

Sale of goodwill

(Lecture B1139 – 17.07 minutes)

The recently released judgment of the First-Tier Tribunal in *Villar v HMRC* (2018) considered the tax implications of a sale of goodwill by a professional individual and is very helpful in clarifying some of the perceived difficulties about the law in this area.

The taxpayer (V) had a successful medical practice as an orthopaedic surgeon, specialising in hip arthroscopic procedures. On 31 March 2010, he entered into an agreement with a company called Spire Healthcare Diagnostics Ltd (Spire) for the sale and purchase of 'The Richard Villar Practice', for which he received a payment of £1,000,000 upon completion on 1 July 2010.

The taxpayer argued that his sale gave rise to a capital gain, whereas HMRC's contention was that the receipt of £1,000,000 was subject to income tax.

A key part of HMRC's reasoning was that the payment was essentially attributable to goodwill which they maintained could not be transferred to Spire, given that it was personal to V. They also said that there was effectively no business to dispose of and that the money was really an advance payment for the exploitation of V's professional skills in return for a future flow of income. In other words, the transaction represented an arrangement for V to obtain money in a capital form (taxed at 10%, having regard to entrepreneurs' relief) rather than as income that would have generated a much higher tax liability.

It is fair to say that, when anyone buys a business, they are buying an income flow. They buy the business because the business makes profits and that is what provides the capital value. The purchaser may be able to exploit synergies with his own business or he may feel that he has something to add to it that will increase the profitability of the business, making it additionally attractive.

When a business is sold, the vendor gives up his right to the future profits which are subsequently received by the purchaser, but that does not of course mean that every sale is therefore a sale of future income chargeable to income tax on the vendor. The sale of a business typically gives rise to a capital receipt chargeable to CGT.

HMRC's line that the taxpayer did not have a business to sell is a tough argument to support. V certainly felt that he owned a business capable of being sold – and he sold it. The expert valuers who valued the business before the deal went through (Bruce Sutherland & Co) thought so too. And Spire obviously believed that V had a business able to be sold because they paid £1,000,000 for it.

The first question for the tribunal to determine was therefore whether the £1,000,000 received by V was capital or income in nature.

The key points made by V's barrister on his behalf are summarised in the case report as follows:

'V had developed a loyal worldwide following through his private orthopaedic practice, carried on under the name of "The Richard Villar Practice". He ran this practice under what was then a unique business model within the UK private medical sphere, in which patients would come to the practice, of which V was the figurehead, rather than to a specific named practitioner. This made the practice a business in contrast to the way consultant surgeons more usually worked.

That the practice did constitute a business capable of sale was demonstrated by the valuation which was carried out independently when V began to contemplate retirement. The fact that the business had to date been so dependent on V and his name and reputation and the risk (which) that represented to a purchaser were taken into account by the valuer and, to reflect these factors, (the valuer) applied a conservative multiplier of two in calculating the value on the earnings basis.

The sale of the business involved, inter alia, the disposal by V of his right to earn any income from the practice and the transfer of all intellectual property, including the database of former patients, website domain name and the business name (all of which belonged to V), in return for the sum of £1,000,000.

That right to earn any income from the practice was transferred from V to Spire and V was precluded from carrying out any paid work in the UK as a consultant surgeon, except through Spire, which engaged him on an ad hoc basis through his private services company, Vineyard Press Ltd (Vineyard). Spire had no right to require V to provide any services, through Vineyard or otherwise. Indeed, Spire were aware that V wished to continue volunteering (for special overseas work) and that this meant there was a real prospect of him not being in a position to provide surgical services after the sale. Neither V nor Vineyard had any right to require Spire to engage V's services. So the sale of the business led to Spire controlling the extent to which V was able to practise in the UK.'

As a matter of fact, V did continue to work in the practice for Spire, for which he was remunerated, via Vineyard, at what was agreed to be a commercial rate. But his role with Spire was substantially different from what he had previously been doing. He no longer ran the practice nor took any decisions concerning its administration and management.

There is surprisingly little authority on the capital nature of the sale of a business. However, in *John Lewis Properties plc v CIR* (2003), the Court of Appeal set out five indicia of a capital payment:

1. the duration of what is disposed of;
2. the value of what is disposed of;
3. the fact that the payment causes a diminution in the value of the vendor's interest;
4. the payment of a single lump sum; and
5. the transfer of risk.

Given that, in this case, all five of these indicators were satisfied by V, his barrister's argument was that the £1,000,000 was unquestionably a capital payment.

In response, HMRC suggested that the payment of £1,000,000 had not been made to purchase the business but rather represented consideration for V changing the way in which he carried on that business. A payment for making such a change is, HMRC stated, essentially income in nature, whether or not it is paid by way of a single lump sum. Therefore, it should be chargeable as part of V's professional profits under S5 ITTOIA 2005. They cited a number of cases in support of this contention, including two Court of Appeal decisions:

1. British Dyestuffs Corporation (Blackley) Ltd v CIR (1924); and
2. John and E Sturge Ltd v Hessel (1975).

V's barrister countered by saying that HMRC's arguments denied the commercial reality of the situation, namely that Spire had bought the practice. The fact that the greater part of the value of the business consisted of goodwill rather than tangible assets did not alter this fact. Goodwill was an asset that could be disposed of in the same way as any other property. Undoubtedly, the involvement of V was part of the attraction and it was entirely rational for Spire to seek to protect its investment by preventing V from practising elsewhere in competition to themselves.

The question of whether or not personal goodwill can be transferred was then discussed, with V's barrister adducing the findings in:

1. Allied Dunbar Ltd v Weisinger (1988); and
2. Balloon Promotions Ltd v Wilson (2006).

In the event, the First-Tier Tribunal did not take long to conclude that, as a matter of fact, the sale by V was a sale of his business and that the amount received represented a capital sum.

However, that was not the end of the story because HMRC raised a second argument that, even if the payment was capital, it should be taxed as income under Ss773 – 789 ITA 2007 (sales of occupation income). S773 ITA 2007 brings into charge as income a capital sum which is received to exploit the earning capacity of an individual in an occupation (which includes a profession or vocation).

The First-Tier Tribunal observed that there was no fixed intention or obligation on V's part to continue to work in this way. On that basis, it was difficult to conclude that the purchaser was exploiting V's earning capacity. In reality, Spire were exploiting the practice and goodwill which V had sold to them.

Another requirement in order for S773 ITA 2007 to apply is that one of the main objects of the arrangements has to be the avoidance of a liability to income tax. HMRC maintained that, if V had continued to receive the profits of his practice, they would have been chargeable to income tax, whereas, having sold the practice, he received £1,000,000 which was chargeable to CGT and was eligible for an entrepreneurs' relief claim. Without doubt, that is a substantial advantage – indeed, a saving of the whole of the income tax. However, the First-Tier Tribunal found that there was no intention or desire to avoid or reduce income tax and they said that they saw no evidence that income tax was a matter which had been considered at all. As a result, the judges decided that S773 ITA 2007 had no application in this situation.

Villar v HMRC (2018) is an important case, given that it clarifies the tax position of goodwill in a professional practice which has certainly been the subject of controversy in the past. Unless there is an appeal (and the indications are that there will not be one), this is obviously a very helpful decision, despite the fact that it has no precedential value.

Contributed by Robert Jamieson