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Transcript of Webinar

Mr Barry Roland, Assistant Director of HMRC who leads the main share valuation operational functions at HMRC is interviewed by the team at Pett Franklin.

Mr Roland explores current topics and give some of HMRC's thinking as to how lawyers, accountants and companies might work more efficiently with HMRC to achieve a smoother share valuation process.

Stephen: **Looking at an administrative and structural question, how is the Share Valuation department at HMRC structured?**

Barry: Those of you who deal with us will probably know that SAV is based at the HMRC premises in Nottingham. There, we have around 80 staff, and we deal with all sorts of valuations. We're structured by having a small clerical support team; that's the clerical and support functions. But most of the people you'll probably deal with will be in our general valuation group, which is the teams that I head. That's arranged in 5 teams of around 40 valuers and we deal with valuations arising from all sorts of taxes.

Now, most of the valuations are settled in that group, but if things drag on for a while longer, or things are getting a bit difficult and practically can't reach agreements, then you might also end up dealing with our litigation and technical team. That's a team of valuers who take forward cases that are, as I said, stuck in some sort of way, or perhaps it's something involving an issue that we think, perhaps, needs to go to the First Tier Tribunal to be resolved.

Over the past couple years, most of the experienced valuers within Shares and Assets Valuations have become RICS accredited members, so we will now provide expert witnesses as necessary for the First Tier Tribunal.

The third major valuation group within SAV is the intellectual property team. As their name suggests, they deal mainly with the larger intellectual property-type valuations, and their work has certainly grown since Finance Act '02 brought in a new intangibles regime. They largely deal with the large business valuations, often very significant, very large valuations.

As a whole, last year, SAV brought in yield of £196 million, which I think is our record figure. Like I said, that includes a number of very large settlements, and then also more run of the mill valuations that perhaps most of you will be dealing with.

Stephen: **How many cases do you believe that SAV with deal with each year, and how do they break down between share schemes, ITEPA, IHT, CGT, etc?**

Barry: The first thing said about the sort of valuations we receive is that most of the valuation we deal with actually come from other parts of HMRC, from the IhT people, from the compliance large business, and a smaller percentage come direct from tax payers or their agents. At the moment, we're dealing with roughly 14,000 valuations a year. Now, a couple years ago, that used to be a way bit higher, around about 20,000. What we've been doing the past couple years is working with the people who send us valuations, namely other parts of HMRC, to try and make sure we receive those valuations that are most worthwhile. Those that are more or less there or thereabouts, or don't need to come to us for some reasons, we try and weed out before they get to us. Most of these, of those that do come to us, roughly 3,500 are for inheritance tax, about 1,500 are Post-Transaction Valuation Checks of various kinds and, again, those are ones that come directly to us from you as taxpayers or agents.

Something that's grown in the past couple years, that fluctuates, is goodwill incorporation valuations and, at the moment, we'll be receiving something like, about 2,000 of those. And again, one of our larger categories is around 4,500 valuations relating to share schemes of various types. Probably the most of those are EMI-type valuations.

I mentioned earlier, this will be yield we get, and a lot of those from IHT, or goodwill valuations, or valuations from large business, are tax yielding. Whereas a lot of the share schemes work we do, particularly EMIs, there isn't any immediate tax yield, but we are providing that valuation service to give certainty to your clients, your customers.

Stephen: Bearing in mind the dynamics of the way that the cases are coming in, what operational changes have Share Valuation made in the last couple of years, and what others are planned?

Barry: Shares and Assets Valuations, like other parts of HMRC, and like all parts of government, has to operate within ever-reducing budgets. Within those reduced budgets, we try to maintain high standards of customer service, as far as we can manage, and also fulfil our compliance function of bringing in revenue for the government. So what we've done in the past couple years is have some shift in resources to our large business teams, which bring in a lot of revenue, and also to our litigation teams so we can try and resolve cases more quickly that need to be resolved.

Something else we've done in the past couple years is look at our procedures, and in particular we have changed our procedures in relation to the EMI valuation service that we offer. We try and apply a rigorous risk assessment to those valuations so that we're not getting involved in lengthy and prolonged discussions about values that perhaps aren't that significant, and so that you can get an agreed value at an early stage.

