

VAT will do very nicely thanks

Whether a business is sold as a transfer of a going concern can be a tricky issue that needs careful consideration, says *Anthony Judge*

● Case law has provided useful analysis of issues involving exclusive possession and business risk

● The VAT case of *Tezgel* contains helpful guidance on when a sale of a business is not a transfer of a going concern

● Buyers and sellers need to be prudent to avoid VAT problems with HMRC

The VAT Tribunal case of *Tezgel (t/a Master Chef) v Commissioners for HM Revenue & Customs* unreported 19 November 2007, contains useful guidance as to when the sale of a business is not a transfer of a going concern (TOGC).

In January 2005, Mr Tezgel sold his restaurant business to Mr Kocak. No VAT was paid on the purchase price. Twelve days after the sale, a Mr Karaaslan applied to HM Revenue & Customs (HMRC) for VAT registration of a restaurant business, which according to his VAT forms, he had started to run at the same premises on that date.

The documentation between the three parties was scant. However, it emerged from correspondence with HMRC that Karaaslan ran the business while Kocak lived in a flat above the premises and took a VAT-free fee of 15-20% of the profits. HMRC contended that Kocak had bought the business as an investment and as living accommodation, and had in effect granted Karaaslan a licence to trade from the premises.

VAT liability

Annually, under the sale agreement, Tezgel was liable to pay any VAT charged on the purchase price. Using alternative arguments, he claimed that he believed that: (i) Kocak would be running the business; (ii) Karaaslan would be managing the restaurant but Kocak owned it; and (iii) Kocak ran the business for the 12 days between the sale date and the date of the VAT application.

In response, HMRC argued that: (i) it is not enough for the seller to think that the buyer intends to carry on the same business, the buyer must actually do so; (ii) the fee paid by Karaaslan to Kocak indicated that Karaaslan was not a manager in the sense of being an employee, but was himself the trader, which was supported by the fact that he had registered the business for VAT and was dealing with all the VAT returns on his own account and not as an agent or employee of Kocak; and (iii) in the absence

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of any evidence that Kocak had run the restaurant, the discrepancy in dates in the VAT forms was simply a clerical error. The VAT Tribunal agreed with HMRC on each point.

This case raises three interesting areas of debate. First, the story chimes with a string of cases in which the courts were asked to decide whether various arrangements for running a hotel or a restaurant constituted a lease or a management agreement.

These are landlord and tenant cases (often concerning a tenant that had not obtained a landlord's licence to deal with its lease and was using the notion of a management agreement as a cover), but they provoked the same discussions as to the essence of a management agreement. They provide a useful analysis of the issues concerning exclusive possession – who retains the keys, repairs the premises, is authorised to alter the premises?; and business risk – was there a master/servant relationship, how were business profits divided or paid and who had provided capital?.

Second, the shortfalls in the sale agreement serves as a reminder that the seller must ensure that the contract: (i) contains warranties that the buyer will use the property to carry on the same kind of business post sale and is buying as beneficial owner; (ii) provides that the purchase price is exclusive of VAT; and (iii) states that the buyer will pay the VAT if HMRC determines that the transfer is not a TOGC.

Third, it is frustrating that Tezgel was unable to substantiate the claim that Kocak ran the restaurant for the 12 days between the sale date and VAT application. It would have been useful to have heard the tribunal's view on how long a period of post-completion trading needs to be in order to receive TOGC treatment.

Case law suggests that the correct test is whether a business can continue to operate after the sale without interruption and that, if so, the intention of the buyer to change the nature of the business at some future date will be irrelevant.

Be prudent

Some authorities suggest that the necessary period of trading following a sale can be as short as one week. However, it is prudent for the buyer to retain the business for at least three months (assuming that it makes its VAT returns quarterly) so that it will account to HMRC for VAT at least once following completion, and for a sufficient period so as to receive taxable income, such as rent, and/or to incur taxable costs such as repairs. A seller should obtain a representation from the buyer that it will hold the business for this period.

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