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FACT FILE

Can you separate a business for VAT purposes?

One of our clients wants to hive off a small part of his business to develop and ultimately sell. The main business is VAT registered, but will the registration continue to apply to the smaller business after it's hived off?

Who's registered?

Remember that it's not businesses that register for VAT, but business owners. That is, individuals, partners and companies. That's why, if you run more than one business you usually complete only one VAT return to cover them all. The main reason for this is to prevent businesses splitting up so that each is below the registration limit, meaning they don't have to charge VAT.

Breaking the rules

Attempts to work around the so-called disaggregation rules are uncommon, usually by splitting the ownership of a business. For example, a husband owns and runs a pub, while his wife owns and runs a B&B from the same premises. HMRC takes a dim view of this type of arrangement and will very likely consider it VAT avoidance.

Let's separate

Our client's position is somewhat different from the example above. He runs two businesses which have different types of trade. The main business has an annual turnover in excess of £1 million, while the other is a fledgling one and currently turns over around £50,000. However, our client thinks it has potential and wants to hive it off to a new company and, after a little development, sell it for its profit. It's not his intention to evade VAT, but it would be helpful if he didn't have to register the smaller business.

Intentions don't matter

When considering whether or not a business has been disaggregated, HMRC doesn't put a lot of weight on the intentions behind the split. Instead, it looks at the facts and decides first whether or not there is a loss of VAT, and then if the two businesses are run closely enough that they should fall under a single registration.

Tip. The key to avoiding the disaggregation rule is proving to HMRC that each business has a significant degree of commercial and administrative independence from each other.

Key factors

Our client can increase the chances of a successful separation for VAT purposes if, as far as possible, the two businesses have:

- separate bank accounts and financial records
- separate telephone numbers, websites, phone numbers, etc.
- their own premises. If that's not practical, then they should occupy separate floor space
- their own equipment, e.g. IT network, phone system
- at least some employees who work solely for each business.

Tip. Where one business owns the premises or floor space, it should charge a market value rent for its use by the other business.

Is there a risk?

Our client could kowtow to HMRC's disaggregation rule to avoid any hassle, but he needn't worry too much. As long as there's no deliberate attempt to evade VAT, HMRC can only apply the disaggregation rule going forward, which means there's no risk of retrospective VAT bills.

HMRC can rule that the separation of a business has no effect on its VAT registration if it loses VAT as a result. However, the risk reduces the more independent you can make the businesses. As far as possible, they should have their own employees, separate banking, financial and administrative arrangement