Institution **CIOT - CTA**
Course **APS VAT and Other Indirect Tax**

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Answer-to-Question-_1_

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Dear Bernie,

Targera Ltd: Business acquisition proposals

Thank you for your letter dated 30 April 2024 regarding the tax issues and possible acquisition structure of Targera Ltd ("T Ltd"). We have outlined our key tax considerations below in response to the queries you have raised, and provided our recommendations.

This letter has been prepared using the information provided by Bernie Krell, and has not been subject to any further investigations. This letter is for the benefit of ABundle Ltd ("A

Ltd") only, and may not be shared with or relied upon by any third parties without our prior written consent. We recognise that some of the issues discussed may be relevant to Charles Krell ("Charlie") and Gabriela Krell ("Gabriela"), but this letter should not be relied upon by them, and is for the use of ABundle Ltd only.

1. Executive Summary

1.1 There are two primary methods of acquisition available which may be considered, a purchase of the trade and assets of T Ltd, or a purchase of the share capital of T Ltd.

1.2 For VAT purposes, the purchase of the trade and assets of T Ltd could be a TOGC for VAT purposes where the conditions outlined in Section 2 are met.

1.3 In order for the leased building to fall under the TOGC, an option to tax must be applied by T Ltd and A Ltd before the date of the transfer to include the building in the TOGC. However, A Ltd should not occupy the building if they wish to pursue this option, as it would potentially result in their OTT being disapplied. SDLT will be chargeable on the lease premium for the transfer of the lease under a TOGC.

1.4 For the sale of trade and assets, a new partial exemption special method would need to be agreed with HMRC to account for the new taxable activities for A Ltd. A sectorised method may be appropriate considering the current activities of the businesses.

1.5 A joint election would be required on the transfer of the

fixtures and fittings to agree a value for capital allowance purposes, and should be agreed within 2 years of the transfer. As the value of F&F is fairly minimal, this should be easier to agree.

1.6 The purchase of the shares in T Ltd would be exempt for UK VAT purposes, and T Ltd would become a wholly owned subsidiary of A Ltd on the purchase. Any input tax incurred on the purchase of the shares could be recovered by A Ltd where it plans to make taxable management charges to T Ltd. This would require a VAT registration for A Ltd.

1.7 It will be possible to reclaim the VAT overpaid and underclaimed, provided the claim is made within a 4-year period. T Ltd should therefore make this a priority following the acquisition, as the VAT will fall out of time post July 2024. HMRC may require a reasonable excuse as to why the VAT has not been addressed previously.

1.8 A Ltd could form a VAT group with T Ltd, meaning any supplies between them would be disregarded for VAT purposes. This would require a new partial exemption special method to account for the partly exempt VAT group, accounted for by the representative member.

1.9 If a share sale is pursued, group relief may be available on the losses in T Ltd, which can be set against the profits of A Ltd. However, T Ltd should continue to operate its current business model, as it would otherwise be at risk of losing the losses from before the transfer (see Section 3).

1.10 Regarding the change to distribution model, this would also have VAT registration implications due to the nature of the electronically supplied services (see Section 4)

1.11 Where Charlie and Gabriela make supplies of consultancy services, or a licence fee to the UK companies, this would be a supply subject to the reverse charge in the UK, and input tax would be recoverable subject to the partial exemption position of each business.

Overall, due to the ability to utilise the losses in T Ltd against the losses in A Ltd, we would recommend that T Ltd is purchased through a share purchase. This would also reduce complexities around partial exemption position created by combining the businesses, and reduce any SDLT payable on the value of the lease.

2. Acquisition of trade and assets

VAT

2.1 The purchase of trade and assets for VAT purposes can fall under the provisions for a 'transfer of a going concern' ("TOGC"). Typically, the purchase of a business' assets would be subject to VAT at the standard rate. However, where the purchase is a TOGC, this is a sale outside the scope of VAT by the seller.

In order to be a TOGC, the basic conditions to be met are that the assets must be capable of forming a business in their own right, and they must be used by A Ltd to carry on the same kind

of business operated by the seller.

2.2 Another key aspect of a TOGC is that where the seller is registered for VAT (as T Ltd is), the buyer must be registered for VAT, or at the date of the transfer, be required to be registered for VAT as they would meet the conditions for compulsory registration. Alternatively, A Ltd could apply for a voluntary registration in advance of the transfer taking place.