Something that we're looking at most recently is changing our working practices, and we've had lots of feedback and comments about why don't we make more use of emails, telephones, meetings. HMRC's got particular sensitivities about using emails because we've got to be very careful about safeguarding customer information, and it's also a danger that emails can go astray. But we're trying to overcome those problems, and with the agreement of agents or taxpayers, try to make more use of those sort of means of communication.

Essentially, what we're trying to do is find new ways of working cooperatively and more quickly with those who want to get an earlier settlement and reach a reasonable agreement, but at the same time, for those difficult cases that sometimes drag on a little bit longer than they should, we're trying to boost our litigation resources and be quicker with making sure we try and resolve things that have been capable of an agreement in a short period.

William: **Growth shares, very often with quite complicated articles, have become a lot more popular in recent years and I believe they've required SAV to allocate quite substantial internal resources to deal with them. My question is, how do you believe practitioners could present valuations for growth shares in a better way maybe and in a form which might make it easier for HMRC to consider them and hopefully agree them?**

Barry: I'm pleased somebody asked this question, because it's quite a hot topic for us in Shares and Assets Valuation at the moment, and we are looking at how we deal with ITEPA type post-transaction valuation checks. The problem as we see it is that sometimes we get to see quite complicated rules and arrangements, which can be difficult for us to understand, it's difficult to see what the schemes are trying to achieve, and it's difficult sometimes to see how the arrangements might give a value to the people taking the shares.

What's also slightly concerning is sometimes we then ask the valuer that we're dealing with, how do these arrangements actually work? And we're told, "Well actually, we've better go back and consult lawyers who drafted these things to get a grip on that." So what we think we need to do is, arrangements being put to us, to have a very clear statement of what the arrangements are trying to achieve, what the targets are, and also what the outcome might be for the shareholder if the targets are met.

As I said earlier, we are finding we've got to devote more and more resources to these type of arrangements. Very often we find that once we've looked at it in great detail, well actually there's not a huge issue over the valuation. So we'd just like to perhaps have some of that information more upfront, perhaps some more open disclosure. Like I said, we're looking at these arrangements, and what we intend to do is, once we come up with some ideas, go out to the profession and see if we can work together to come up with a better way of delivering them because, as I said, in times of reducing resources, unless we can find a quick way of dealing with these things, it does place the post transaction valuation service in jeopardy.

William: **Could you describe HMRC's policy regarding the agreement of EMI valuations after the awards have been granted, and the time limits that you expect advisors to work to?**

Barry: Before I get to the "after" point, I'd just look to say a few words about what we're trying to offer with the EMI valuation service. As most of you are probably aware of, what we do with EMIs is, we offer employers and employees the certainty of having the valuation agreed before you enter into the EMI arrangements so that you know exactly where you stand. Apart from offering the pre-transaction valuation checking service, we will also look at the valuation after the event if for some reason it's not been agreed beforehand.

As you're probably aware, the company has 92 days after the grant of the options to notify the Small Companies Enterprise Centre within HMRC, and that body then has an acquiring window of 1 year with which to raise a new query on those. Effectively, there's an enquiry window of up to 15 months. So what we say we'll do, we will look at the valuations before you enter into arrangements. We will also look at them within the time frame that we've got to make the adjustments to them. So overall, that could be a period of about 15 months. But if anything happens outside that window, well there's not really anything we can do with changing the value. You'll then just have to wait for the arrangement to take its course.

William: **Could you explain the principles for valuing shares in an unquoted company, or rather how they might differ, or to what extent they might**

differ, when you're valuing shares on the one hand for ITEPA or CGT purposes, and on the other hand for inheritance tax purposes.

Barry: The fundamental principles are essentially the same, whatever valuation we're looking at. Most of the valuations we look at are regulated under section 272 TCGA. For IhT, perhaps we're looking in section 160, but we're all trying to get to the open market value. Within that concept, we're trying to look at anonymous parties to the transaction, except, perhaps, in some employment income cases where we're looking at money's worth, but we can have some regards, perhaps, to the individual characteristics of the people entering into the arrangement.

