

Why it is important to identify transfer of business

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Companies sometimes buy and sell property, plant and equipment, transfer liabilities, restructure their assets, and conduct other transactions necessary to improve their business. It is important to assess whether this gives rise to a transfer of business as a going concern (TOGC), which has specific implications for both the transferor and the acquirer.

Cases of TOGC

While the term “TOGC” might seem to involve share dealings, that is not true. Under the Commerce Act a business is an organised business unit that includes a trader’s tangible and intangible assets as well as other economic assets he uses to carry on a business. A TOGC occurs when the ownership or use of a business or its independent part (“business”) is transferred to another person.

When a specific line of business is split off, it is easy to notice that a TOGC takes place. Yet a TOGC may also arise when a group of assets are transferred together with, for instance, the employees operating them or the liabilities (contracts) attached to them. Latvian and international case law and theory analyse ways of determining whether the group of assets transferred constitute a going concern. There is no single formula to cover all cases and allow us to unmistakably determine whether a TOGC arises because in each case we need to evaluate the nature of the business, what assets make up the group, how they are used in business, how independent the business is, and what the necessary elements are for conducting it. A key indicator is whether the group of assets transferred is autonomous and whether it is used and is sufficient to carry on an independent business. We also need to assess whether the transfer includes elements that allow the group of assets to be used as before, with no substantial changes.

If there are no grounds for finding the group of assets amounts to a going concern, then the sale or transfer is governed by its documentation. If the transaction is considered a TOGC, then its terms and conditions are governed by law and the parties cannot restrict them with respect to third parties.

For example, the question of liability plays a significant part in a TOGC. [Section 20\(1\) of the Commerce Act](#) states that if another person acquires the ownership or use of a business, the acquirer is responsible for all of its liabilities. The Commerce Act also provides that the transferor and the acquirer are jointly and severally liable for any obligations that arose before the TOGC and fall due within five years after the TOGC. So over this period the creditors can claim their debts from both the transferor and the acquirer. The liabilities attributable to the business may follow it, including contractual liabilities (e.g. an obligation to refund a deposit to a tenant in the case of a real estate transfer) and administrative liabilities (e.g. tax charges). In a TOGC the State Revenue Service may claim any earlier tax charges attributable to the business from both the transferor and the acquirer.

Ensuring correct tax treatment is another reason why it is important to determine whether the proposed transaction qualifies as a TOGC. [Section 7\(2\) of the VAT Act](#) implies that where the ownership or use of a business is transferred to another trader (a transfer of property in whole or in part that takes the form of a transfer of assets and liabilities) this is not considered a taxable supply if:

- the transfer of assets and liabilities for a consideration or free of charge, or their contribution to a company’s or partnership’s capital, results in the acquirer succeeding to the transferor’s rights and obligations under the Commerce Act; and

- the unit keeps trading and this does not involve selling the business or winding up the company.

Accordingly, the consideration paid for a TOGC (meeting statutory conditions) is not subject to VAT.

In summary, it is important to correctly classify each transaction and assess whether a restructuring, an asset sale or a similar transaction has any of the hallmarks of a TOGC, which may affect liability and tax matters.