Minimalist approach

Indirect Tax

01 May 2015

Chris Nyland sets out the facts behind the Royal College of Paediatrics' purchase of a new property, and explains why the TOGC should be an issue that concerns us all

Key Points

What is the issue?

To enjoy TOGC treatment, you first need to have a business to transfer – but what is the minimum requirement to evidence a business?

What does it mean for me?

Mere 'box-ticking' of HMRC's guidance on minimum conditions for TOGC treatment is not enough – you need to look at the economic reality to determine whether the seller has a business to transfer

What can I take away?

If a seller has not really taken much risk in putting a 'business' together and cannot enjoy much, or any, reward from the operation of that business, then there may not be a going concern in its hands to have a transfer of

In *HMRC v Royal College of Paediatrics and Child Health et al* [2015] UKUT 0038 (TCC), the Upper Tax Tribunal considered a situation in which there was no assertion of abuse of VAT law, but there were strong intimations of artificiality to obtain a VAT advantage.

There are two important findings in the case. The most crucial for the college is that HMRC were out of time to assess VAT in any event. However, the Upper Tribunal's comments create binding precedent in relation to VAT on the transfer of property letting businesses and give important insights into this high risk area.

Transfer of a going concern

The facts of the case are as follows. The college wanted to buy a property that, in the main, it would occupy. Its seller had opted to tax the property, meaning that VAT would have been due on a supply of the property. The college did not want to pay VAT. It may have been eligible for stamp duty land tax (SDLT) relief (so that the SDLT on VAT liability would not have been an issue); however, the college would certainly have incurred a significant amount of VAT, not all of which was recoverable. Therefore, the college explored with the seller whether the default position could be overridden by securing a favourable VAT treatment and rendering the sale VAT free.

The chosen route was to treat the sale of the property as a transfer of a going concern (TOGC). TOGC originally stood for 'transfer of a going concern'. In modern VAT parlance, though, this more commonly means 'transfer of a going concern that has gone on to meet the conditions for it to be treated as outside the scope of VAT'.

Most business transfers are TOGCs, which impacts on the VAT registration and record keeping obligations of the transferor and transferee under VATA 1994 s 49. Not all TOGCs, though, then go on to meet the conditions set out in Value Added Tax (Special Provisions) Order 1995 (SI 1995/1268) Art 5 to take them outside the scope of VAT. These conditions seek to prevent both the avoidance of tax and the distortion of competition that VAT free status could give. At their core, they are seeking to ensure that the transferee's use of the business is no less taxable than the transferor's was.

These conditions are not analysed here; nor is the question of whether or not there was ever a 'going concern' to have 'transfer of' in the first place. If there wasn't, then there was nothing that Art 5 could take outside the scope of VAT.

A matter of interpretation

The sale of a property rental business can be a TOGC, because it is widely accepted that (as an income generating asset), a let, rent-bearing property is a business. However, whether there is in fact a let, rent-bearing property will be informed by two points of interpretation.

First, it is generally understood that the property need not be subject to an actual lease. It suffices that the seller has found a prospective tenant and has entered into a legally binding agreement for lease with them. The logic of equity mandates this; and the case of *Dartford Borough Council* [2007] UKVAT V20423 confirms it. The effort of finding a tenant, and of negotiating and concluding a legally binding agreement for the grant of a lease, is proof positive that a property letting business is underway.

Second, it is also accepted that a property need not be fully let for the whole property to be a transfer of a property letting business as a going concern. The sale of a building that is subject to an agreement for lease of part can be a transfer of a property letting business as a going concern.

The parties sailed very close to the wind in respect of both points of interpretation. The college introduced a party 'affiliated' to the seller, and invited the seller to enter into an agreement for lease with the affiliate in relation to a single room in the whole building. The agreement for lease had a heavy raft of conditions and triggers. It was exchanged on a conditional basis on 16 November 2007, and only became unconditional after the seller had agreed to sell the property to the college. The agreement for lease fell away if the seller had not reached an agreement with the college by 16 November 2007 to purchase the property. Therefore, the affiliate had an extremely narrow window in which it could ever compel the seller to grant a lease to it (if indeed, it had such right at all) – and *vice versa*.

Risk and reward

None of this had been an obstacle for the First-tier Tribunal (which found that there had been a TOGC). However, the judge in the Upper Tribunal appears to have concluded that the minimalist approach in relation the first point of interpretation prevented there from being a property letting business in the seller's hands. Therefore, there could be no TOGC treatment and VAT was due. There were two areas of concern, which one could summarise using the two hallmarks of business – risk and reward.

First, risk. It was unhelpful to the college that it introduced the affiliate to the seller. This should not be sufficient to prevent there being a transfer of a property letting business as a going concern. Indeed, institutional investors commonly have a roster of preferred tenants (chosen for their covenant strength), which they will introduce to land owning developers that may be trying – and failing – to tie up a pre-let on their own. What the decision appears to suggest is that mere entry into an agreement for lease alone is not enough to argue that a letting business existed. A seller should be able to point to genuine investment on its part to build the business it then purports to transfer, and not simply to the rubber stamping of someone else's work. In this regard, evidence such as business plans, marketing documents and so on is likely to be useful when dealing with HMRC officers.

Second, reward. It was difficult to see the extent to which the business of letting could be (or, more importantly, could not be) enjoyed by the seller. If it only had the benefit of an agreement for lease over its property once it had committed to sell that property, then to the impartial observer it never really had a business of its own that it could enjoy and – more importantly – sell on.

Contradictory rulings

No risk, no reward, no business – and so no TOGC. There should be enough factual differences to distinguish a normal commercial deal from the one here – and indeed the judge in the Upper Tribunal made this point. There is seldom so close a nexus between a tenant and a buyer. Sellers are generally actively marketing their property for letting, even if the tenant is ultimately introduced by a third party. And documents are rarely quite so constrictive that the letting business can be so scarcely enjoyed by the seller.

One common question has been why the Upper Tribunal did not (or was not asked to) explore the college's ability to give the requisite notice required by para 2A(b) of Art 5 (ie that its option to tax would not be disapplied by the anti-avoidance provisions). One, or possibly two, lessons can be drawn from this, if we assume that HMRC did not sit on its best argument (as it did in *Principal and Fellows of Newnham College in the University of Cambridge v HMRC* [2008] UKHL 23). This case may be tacit confirmation of HMRC's interpretation of another pillar of the disapplication rules; specifically, of the phrase 'the land' in VATA 1994 Sch 10 para 12 (it appears their view is that the correct unit of analysis here was the let room, and not the whole building). It may also be that the 'affiliation' fell short of the 'connection' that the disapplication rules need in order to apply – although the linkage between the college and the affiliate certainly served to highlight the issues

that the Upper Tribunal *did* explore.

TOGC is an area rich in overlapping (and occasionally contradictory) case law, which has traditionally relied – in the absence of quality guidance from HMRC – on written rulings from HMRC. HMRC officers confirmed in evidence at the First-tier Tribunal that HMRC refuses, as a matter of policy, to give rulings on TOGCs.

For as long as there is uncertainty around these points, any contrivance or ‘choreography’ (to use HMRC’s term) in structures securing tax advantages – and anything that fails to do more than tick the boxes in published guidance – should continue to be viewed with care.