of a VAT group and uses the new acquisition simply to make supplies to VAT group members, the business has effectively ceased and it cannot be treated as a TOGC. However, if supplies are also being made to businesses outside of the VAT group, a TOGC is possible.’

The HMRC approach defined a ‘business’ solely by reference to supplies for VAT purposes: that is, fiscally, not economic. It also contains a fundamental error in this author’s view. There can never be *supplies* within VAT groups (unless the supplies fall within the evasion/avoidance provisions of the second paragraph of article 19 PVD), only transactions. It is an elementary principle of VAT that commercial transactions amount to supplies when carried out for consideration ‘by a taxable person acting as such’; see article 1(a) and (c) PVD. And the only single taxable person is the VAT group; see article 10 PVD and *Ampliscientifica Srl & Amplifin SpA v Ministero dell’Economia e delle Finanze* [2011] STC 566 (Case C-2008/301) and *EC v Ireland (No 3)* [2013] STC 2336 (Case C-85/11). Moreover, supply must involve a form of bilateral arrangement between two or more parties for delivery or performance in return for payment; see *Tolsma v Inspecteur der Omzetbelastung Leeuwarden* [1994] STC 509 (Case C-16/93).

## VAT groups and Skandia: developments at the CJEU

The First-tier Tribunal (FTT) upheld HMRC’s approach, considering the purchaser to be the contractual not fiscal purchaser. On appeal before the Upper Tribunal (UT), HMRC did not even seek to maintain its arguments on VAT groups because, in September 2014, the CJEU had issued its judgment in *Skandia America Corp (USA), filial Sverige v Skatteverket* (Case C-7/13) (2014). At issue was the same point as in IMSL: who was the purchaser of a service into a VAT group, the legal entity, in that case a branch of a US company or the fiscal entity itself, the Swedish VAT group?

The CJEU stated at paragraph [30] of its judgment in *Skandia* that:

> ‘For VAT purposes, the services supplied by a company … to its branch which … belongs to a VAT group, are considered not to be supplied to that branch but must be regarded as being supplied to the VAT group.’

The CJEU confirmed decisively that, for VAT purposes, it is the fiscal not legal person who is the recipient of goods and services. The UT did not overturn the FTT; it set aside the decision and remade it. But it had to deal with the issue of the UK regulations and whether the business conducted by the VMG VAT group was the ‘same kind of business’.

## Interpreting legal fictions in EU law: prescriptive or remedial?

The proper approach to legal fictions can be seen from the case law of the CJEU in *Abbey National v CCE* [2001] STC 297 (Case C-408/98). At issue was whether input tax was deductible on the costs of a transaction that was treated as a TOGC – that is, a non–supply. To obtain deduction of input tax, the case law had held that there needed to be a direct and immediate link to a taxable transaction – one that amounted to a supply because it was taxable for VAT purposes. But a TOGC was not a taxable transaction.

*Abbey National* argued that the common law approach should apply. In other words, but for the transfer of a totality of business assets (TTBA), there was a real-world underlying taxable transaction taking place, so the TTBA fiction should be taken only as far as necessary. This is the approach Francis Bennion suggests in *Bennion on Statutory Interpretation, Sixth edition*, LexisNexis, 2013, at section 304. The CJEU rejected those arguments at paragraphs [33]–[34]. A TOGC event is a non-supply.

The CJEU then moved to the remedial aspect of the case, pausing to examine what the VAT system was designed to achieve – in that case, full deduction of input tax for economic operators making taxable supplies. To give effect to those policy objectives it then adapted the case law by applying a direct and immediate link for the costs of the TTBA to *all* the previous taxable output transactions, thus triggering the right to deduct input tax. This can be shown in paragraphs [35]–[36] of the judgment.

The approach to legal fictions in EU law emerging from the *Abbey National* case has three stages – prescriptive, then remedial:

1. the legal fiction is always prescriptive – full effect must be given to the provision in the legal code and legal certainty prevails;
2. a remedial approach should then be adopted if policy objectives of the legal provisions are frustrated or arbitrary outcomes arise; and
3. the remedial approach can be applied by interpreting the legal provisions, including adapting the case law as required, in such a way as to ensure arbitrariness is avoided and the legitimate objectives pursued are achieved.

## UT approach in longer supply chains

The UT followed the *Abbey National* approach of the CJEU by interpreting the meaning of 'business' by reference to transactions, not supplies – both terms used in EU law. At paragraph 49 its approach is also domestic, limiting the fiction so it does not extend to the term 'business', as used in the UK regulations. Businesses continue within VAT groups, as the House of Lords had pointed out in *Thorn Materials Supply Ltd v CCE; Thorn Resources Ltd v CCE* [1998] STC 725.

A business can be operated within a larger group or entity and TOGC treatment can apply to business transfers because the activity is part of the 'same kind of business' of the transferor or transferee, where that business or undertaking:

- provides goods and/or services internally;
- is an integral element of external supplies; and
- directly contributes to economic activity (that is, third-party supplies to external parties) as a whole.

Sales and purchases of businesses held, or to be held, within vertically integrated single entities organised in economic divisions with recharges or fiscal entities with a number of internal transactional stages within a VAT group will also qualify. HMRC's policy on transfers of opted rental property into and out of VAT groups is no longer sustainable after IMSL, and a potential SDLT saving on the VAT element of such transactions may be possible.

The UT also held that the outcome of application of TOGC treatment must not be arbitrary.

## TOGC: cumulative conditions set out by the UT

The UT has set out several cumulative conditions to apply to determine whether a TOGC has taken place:

- the assets transferred must together constitute an undertaking capable of carrying on an independent economic activity (this is to be distinguished from a mere transfer of assets);
- an overall assessment of the factual circumstances is needed. This must include the intentions of the transferee, as determined by objective evidence and the nature of the economic activity sought to be continued;
- the transferee must intend to operate the business, or part, transferred and not simply to liquidate the activity immediately and sell the stock, if any;
- although succession to the business is not a condition, but a consequence of the application of the no-supply rule, the nature of the transaction must be such as to allow the transferee to continue the independent economic activity previously carried on by the seller; and

- arbitrary distinctions are to be avoided and the principle of fiscal neutrality must be respected.

## Opportunities for businesses since the IMSL ruling

Businesses should review whether a tax charge, either VAT or SDLT, has occurred in the past six years on business transfers not treated as a TOGC. For example, rental properties into or out of a VAT group, or business transfers into or out of vertically integrated businesses higher up the chain than the final downstream VAT supplies being made.

## Conclusion: VAT or no VAT?

To protect the taxpayer and not overburden economic operators, there are specific legitimate objectives of TOGCs in the VAT system. The purpose of these is not to charge VAT on business sales when a business is transferred between VAT-registered persons and continued by the purchaser. A restrictive approach to TOGCs should not apply. A TOGC is a legal fiction, hence it must be given its full effect according to the code and there is no supply. But the general legitimate objectives of the VAT system should also apply. Fiscal neutrality, no burden on the economic operator and no arbitrary tax burden arise as a result of how the purchaser has structured itself. It is to be hoped that taxpayers will not have to contact the banker (the tribunal) and take an offer, but proceed to the last box where, on opening, it will simply say ‘TOGC – no VAT’.

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