

Transaction recognised as transfer of business, not supply of goods (2/46/19)

Hiding the true substance of one transaction by substituting another to obtain a tax advantage is not an unusual case heard by the courts. This time the court ruled in favour of the State Revenue Service (SRS) after finding that a taxable person had wrongly deducted input VAT according to a supplier's pro forma invoices for the purchase of movables, because the real transactions are recognised as the transfer of a business as a going concern, which is outside the scope of VAT.

The circumstances of the case

A taxable person purchased from a supplier the goods held in his shops and warehouses, the cash registers as well as the shop and warehouse equipment, documented this as a purchase of movables, and exercised the right to deduct input VAT. On a tax audit, the SRS reduced the amount of VAT refundable to the taxable person and imposed a penalty on the grounds that, even though the disputed transactions were not documented as the transfer of a going concern (TOGC), they should be recognised as such after being assessed according to their economic substance.

The Supreme Court's findings

The Supreme Court found that under section 7(2) of the VAT Act, the TOGC involves a transfer of assets and liabilities in whole or in part. Also, the case law of the Court of Justice of the European Union implies that for recognising that the whole business or an independent part of it has been transferred, it is important to establish that the purchaser has received a combination of business elements that are sufficient for conducting an independent business, but this excludes a simple transfer of goods such as inventory sales. The sufficiency of those combined elements depends on the particular type of business.

The Supreme Court's case law implies that a TOGC may arise from a combination of different circumstances, including staff transferring to work for the purchaser, a transfer of fixed assets and inventories, retention of the company's location and registered office, taking over its banking liabilities, the selling company's board member transferring to work for the purchaser. Having analysed insights into the legal doctrine in conjunction with the rules laid down by the Commercial Code, the Supreme Court found that the transactions and their circumstances should be assessed according to their economic substance, not their legal form. Since the Commercial Code prohibits a distribution of company property that passes all the assets to one party and the liabilities to another, it does not matter whether the parties have formally agreed to transfer the liabilities.

On a tax audit, the SRS found that the taxable person had formally documented the deal as a transfer of goods and signed only pro forma invoices, without verifying the existence of those goods. The taxable person continues to conduct its business in the supplier's former warehouses and shops after signing new tenancy agreements or novation agreements. The taxable person has also signed contracts of assignment to take over the supplier's liabilities comprising the principal debt, a contractual penalty and statutory interest, which indicates a transfer of liabilities to the taxable person. The taxable person also signed contracts of employment with most of the supplier's former staff, who continue the same job duties at the same place of work.

In view of the circumstances of the case, the Supreme Court found that the taxable person took over the entire business from the supplier, rather than buying certain goods. Under section 7(2) of the VAT Act, a TOGC is outside the scope of VAT, so the SRS had correctly reduced the amount of VAT refundable to the taxable person.