The main differences between things like CGT, ITEPA, and IhT is that in IhT valuations, it's not so much the fundamental principles, but under IhT, there are other considerations about what we're actually valuing. For IhT, we're looking at the principle of the loss to the estate, so we might be looking at values before and after the transaction. IhT also brings in the notion of related property which means, again, we're not looking at a particular size of shareholding that's been transferred, but also taking into account other shareholdings related with that.

Another aspect of IhT is whether the valuation has been ascertained for the purpose of the estate. If it has, and it's been ascertained, considered, agreed, then that will form the base cost for CGT purposes. If it's not been ascertained, perhaps because the transaction's covered by business property relief, or for the reasons the estate wasn't considered in great detail, then a late base cost might be required.

William: I think one of the subjects that often engages valuers with HMRC concerns what is sometimes called the information standard, what information you can properly take into account in a fiscal valuation. Could you describe HMRC's views regarding this?

Barry: The information standard has developed over the various cases where share valuation has been considered by the courts. Essentially, all it tries to address is that the information available to parties entering into a transaction will vary according to the size and significance of the transaction they're entering into. For example, if an individual will agree to buy a whole company or a large group, then they will probably want to conduct very extensive due diligence, know absolutely everything about the company, its forecasts, its prospects, details of the senior employees. But then there is the purchase of a smaller shareholding. Again, if it's a large shareholding, they'll probably want quite a lot of information. But then, as the size of the holding diminishes and we're getting down to quite a small holding, maybe quite a small number of shares, then clearly the amount of information that somebody would require in purchasing that holding will be a great deal less.

The legislation actually refers to a section 273 TCGA, the information that a prudent purchaser might reasonably require. That takes into account the information the purchaser would like to receive, but also brings in the notion of what they might reasonably require, because clearly some individuals might like an awful lot of information, but the amount of information has got to be related to the significance of what they are gathering.

In the past couple years, the debate has mainly focused around what's been increasingly described, what we regard as growth shares. Those are shares that perhaps only form quite a small holding within the company. In other terms, we might say quite they're insignificant, and the degree of information that might be available to the parties would be quite limited. But then, we're looking at what could be reasonably required, and I think there is a view that if a prudent purchaser is considering a purchase of a parcel of shares that could deliver a gain and a return over a relatively short period with a notion of an exit over a very short period, and his value is entirely related to a degree of growth of that determined period, then that raises a question whether it might be reasonable to require some knowledge as to how the business or the entity might grow over that quite short defined period.

William: **Does HMRC ever encounter situations where, say, there were transfers of shares and/or option awards which were made at or about the same time, but for different tax purposes. For example, EMI option grants, corporation tax deductions, CGT calculations, or even IhT valuations or stamp duty where as a result market values are needed for different purposes. If so, does HMRC believe it's possible to have different taxable market values agreed for essentially the same shares at essentially the same time?**

Barry: In a nutshell, no. But I'll expand on that a little bit.

As I said just now, the basic fundamentals of valuation are the same pretty much for most of the categories we're looking at, and I've mentioned before that for IhT, sometimes we might be looking at a different sized shareholding. So in most circumstances, if we've fully investigated, negotiated, discussed the values, and agreed something, then that's how that should carry across to have a valuation for similar sized shareholdings that may be required at a similar date.

I think this point's become relevant more recently, because our practice now in agreeing many EMI valuations is that sometimes the valuations are not fully investigated and so we agree the EMI figure on a without prejudice basis. That means we're quite happy with the taxpayer or the company to use that value for the purpose of the EMI option being granted, but if there is another issue of shares for some other purpose, then it isn't possible to rely on the EMI value agreed on a without prejudice basis if the other parcel of shares might have a more pressing or more immediate tax effect.

Something else we've also been looking at recently around this general area is we are noticing that for many of the share awards issued, or where we are advising on the value for tax purposes, we're also noticing the company might be also considering the value for their accounting purposes. We do sometimes just have a look at the underlying assumptions used in both valuation approaches. We're not saying that the approaches might lead to identical values, but we do have a view that with so many underlying assumptions it probably should be similar.

