

3

VAT: TRANSFER OF GOING CONCERN - RETENTION OF RECORDS

PURPOSE AND INTENDED EFFECTS OF THE MEASURE

Objective

3.1 To simplify VAT record-keeping rules when a business is transferred as a going concern (TOGC) with effect from 1 September 2007.

Background

3.2 Special VAT rules apply where a person acquires a business and its assets as a going concern, and they intend to continue operating the business. In these circumstances, VAT law prescribes that the business records of the seller must be transferred to the buyer.

3.3 However, there are two common situations when this does not happen:

- Where on application from the seller HMRC directs that the records can be retained by the seller;
- Where the seller or buyer and their advisers are unaware of the VAT rule.

3.4 HMRC estimates that there are around 50,000 TOGC's per year. Business advisors tell HMRC that in practice, many businesses are unaware of the rules and that the proposed changes will create greater certainty for them.

3.5 Requiring the records to be transferred to the buyer is at odds with direct tax, company law and insolvency law rules, which all require the seller to keep their records. In addition, there are a number of areas where the buyer needs to obtain certain information from the seller to enable them to comply with their VAT obligations. Thus the current rule does not tally with other regulatory regimes.

CONSULTATION

3.6 During an extended consultation (which was delayed pending a decision in the Zita Modes Sarl European Court of Justice case (C-497/01), which arrived at the end of 2003) businesses and advisers have consistently told us that they wanted HMRC to change the law so that the seller was allowed to retain his records following a TOGC, and that this was their main aspiration for the review.

3.7 Following announcement at 2006 Pre-Budget Report of the intention to change the record keeping requirements, HMRC informally consulted interested parties on the draft legislation. No issues were raised that necessitate any significant changes in the legislation as drafted.

OPTIONS

1. Do Nothing

3.8 This option maintains the current rules, which prescribe that the business records of the seller must be transferred to the buyer.

2. Change the law so the records are retained by the seller

3.9 Amend VAT law so that:

- The seller will keep the business records in all but a few specified cases
- The seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act
- HMRC can obtain from the seller and disclose, if necessary, such information to the buyer.

COSTS AND BENEFITS

Sectors and groups affected

3.10 Some 100,000 businesses are expected to fall under these TOGC rules each year by buying or selling a business and over 99% of these are expected to be small businesses. TOGC is used across all business sectors and although no individual sectors are likely to be affected to a significant extent, it is often seen among restaurants, cafés and small retailers.

Analysis of Costs and Benefits

Option1. Do nothing

3.11 This option has no costs as it maintains the current rules, which prescribe that the business records of the seller must be transferred to the buyer. Requiring records to be transferred to the buyer under the TOGC rules, especially for small businesses, was top of the list of concerns that came out during the review. It causes uncertainty plus an unnecessary administrative burden on sellers who wish to retain their records and have to apply to HMRC to do so. As such, this option offers no direct benefits to businesses.

Option 2. Change the law so that records are retained by the seller

3.12 Amend VAT law so that:

- The seller will keep the business records in all but a few specified cases
- The seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act
- HMRC can obtain from the seller and disclose, if necessary, such information to the buyer.

Costs and Benefits

3.13 The proposed simplifications relate to three main areas:

Transfer of Records

3.14 This option removes the requirement for the seller to transfer business records to the buyer and provides the major benefit to businesses. A transfer of full records does

not happen in all cases of TOGC (such as where on application from the seller HMRC directs that the records can be retained by the seller or where the seller or buyer and their advisers are unaware of the VAT rule). However, where records are transferred the time involved to produce the relevant records will vary. Sellers will normally have to examine records to make sure they are not needed for other purposes and this is likely to take many of them, or their agent or accountant, an hour or more. Assuming that across all 50,000 TOGCs each year it takes sellers on average at least one hour to transfer business records, the current administrative burden is estimated at around £760,000, of which around 99% relates to small businesses.

3.15 Businesses will welcome the removal of this obligation, which will end the uncertainty for sellers that wish to retain their records and reduce the administrative burdens from costs incurred by some sellers in having to apply to HMRC for confirmation that they can keep the records.

