

VAT transfer of a going concern (Lecture B1315 – 22.10 minutes)

Introduction

When a VAT registered taxpayer sells their trade and assets to a VAT registered buyer, the sale is normally treated as the transfer of a going concern and so is outside the scope of VAT.

This treatment would extend to partial sales of their business where the part sold is capable of separate operation (so for example the sale of one of two shops owned).

If VAT is incorrectly charged by the seller and the buyer pays it, input tax recovery by the buyer is not permitted. In this situation, recourse would be to the seller and not HMRC.

Capital goods scheme

Property costing more than £250,000 is subject to the capital goods scheme rules with the rules applying for a ten year period.

Where the seller has been operating the capital goods scheme on property that is transferred as part of the sale, the buyer must continue with that scheme, inheriting the remaining capital goods scheme periods. These can be adjusted to the buyer's year-end but only after discussion with HMRC.

This issue must be addressed in the sale contract as the buyer will need all of the historical information relating to the capital goods scheme calculations and adjustment up to the date of sale. This will then enable them to continue these calculations in their books.

Buyer obligations

After the sale, the business must be carried on by the buyer post sale. This fact is normally warranted in sales contracts and is fundamental to securing the transfer of a going concern treatment.

The purchaser must be VAT registered. Some buyers believe they have the choice of whether to register for VAT, as they may regard themselves as a start-up. They often overlook that they will inherit the turnover of the seller. Where a seller is compulsorily VAT registered, the buyer will also be compulsorily registered from the date of purchase. They would not have the option of not registering and paying VAT on the purchase.

If the seller was voluntarily VAT registered, the buyer could of course choose not to register and may well do so if they are dealing with the public (i.e. non-registered customers).

However, they must bear in mind that they will inherit the seller's turnover which could affect their position. Assuming that the buyer is still below the VAT registration threshold, they can choose not to register. By not registering, the transfer of a going concern conditions are breached and VAT will be charged on sale.

The buyer will need to continue to monitor their turnover level on a monthly basis. If and when they exceed the VAT registration threshold of £85,000, they will need to register for VAT at that time. If the buyer registers within 4 years of the trade and asset purchase, and still holds the assets purchased at that point, VAT on the purchase could be recovered as pre-registration input VAT.

Standard rated property

If there is a standard rated property within the assets transferred (e.g. a new freehold commercial or an opted to tax property), this will be treated in one of two ways.

If the buyer chooses not to opt to tax, the property will be transferred outside of the transfer of a going concern and will be standard rated. Buying a property standard rated will increase the cash flow requirement including the effect of higher SDLT payable on the VAT inclusive price. It will also trigger a new 10 year cycle for the capital goods scheme when the property is £250,000 plus VAT or more as a standard rated transaction is treated as a new asset capital goods scheme asset.

On the other hand, if the buyer opted to tax the property, it would be transferred within the transfer of a going concern and as such would be outside the scope of VAT. To be effective, the buyer would need to opt to tax pre-completion to ensure the property falls within the transfer of a going concern rules. Their option to tax must be confirmed to the seller and the buyer must confirm that there will be no disapplication of the option to tax. This is normally covered within the sale and purchase agreements. This would reduce the cash flow requirement including the SDLT payable. It would also reduce the exposure to the capital goods scheme as the buyer simply inherits the remaining capital goods scheme intervals from the seller.

Tenanted property

Tenanted properties are regarded as a business in themselves and are therefore within the transfer of a going concern provisions. The purchasing landlord would be best advised to opt to tax when buying a tenanted commercial property from a landlord that has exercised their option to tax. This would secure the transfer of a going concern treatment making the transfer outside the scope. Rent charged to tenants would be standard rated rather than exempt

Landlord selling to the tenant

However, when the tenant buys the property from the landlord, this cannot be a transfer of a going concern as the property is owner occupied post-purchase rather than tenanted. VAT would normally be charged on such purchases as the landlord is likely to have opted to tax the commercial property. This will cause cashflow issues and will increase the SDLT payable.

The simple solution is to contact the seller's solicitors and ask how long ago the landlord opted to tax the property. If this was more than 20 years ago, the option to tax could be revoked prior to sale by the seller completing Form 1614J, sending it to HMRC, informing them of their revocation of the option to tax. The property sale then becomes an exempt transaction. The input tax suffered by the seller on professional fees relating to the sale should be deductible under the partial exemption de minimis rules.

Where 20 years has not passed since the option to tax was made, revocation of the option to tax is not possible. In this situation it is worth considering buying the property in the individual shareholders' names to be able to obtain the transfer of going concern treatment. They would need to register for VAT and opt to tax the property at the same time, sending the relevant forms to the VAT registration unit. The individuals would then rent the property to their trading company, charging standard rated rent. Note that if the tenant company is partially exempt, making more than 20% exempt supplies, then the option to tax will be disapplied under anti avoidance rules.

Selling to one of two tenants

A landlord owns a property that is being rented to two tenants who are currently paying standard rated rent on the property as it has been opted to tax.

If the landlord sells the property to one of the tenants, the sale will be standard rated unless the tenant has opted to tax the property by the completion date. By opting to tax in this way, they secure the transfer as a going concern treatment, meaning that the sale is outside the scope of VAT. Rent payable by the second tenant to the new tenant-buyer is standard rated. In summary, the sale of a partly tenanted property falls within the transfer of a going concern rules and is outside the scope of VAT. It is still a tenanted property, albeit partly tenanted.

Contributed by Dean Wootten