2.3 We note that within the assets there is a property lease included. As such, there are SDLT implications for the transfer of the lease as outlined below. Furthermore, where property is included within a TOGC, the seller must have opted to tax the building, and the option must not be disapplied in relation to the transfer. The buyer (A Ltd) must then also opt to tax their interest in the building, and notify T Ltd that their option to tax will not be disapplied under anti-avoidance provisions.

Where A Ltd were to use this as a branch office to make supplies of gambling, this would mean that the office is being occupied by them to make exempt supplies at a later date. Where the building is a CGS asset, this would mean the OTT is disapplied and VAT will be payable on the transfer of the lease, and any input tax reclaimed would also be irrecoverable. Therefore, we would not recommend that A Ltd uses this as a branch office for the main activities of T Ltd.

2.4 As T Ltd makes fully taxable supplies of its game licences to distributors, this would mean that A Ltd would become VAT registered and partially exempt on the acquisition of the business. As such, a new partial exemption special method would

need to be agreed with HMRC to account for the taxable supplies. In order to use a special method, an application must be made to HMRC, and this can be done using the online service. A Ltd could select any method which is appropriate to the business, and provides a fair and reasonable apportionment of input tax.

A sectorised method would likely be most appropriate in these circumstances, as the games business and the gambling business would form discrete areas of the business, which would be easier to assign input tax recovery to, and could be based on the internal cost accounting system used for management purposes, to assign specific costs to each business.

2.5 Any fees incurred on professional costs would be recoverable as overheads according to the partial exemption position of the business, per the principles set out in the UBAF case.

Stamp Duty Land Tax

2.2 SDLT is chargeable on the value of the lease premium for the lease transferred. The value for SDLT purposes also includes any VAT chargeable on the lease. This would form a potentially significant cost to the business. However, where an SDLT group is formed with the T Ltd business on acquisition, this would allow no SDLT to be charged on the transfer.

Corporate Tax and Capital Allowances

2.3 A Ltd and T Ltd would be required to perform a joint election for the purchase of the fixtures and fittings, to determine the amount of capital allowances that can be claimed by T Ltd

following the acquisition. As the amounts involved are fairly minimal, and the parties involved are closely connected, a joint election should be suitable.

2.4 It should be noted that capital allowances can only be claimed where the 'pooling requirement' is met. This is applicable for both the fixtures and the plant and equipment. This states that CA can only be claimed if they were claimed by the previous owner. We recommend that A Ltd should therefore confirm whether CA was claimed under any pool (AIA, WDA, etc.) during the purchase process.

3. Shares

VAT

3.1 Alternatively, A Ltd could purchase the shares of T Ltd. The sale of shares is exempt for VAT purposes in the UK, so VAT would not form an immediate cost to A Ltd on the purchase.

3.2 Following the purchase of T Ltd, it would become a wholly-owned subsidiary of A Ltd, and would be subject to its own concerns for VAT purposes, as a subsidiary is a separate legal entity from its parent company.

As the parent company, A Ltd would be able to reclaim VAT incurred on the purchase of the shares where it planned to make future taxable supplies to the business, such as a management or administrative charge. However, in order to reclaim input tax, it would be required to be a taxable person for VAT purposes (i.e,

registered for VAT). As A Ltd is currently wholly exempt and not registered for VAT, they would not currently be able to reclaim the input tax incurred.

3.4 There are not outstanding VAT or other tax liabilities that would become the responsibility of A Ltd under a share sale. This would also be applicable for the potential VAT reclaims that form part of the assets of the business. Regarding the overpayment and underclaim of VAT, it is possible to reclaim these amounts, providing they fall within the 4 year period before the claim is made. As it is currently May 2024, the timeline for reclaiming this VAT will be coming up shortly, meaning it may be difficult for A Ltd to reclaim this VAT if this is not acted upon straight away.

We would recommend that a notification should be made to HMRC as soon as possible to recover the overpaid/underclaimed VAT. These amounts should only be considered assets of the business where they can actually be reclaimed from HMRC. As such, where the transfer of the business takes place after the submission of the July 2024 VAT return, any overpaid/underclaimed input tax will cease to be reclaimable by T Ltd.

3.5 A Ltd could also form a VAT group with T Ltd. In this scenario, any charges made between the companies would be not be considered to be a supply, and no VAT would be chargeable. However, made by T Ltd are fully taxable for VAT purposes, a new partial exemption special method will not be required on the purchase of the company to account for the fact that this would form a partially exempt VAT group. VAT is accounted for by the representative member of the group, which would likely be A Ltd

in this case.

