FIELD COURT TAX CHAMBERS

Professional goodwill [1]

Some welcome clarity of the tax treatment of goodwill of a professional practice

The recent case of *R Villar v HMRC* [2019] UKFTT 117 (TC) examined the tax implications of the sale of goodwill by a professional person, and it is a helpful clarification of the law in this area.

Mr Villar had a successful medical practice and he sold the business as a going concern to Spire Healthcare Diagnostics Limited for £1m. Mr Villar said that the sale gave rise to a capital gain. However, HMRC argued that the payment was chargeable to income tax.

An important part of HMRC's argument was that the payment was mainly attributable to goodwill, which it said could not be transferred to Spire because the goodwill was personal to Mr Villar.

HMRC also argued that this was not the disposal of a business because there was no business to dispose of; this was really a payment to Mr Villar for the exploitation his professional skills for a future flow of income. In other words, it was an arrangement for Mr Villar to obtain money in capital form (taxed at only 10% having regard to entrepreneurs' relief), and not as income which would have given rise to rather more tax.

However, when anybody buys a business, they are buying an income flow. They buy the business because it makes profits and that is what provides the capital value. The purchaser may be able to exploit synergies with his own business or may feel that he has something to add to the business which will increase the profitability. On the sale, the vendor gives up the future profits which are subsequently received by the purchaser – but that does not mean every sale is therefore a sale of future income which is chargeable to income tax on the vendor. The sale of a business gives rise to a capital receipt chargeable to capital gains tax.

Mr Villar certainly believed that he had a business capable of sale – and he sold it. The expert valuers who valued the business thought so too – and they valued it. And Spire obviously thought he had a business capable of being bought because it paid £1m for it.

The tribunal did not take long to conclude that the sale by Mr Villar was a sale of his business and that the amount received was capital.

However, that was not the end of the story because HMRC then argued that even if the payment was capital, it should be taxed as income because of ITA 2007 s 773 which charges income tax on any capital sum received to exploit the earning capacity of an individual in an occupation.

The tribunal observed that there was no intention or obligation on Mr Villar to continue to work in the business. Accordingly, it was difficult to conclude that the purchaser was exploiting Mr

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Villar's earning capacity. In reality (and in fact) Spire were exploiting the practice (and the goodwill) that Mr Villar had sold to them.

The second condition for s 773 to apply is that one of the main objects of the arrangements was the avoidance of a liability to income tax. HMRC said that if Mr Villar had continued to receive the profits of his practice, they would have been chargeable to income tax; whereas by selling the practice, he received £1m which gave rise to a capital gain. That was a substantial tax advantage; indeed, it saved the whole of the income tax.

The tribunal found that there was no intention to avoid or reduce income tax, and it saw no evidence that income tax had been considered at all. Having regard to the huge tax saving involved, this view was no doubt welcomed by Mr Villar, but it did not matter because the tribunal found that s 773 had no application in any event.

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