3.16 This option will also set out in the law that information must be transferred to the buyer, so that they can comply with their taxpayer obligations. It had been intended originally that the information that must be passed to the buyer would be set down in the law. However, this has not been possible because of the variety of information that would need to be covered. Therefore, the seller will be required to make available to the buyer the information the buyer needs to comply with his duties under the VAT Act 1994. Also, HMRC will be able disclose such information to the buyer where the seller fails to provide it to the buyer. The information that must be passed to the buyer is expected to be readily accessible from the seller's records and sellers should not need to spend much time finding and sending information to the buyer. Assuming that extracting the specific information and sending it to their buyers will save 50,000 sellers over 50 minutes compared with the assumed time required for the current rules suggests that their administrative burden might be reduced by at least £650,000 a year.

Retention and VAT records

3.17 Under the current rules, at the request of the seller, HMRC may allow it to retain the VAT records of the business. HMRC estimate that requesting permission to retain their records each year costs businesses around £200,000, 99% of which is borne by small businesses. By removing this obligation, businesses will no longer incur administrative burden costs of having to request permission from HMRC to retain their business records.

3.18 It is expected that businesses will welcome the removal of this requirement to seek permission and reduce the administrative burdens by around £200,000 from costs incurred in having to apply to HMRC for direction.

3.19 When the seller's VAT registration number is transferred to the buyer, the records will continue to be passed to the buyer. The seller will be able to seek permission from HMRC for the records to be retained. However, this is likely to affect very few businesses because transfer of VAT number usually occurs only where a business merely changes its legal status (and so it is essentially the same business).

Obligation of Transferee

3.20 To meet their VAT obligations following a TOGC, buyers will usually need to access and use information about the business before they take ownership. This is currently assumed to involve around 15 minutes of a buyer's time at an annual cost of over £190,000. Replacing the requirement for sellers to transfer all the business records

with a requirement to make available to the buyer the information the buyer needs to comply with his duties under the VAT Act 1994, will make it much easier for buyers to fulfil their obligations. Although the exact information buyers will receive will vary according to the nature of business, the requirement is expected to ensure direct access to the information commonly needed by buyers and cut the amount of time they need to spend in obtaining information about the businesses before they take ownership. Assuming this will reduce the amount of time involved by 10 minutes indicates an administrative burden saving of around £125,000 a year.

3.21 The total savings in administrative burdens from this option in these three areas is estimated at around £1 million a year. The majority of businesses affected are small businesses, who are often confused by the perceived complexity of the rules or are totally unaware of them. By increasing certainty about the VAT treatment of TOGCs, this option provides a significant benefit to such businesses. As businesses tend to fall within TOGC rules on an occasional basis only, no initial set-up costs are anticipated.

3.22 Representatives of business and their advisors tell us that these proposed changes will reduce the administrative burden associated with a TOGC. Additional compliance costs for representatives and advisers are unlikely to be significant being restricted to a brief familiarisation with the new simpler rules.

3.23 Businesses will see other additional benefits from regularising the position with other regulatory regimes. The proposed changes will clarify the law and bring record keeping into line with other tax and regulatory regimes in that the seller will keep his business records in all but a few specific cases and legislation will require that the seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act.

Option 3. Seller retains records even where the VAT registration number is transferred

3.24 Amend VAT law so that:

- The seller will keep the business records in all cases, and
- The seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act, and
- HMRC can obtain from the seller and disclose, if necessary, such information to the buyer.

Costs and Benefits

3.25 This option would similarly relate to three main areas:

Transfer of records

3.26 As for Option 2. However, under this option, the administrative burden will also be removed when a VAT registration number is transferred from the seller to the buyer. There would be a requirement that the seller make available to the buyer the information he needs to comply with his duties under the VAT Act. Although this is expected to apply to very few TOGCs, as the transfer of a VAT number usually occurs only where a business merely changes its legal status, it presents a revenue risk, since the buyer takes on the liabilities and obligations of the seller.

