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Payment for non-compete clause can be VAT-free as part of the sale of a business

The Supreme Tax Court has held that a lump sum compensation payment for an agreement not to compete with the purchaser of a business can be free of VAT as part of the price paid for the sale of an entire business.

The proceeds from the sale of a self-contained business are not turnover subject to VAT, provided the sale includes all assets necessary for the purchaser to continue the operation. The sellers of a nursing service took this to include the amount received from the buyer in return for their undertaking for the next two years not to operate a competing business within a distance of 100 km and not to entice customers (patients) to seek a rival service. This agreement to refrain from competing with the buyers was included in the contract for the sale of the business. The contract put a value on the restraint, but went on to add that the amount mentioned was not a further payment obligation as it had already been included in the selling price. The tax office, however, took the view that the undertaking not to compete was a separate transaction subject to VAT as a service provided. In this, it pointed to the fact that the undertaking had been valued separately and that the buyer of the business had merged it into its own operation, rather than continuing to run it as a separate entity.

The Supreme Tax Court decided in favour of the taxpayers for VAT exemption. By its very nature, a nursing service was far more dependent on intangibles than on tangible assets, and an agreement to refrain from competing with the buyer could be an important aspect in the continuing operation. That the original name was discarded was of no moment; the buyer had continued the business under its own name. The fact of the agreed refrainment from competition should be respected; it had been agreed in the context of the sale of a business and the exact contractual status should be ignored as to do otherwise would be to open to all others a free choice between tax liability and tax exemption.

Supreme Tax Court judgment XI R 1/11 of August 29, 2012 published on February 13, 2013

Keywords

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