

REGULATORY IMPACT ASSESSMENT

VAT: TRANSFER OF GOING CONCERN - RETENTION OF RECORDS

1. PURPOSE AND INTENDED EFFECT

i) Objective

To simplify VAT record-keeping rules when a business is transferred as a going concern (TOGC).

ii) Background

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.

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

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

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.

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, but this is implicit in VAT law, and so causes difficulties for businesses and advisers. Thus the current rule does not tally with other regulatory regimes and does not really work in practice (in terms of putting buyers in a position to comply with VAT rules).

2. CONSULTATION

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.

The draft legislation will be discussed informally with interested parties prior to publication of the Finance Bill to ensure it is workable for business.

3. OPTIONS

Option 1: Do Nothing

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

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

Amend VAT law so that:

- The seller will keep the business records in all but a few specified cases, and
- The information that must be passed to the buyer is set down in the law.

This is the preferred option.

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

Amend VAT law so that;

- The seller will keep the business records in all cases, and
- The information that must be passed to the buyer is set down in the law.

4. COSTS AND BENEFITS

i) Sectors and groups affected

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.

ii) Analysis of costs and benefits

Option 1: Do Nothing

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

Amend VAT law so that:

- The seller will keep the business records in all but a few specified cases, and
- The information that must be passed to the buyer is set down in the law.

Costs and Benefits

The proposed simplifications relate to three main areas:

- **Transfer of Records**

This option removes the requirement for the seller to transfer business records to the buyer and provides the major benefit to businesses. On average it is expected that this takes businesses one hour to do. Although 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) some 50,000 businesses are currently assumed to transfer business records each year with an estimated total cost of almost £760,000 of which around 99% relates to small businesses.

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.

This option will also set out in the law certain information that must be transferred to the buyer, so that they can comply with their taxpayer obligations. Although this change introduces a new obligation on the seller, in having to obtain and transfer specific information, it is expected to be less costly than the current situation and will provide a significant benefit to both buyers and sellers by clarifying what information should be provided.

Draft legislation setting out the information that must be passed to the buyer is not yet available but the information is expected to be readily accessible from the seller's records and that sellers should not need to spend much time finding and sending information to the buyer. Informal discussions planned with interested parties will seek feedback on the information listed in the draft legislation to inform understanding of the likely costs for sellers. Assuming that extracting the specific information and sending it to their buyers will save 50,000 sellers over 50 minutes

compared with the current rules suggests that their costs might be reduced by up to **£650,000** a year.

- **Retention of VAT records**

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.

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.

When the seller's VAT registration number is transferred to the buyer, the records will continue to be passed to the buyer. Permission can still be sought from HMRC (by the seller) 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).

- **Obligations of Transferee**

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 provide specific information will make it much easier for buyers to fulfil their obligations. Although the exact information buyers will receive is not yet available, the list 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 took ownership. Assuming this will reduce the amount of time involved by 10 minutes indicates a saving of around **£125,000** a year. Furthermore, specified information will provide certainty for the buyer on what will be provided.

The total savings in administrative burdens from this option in these three areas is provisionally estimated at almost £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.

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.

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 set out what information must be passed to the buyer.

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

Amend VAT law so that;

- The seller will keep the business records in all cases, and
- The information that must be passed to the buyer is set down in the law.

Costs and Benefits

This option would similarly relate to three main areas:

- **Transfer of Records**

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. But there is a risk of tax loss if the records are not required to be transferred to the buyer by law, which at present outweighs the minor administrative burden associated with it. Therefore, this option will not be pursued.

- **Retention of VAT records**

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

- **Obligations of Transferee**

As for Option 2.

5. SMALL FIRMS IMPACT TEST

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.

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. We would welcome comments from small businesses on the extent of the impact expected.

6. COMPETITION ASSESSMENT

The competition filter test has been applied and the proposed changes passed. The proposed 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.

7. ENFORCEMENT, SANCTIONS AND MONITORING

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

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.

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