Retention of VAT records

3.27 As for Option 2, with the caveat in the above paragraph.

Obligations of Transferee

3.28 As for Option 2.

SMALL FIRMS IMPACT TEST

3.29 Small businesses were consulted as part of the review, which commenced in 2000. Some 100,000 businesses are expected to fall under these TOGC rules each year when they buy or sell a business and over 99% of these are expected to be small businesses. TOGC is used across all business sectors and although no individual sectors are likely to be affected to a significant extent, it is often seen among restaurants, cafés and small retailers.

3.30 The proposed changes will be of benefit because the current rules cause difficulties by being at odds with other regulatory regimes. The clearer rules will reduce administrative burdens by saving time, particularly for the smallest businesses.

COMPETITION ASSESSMENT

3.31 The competition filter test has been applied and the changes passed. The changes will not impact directly on any particular markets as TOGC is used across all business sectors by mainly small local businesses. Sectors where TOGC is particularly common include restaurants, cafés and small retailers. These simplifications are not expected to have any significant effects on competition in any sector although they will make it easier for those businesses that change ownership and fall under these rules.

ENFORCEMENT, SANCTIONS AND MONITORING

3.32 We do not expect any enforcement, sanctions or monitoring issues because these changes release businesses from current requirements.

3.33 HMRC staff, as part of the assurance of the businesses affected, will monitor compliance with the law. Those businesses will be subject to the usual enforcement procedures for VAT registered businesses. No additional cost is envisaged as a result.

3.34 Options 2 and 3 should have an administrative saving for HMRC who will no longer need to grant permission for records to be retained by the seller.

IMPLEMENTATION AND DELIVERY PLAN

3.35 The intended changes will be effective for contracts entered into on or after 1 September 2007. Prior to the effective date, VAT Notice 700/9 and HMRC guidance will be revised to reflect the changes.

POST IMPLEMENTATION PLAN

3.36 HMRC will carry out a post-implementation review as soon as the change has bedded in and suitable data are available. This is expected to be within 3 years of implementation, but developments will be monitored to ensure that any review is

neither premature, nor unnecessarily delayed. The findings will be used to enhance the policy-making process – both in this area and across HMRC in general.

SUMMARY AND RECOMMENDATION

3.37 The measure is intended to simplify the VAT record-keeping rules and reduce administrative burdens for businesses when a business is transferred as a going concern. The current rules are poorly understood, and out of step with other tax and regulatory regimes.

3.38 The options are;

- Do nothing (Option 1). This would maintain the current rules so that the business records of the seller must be transferred to the buyer. This would be unwelcome by business and at odds with direct tax, company law and insolvency law rules, which all require the seller to keep his records.
- Change the law so that the records are retained by the seller in most cases (Option 2.). It is HMRC's view that changing the law would provide an important contribution to reducing administrative burdens for business that are transferred as a going concern.
- Change the law so that records are retained by seller even where the VAT registration number is transferred in most cases (Option 3.) Under this option, the administrative burden will also be removed when a VAT registration number is transferred from the seller to the buyer. However, the risk of tax loss if the records are not required to be transferred to the buyer by law, the limited number of TOGCs involved and the need protect buyers taking on the obligations of the seller, outweigh the minor saving in administrative burden associated with it.

3.39 It is therefore recommended that the changes outlined in Option 2. are taken forward.

3.40 At the same time, changes will be made to confirm that in UK VAT legislation the transfer of a going concern includes the transfer of part of a business which is capable of separate operation. This reflects HMRC current application of UK law, and ensures that UK law more accurately reflects EC law. Therefore, no additional burdens will occur.

Contact Point

Ian Allen
HM Revenue & Customs
CT&VAT Product and Process Group
100 Parliament Street
London SW1A 2BQ

Tel: 020 7147 0009
E-mail: ian.allen@hmrc.gsi.gov.uk

REGULATORY IMPACT ASSESSMENT

Vat: Transfer Of Going Concern - Retention Of Records

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

DAWN PRIMAROLO M.P.
PAYMASTER GENERAL

1 March 2007