William: **Given the statutory basis of valuation is the same for ITEPA and CGT purposes, is it conceivable that a valuation accepted for, say, an ITEPA purpose would not automatically be acceptable for CGT purposes as well, and vice versa?**

Barry: This is an interesting question, and we have considered this in the past. Usually, if SAV has considered the value agreed, and it's been fully negotiated, then that effectively sets the value. You can't go and revisit it. A rather different situation might arise, however, if a valuation is not agreed. It might be used in somebody's self-assessment return, and if that return is not inquired into, then that is the fixed value for that purpose. But perhaps one of those valuations is also relevant for a later tax year. Perhaps the same valuation's being used as a base cost for CGT disposal.

So technically, it would be possible to revisit the earlier valuation if that was not formally agreed and discussed with SAV. That valuation might still be relevant and open in the event of a belated disposal. I think in practice, in most circumstances, we wouldn't choose to do that, but in some circumstances, if the figures and the amounts justified it, then that is a possibility.

William: **If a valuation has not already been agreed under the PTVC procedure, and the employee merely records the award of an employment security in his tax return, giving details of the awards and an unagreed value, how long does HMRC have to raise a question with the taxpayer on the value shown on that return before the valuation is effectively agreed through the self-assessment tax return process?**

Barry: It may still only be circumstances that just fall within the normal enquiry window, which I think is 12 months from the final deadline. The only departure from that, if there is some sort of discovery that something, perhaps, wasn't fully disclosed, but that's a more tricky area. Generally speaking, it falls within the normally enquiry window deadlines.

William: Veering away from the actual area of unquoted company valuations to a slightly different topic, it's actually the Office of Tax Simplification, the OTS, a while back, proposed that for quoted securities, the current quarter up basis in the legislation, as a simplifying measure, should be replaced with the closing price. I know there's been consultations on this, and even draft regulations about this. What point have these proposals currently reached?

Barry: As he said, a couple years ago, the OTS were looking at various aspects of unapproved schemes, and one of them was the various aspects of valuation. The OTS had quite a lot of discussions with SAV. There were lots of ideas floating around as to how the valuation process could be simplified or improved. One of the things that came out of that was that we did publish clearer guidance about valuation of EMIs in our manual. We put forward various valuation scenarios and the approaches that people might take. We did put those out to the consultation to various people. I don't think they were universally agreed, but I think we were after them as a guide.

One more concrete proposal that the OTS came up with, and that has been adopted, was the idea to abolish the, or move away from the quarter up basis of valuation for quoted shares. Now, the reason for that was that I think many practitioners found it difficult in the first place to understand and calculate the quarter up basis, and even more difficult to sometimes explain that approach to their clients.

During that consultation, the overwhelming view was that it would be more straightforward just to move to a valuation basis based upon the closing price. That has been put out for a consultation. Inevitably, moving from one basis to another doesn't please everybody. Some will lose out, some will see some more advantages or disadvantages. But that's gone out to consultation, a lot of feedback has been received, and that's now being considered. As far as I’m aware, that change is going to happen.

I think one of the things to come out of that consultation is that there was also some discussion of proposals to change some of the guidance, and I think that has prompted the fear, amongst practitioners, that some of the flexibility that the share scheme guidance provides on situations where it's sometimes difficult to get a closing price on a certain day, or where disposals have to be made over a slightly longer period, there's this fear that some of our flexibility might be being eroded. I can just say it's certainly not the intention of HMRC to restrict or erode any of the flexibility that is currently there in the guidance. So I'm quite pleased to try and clear that up.

In a nutshell, the closing price change is going ahead, and the flexibility already there within the guidance will remain.