3.7 The input tax incurred on the motor vehicles hired may be subject to a block on input tax depending on the nature of the vehicle lease. Where these are cars which can be used for private purposes, there is a 50% block on input tax incurred. However, where the motor vehicle is a van used exclusively for the purposes of the business, input tax can be recovered as normal.

Stamp Duty

3.8 There would be stamp duty chargeable on the purchase of the shares, however this would only be chargeable at 0.5% on the total value. This would be payable by A Ltd on the purchase of the shares. It is likely that the costs for this cannot be confirmed until valuation experts are consulted on the value of the company, but it should be held in consideration.

Corporation Tax and Capital Allowances

3.9 As T Ltd would continue to be a separate legal entity, it would have its own liability for CT and CA purposes. Any capital allowances previously claimed on the fixtures or plant and equipment, such as AIA or WDA, can continue to be claimed in the same way that T Ltd was already doing so.

3.10 A potential benefit of purchasing the shares of the business is that T Ltd could become part of a loss group for CT purposes with A Ltd, as it is over 75% owned by A Ltd. This would therefore allow A Ltd to offset the losses in the last year

(£100,000) against its total taxable profits in either this year or the next year. This would result in a saving of 25% on the losses, as A Ltd is taxed at the main rate of CT for VAT purposes. Therefore, there is a real tax saving of £25,000 on the losses in T Ltd if they were to be part of the same loss relief group.

It appears that the losses for T Ltd are also likely to continue into future years, as the total revenue from their current games expiring in 2025 will be £65,000. Therefore, any further losses could also be set against future profits of A Ltd, or the profits of T Ltd if Project Z produces the expected financial results.

3.11 However, the losses will only be available to A Ltd provided that there is not a major change in the nature or conduct of trade. This is looked at for a five year period, including the three years before the acquisition. Currently, the new game being developed would not present a MCINOCOT, as this is only use of new technology, which is allowed for these purposes.

A major change to the business model would prevent group loss relief from being used. Where T Ltd becomes the distributor of the game online direct to customers, this would likely constitute a major change, as there are differences in both markets and clients that T Ltd would serve. As such, if A Ltd wishes to use the losses in T Ltd to reduce its total taxable profits, we would not recommend making a major change to the business model. There are also likely to be VAT consequences to this potential change, as outlined below.

4. Other Considerations

Distribution Model

4.1 Currently, we understand that the model for T Ltd's business is to licence its games to UK-established distributors who then operate the internet platforms used to supply the games. In this situation, UK VAT would be charged on the licencing fee, and the UK distributors would be responsible for any tax consequences on the distribution of the game.

We understand that you wish to consider whether T Ltd could distribute the game itself to worldwide customers. The supply of the games online would be considered an electronically supplied service ("ESS"), as it is a supply of music, films and games supplied over the Internet. Where ESS are supplied to customers outside of the UK, the place of supply for VAT purposes is where the customer belongs. As such, if T Ltd wishes to distribute the game worldwide, it would be required to potentially account for the VAT chargeable in every country where it makes a supply of the games, even if this is only to a single individual.

4.2 It should be noted that although the supplies would be made to persons outside the UK, T Ltd would still be able to recover the input tax incurred on these supplies under s.26(2)(b), for supplies which would be taxable in the UK but which are made outside the UK.

4.3 This change in model would present a high level of administrative burden, and potential costs in making these registrations, or employing an agent or VAT representative in each country to complete the returns on behalf of A Ltd.

Therefore, we would recommend that T Ltd continues to follow its current business model, as it will only be liable to account for UK VAT on its supplies to UK customers. For CT purposes, A Ltd is a UK resident company, as it is incorporated here, so would also be taxable on its UK profits.

Consultancy and Licencing - Charlie and Gabriela

4.4 We have considered your query on how Charlie and Gabriela can continue to benefit from the sale of their business. Where Charlie provides consultancy and development services in relation to Project Z, and he has moved to Spain, this would be a cross-border supply of services. The supply of the licence for the characters would also be a cross-border supply of services if they move to Spain.

4.5 As such, T Ltd would be required to account for any VAT due under the UK reverse charge mechanism. This would involve accounting for the output tax, and recovering the input tax on the same VAT return. As T Ltd is fully taxable, this would not present a cost to the business under a share sale option. However, under a sale of trade and assets, where A Ltd is the owner of the business, the input VAT accounted for under the reverse charge would be recovered according to the partial exemption position of the business.

Yours sincerely,

Amal Patel

Tax Manager

Quirer LLP

02 May 2024