

Criteria applied by tax authority to find TOGC

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Companies are sometimes unsure whether a transaction affecting them qualifies as the transfer of a business as a going concern (TOGC). This is a crucial question in identifying a number of potential risks, including VAT liabilities. If a TOGC has occurred, the transaction is not subject to VAT if the acquirer is registered for VAT and continues a business that does not involve asset stripping or liquidating the company.

If a TOGC cannot be found then all the goods and services (including rights) transferred for a consideration are subject to VAT.

For the sake of prudence a company may choose to charge VAT on goods and services transferred as part of a TOGC but this firstly creates an unreasonable extra tax burden and secondly exposes the customer to input tax risk. The State Revenue Service (SRS) denies recovery of input tax based on an invoice issued by mistake, i.e. if VAT is charged where it's not due.

So it's useful to understand what criteria the SRS uses to assess whether a particular transaction results in a TOGC. This article explores a recent ruling from the Administrative District Court dealing with the SRS position on the hallmarks of a TOGC. The case was not concerned with VAT treatment but the TOGC criteria should be no different.

Background

The dispute¹ was over an SRS decision to recover tax arrears based on a TOGC the SRS claimed had occurred from Y Ltd to Z Ltd and W Ltd. Since Y Ltd had tax arrears, the SRS believed Y's liabilities had passed to the acquirers, Z Ltd and W Ltd, jointly and severally under section 20 of the Commerce Act. The SRS claimed Z Ltd had acquired a set of Y's elements, allowing it to essentially continue Y's business, with these changes going practically unnoticed by the companies' customers. Z Ltd sued the SRS and denied a TOGC that gives the SRS the right to recover Y's tax arrears from Z Ltd.

The court assessment

The court started out by referring to the concept of an enterprise analysed in the legal doctrine. Thus, an enterprise is taken to mean the tools it uses to carry on its business. An enterprise comprises corporeal and incorporeal assets (including liabilities) as well as other financial assets it owns.

Enterprises tend to consist of three parts:

1. Assets including corporeal assets the company sells or otherwise uses in trade or business (plant and machinery, raw materials, office furniture, cash, finished goods etc.) and incorporeal assets or rights (receivables, rights arising from securities etc.)
2. Liabilities, including all its liabilities

3. Goodwill – actual relationships without a legal form

Goodwill in a broader sense is taken to mean the company's positive future prospects that are based on public trust in its goods or services and lays a sound foundation for higher returns. This is a non-financial element, yet it may be valued in financial terms. Its financial value is determined according to factors such as good reputation, customer base, skilled workforce, technology, know-how, brand recognition, supply and outlet markets, and connections, including a political lobby. Goodwill is sometimes recorded as an asset².

The court stated that according to the legal doctrine there may be cases where only part of the company is transferred. We need to see if the essential elements have been transferred, i.e. whether the acquirer is able to use the company in its previous form and profile without substantial modifications. If the acquirer is able to essentially continue the company's business, then a TOGC is found even if the transferor keeps some insignificant part of it³.

In its ruling the court also invoked the case law of the Court of Justice of the European Union (CJEU), which lays down business criteria and gives an assessment of whether an enterprise exists and is transferred and whether its identity is retained. The court emphasises that the TOGC criteria may be divided into general (specified) and individual (to be specified). The following general criteria may be identified from the CJEU case law:

- An assessment of the type or nature of the company
- A transfer of corporeal assets (real estate or movables) and incorporeal assets (know-how or inventions)
- Whether most of the employees are transferred
- Whether the customers are transferred
- Similarity of business functions before and after the transfer

The court stated that it's important to establish the existence, identity and stability of the economic unit being transferred.

The SRS based its TOGC claim on concerted efforts for Z Ltd to continue Y's business and listed a number of TOGC hallmarks, which the court assessed each separately, focusing on whether the SRS arguments are reasonable.

The same line of business

The SRS found Y Ltd and Z Ltd had declared the same line of business according to the NACE code (construction work not elsewhere classified). The court stated that merely following the NACE code, without establishing additional circumstances, is not sufficient to reasonably conclude that the two companies have the same line of business. So this claim is not proved.

A link between the companies' officers, shareholders, authorised persons and employees

The two companies had different officers and shareholders, but the SRS had found that Y Ltd officer and Z Ltd officer had been employed episodically by the same companies. Y Ltd and Z Ltd had the same authorised person – accountant (the accountant was employed by Y Ltd from 2014 to 2020 and had been working for Z Ltd since 2021).

The court stated that the fact that the two companies' officers previously shared the same office and know each other does not necessarily mean their activities will be interconnected and coordinated in doing their

business. Since the SRS representative present at the court hearing was unable to describe how the fact that they know each other facilitated a TOGC, the court dismissed this argument.

The same place of business management (that of the acquired company), the same computer used for communication, a shared internet connection and identical contact details

Identical means of communication (email address and phone number) appeared on the two companies' tax returns.

The court stated that even if the accountant keeps books for both companies simultaneously, this information alone is not sufficient to conclude that all of the accounting service provider's clients become related companies that carry out concerted activities because their accountant has access to confidential information on other companies. Moreover, without convincing evidence it's impossible to conclude that the accountant is involved in running the company's business. The fact that the accountant can access supporting documents, make payments and communicate with the SRS on tax matters follows from the nature of this profession, rather than from any special authorisation granted by the company's management.

Revenue

The SRS points to Z's rapid revenue growth, which coincides with Y going out of business. However, in the court's eyes the fact that these processes ran in parallel does not mean that a TOGC occurred. A direct link between the revenue growth and the assets or employees being taken over could indicate a TOGC.

Business partners or employees taken over

Based on the tax returns, the SRS found that the two companies had the same business partners. The court states that checking only the data reported on tax returns is not sufficient to conclude about a business partner being taken over, but we also need to check the circumstances in which the transactions were made and the business relationship began.

Assets taken over

Z Ltd took over three trailers and one goods vehicle from Y Ltd, which the SRS views as a transfer of assets. However, the court finds that a disposal of assets alone with no additional evidence does not suggest a TOGC. We cannot confine ourselves to vehicle re-registration, without assessing explanations made by the parties about the circumstances of the transaction and evidence that confirms them. The court states that companies in financial distress often sell their assets to obtain cash.

So, when it comes to assessing whether a TOGC has occurred, we need to consider the criteria put forward by the SRS and the court.

First of all, we need to establish whether a set of business elements has been transferred that could be treated as essential and sufficient to carry on an independent business in the previous form and profile without significant changes. This set of business elements may vary from case to case.

It's the duty of the SRS to establish and verify the circumstances of the case carefully and comprehensively.

¹ Administrative District Court, Riga Court House, ruling of 15 February 2024, archive No. A42-00889-24/16

² Strupiss A. Commentary on the Commerce Act. Part A. General rules for commercial operations (sections 1-73). Riga: A. Strupiss Law Firm, 2003,

pages 102-103

³ Strupiss A. Commentary on the Commerce Act. Part A. General rules for commercial operations (sections 1-73). Riga: A. Strupiss Law Firm, 2003, page 115