William: **Can we look at a particular case that the tribunals considered about a year ago. It's a case called *Dyer v Dyer*. I'm not sure that it creates any fresh ground, but it goes over an area that does crop up in practice quite frequently, and I thought it might be worth reminding people or introducing the case to people.**

William: The facts of the case concern a company called JD Designs Limited, where there was a sole director called Jenny Dyer. She was a fashion designer. She became a highly successful designer, and Jenny Dyer London became a quite valuable trademark. All of the relevant intellectual property for the Jenny Dyer brand was registered in Jenny's own name, and there was no licensing agreement with the company that she operated. Jenny was the source of all of the company's revenue, effectively, and the sole designer for the brand, but she had no employment contract with the company, and in fact could resign as a director by giving notice at any time.

In October 2007, Jenny's parents, Mr. and Mrs. Dyer, acquired a total of 350 new shares in the company, representing 91% of the share capital. They contributed £50,000 for these shares. In 2007-2008, the company made losses. Over the course of those years, however, the company received a number of approaches from potential external investors. However, none of these approaches ever came through to the extent of a sale taking place.

Then, in 2008, Jenny met someone in the United States and decided to leave the UK move to the US. She therefore abandoned the company completely and eventually it had to be liquidated. The result was that her parents made a claim for a capital loss in relation to the shares they had acquired. Now, HMRC accepted that the shares did have a negligible value when the shares were liquidated, and that claim was made. But the issue was HMRC also argued that the value had always been negligible, even at the time the shares were first acquired, and therefore no loss had actually arisen.

Now, the court considered how much the shares would have been worth on the open market in October 2007. The court concluded that a third party investor, who might have acquired those shares in the company at that time, would have required the company to have had the full rights to the intellectual property that Jenny Dyer held, and to have a firm employment contract in place with her. The view of the court was that the company was therefore worthless. This was amply demonstrated by what happened when Jenny decided to move to the United States.

In the course of the tribunal hearing, the court considered the hypothetical possibility of a buyer who would have not objected to the lack of IP rights, or the failure to have a contract with Jenny in place. But the court concluded, and I quote, "There is no evidence that any buyer existed or might have existed whose attitude to the defects in the assets for sale is hypothesized to resemble that of Mr. or Mrs. Dyer when acquiring shares." Therefore, in this case, the taxpayer lost and HMRC won.

I mean, there are various morals of this story, maybe you should be careful giving money to your daughter, but I think it does reiterate an issue which crops up from time to time in share valuation of companies where the intellectual property in a business is actually owned by the founder. In those cases, how much is the business, the actual company shares worth, even if it appears to be profitable at a superficial level. So I suspect it's a case that, although it's a little bit of an extreme one, could have quite a few practical applications, or one that we might choose to refer to in the future.

William: (question submitted by a listener during the webinar) **A management team is considering acquiring part of a business. That part has been trading at a loss for several years. It has no significant record of growth recently. How would that part of the business be valued, and might the result be a value of zero?**

Barry: Yes. Off the cuff, if we do have a quick look at this interesting question that came in earlier, the answer could be that the result or the value may well be zero. I think the point that we would like to think about or investigate is, if this part of the business has been trading at a loss for several years, no significant record of growth recently, then why would somebody want to buy it? Why would somebody want to buy a business that is purely loss-making? If the assumption is that those losses are going to continue then, really, why would somebody waste their time and energy in trying to buy it? So then it goes to the point of looking at the business and what is there within that business that might deliver growth, might deliver value going forward.

I suppose it comes back to the point we discussed a little bit earlier about looking at information standards, looking at the sort of information that might be available to the pre-purchaser of this business. If we're looking at a whole business that's a significant investment, then we'd be looking at the forecast of the business, the growth prospects, and really understanding what drives value in this business, and that would help us to, in terms of valuation, come to the conclusion, "Is it really worth zero? If so, why would somebody buy it? But if somebody's considering buying it, what would they recognize in terms of value that might be of interest to them or persuade them to stump up their hard-earned cash?"

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Contacts:

David Pett
Partner (lawyer)
david.pett@pettfranklin.com

William Franklin
Partner, Chartered Accountant
william.franklin@pettfranklin.com

Stephen Woodhouse
Partner (lawyer)
stephen.woodhouse@pettfranklin.com

T: 0121 348 7878

Pett, Franklin & Co. LLP
Victoria House
116 Colmore Row
Birmingham B3 3BD