[2022] UKFTT 0285 (TC)

TC 08228

INCOME TAX – relief for gifts of shares to charity – shares listed on the Channel Islands Stock Exchange - market value of shares at the date of the gifts

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal numbers: TC/2017/08383
TC/2017/08434

BETWEEN

(1) DIANE NICE
(2) RON ROBINSON **Appellants**

-and-

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: JUDGE NIGEL POPPLEWELL
MISS SUSAN STOTT

THIS DECISION NOTICE REPLACES THE ONE ISSUED ON 12 AUGUST 2021 AND INCORPORATES AMENDMANTS MADE PURSUANT TO TRIBUNAL PROCEDURE RULE 37 (CLERICAL MISTAKES AND ACCIDENTAL SLIPS OR OMISSIONS)

Hearing conducted in public remotely by video on 7-10 June and 20 July 2021

Charlotte Brown instructed by Taxology LLP for the Appellant

Sadiya Choudhury instructed by the General Counsel and Solicitor to HM Revenue & Customs for the Respondents

DECISION

INTRODUCTION

1. This case concerns income tax and in particular the quantum of the "relevant amounts" for each appellant which they can deduct from their taxable income under section 587B Income and Corporation Taxes Act 1988 **("section 587B")** following gifts of shares by each appellant to charities on 11 January 2006 **("the relevant date").** This requires a determination of the value of the net benefit to the charities of the shares gifted to them. As the shares in question were quoted, their value is determined under the basic valuation rule in section 272 (1) Taxation of Chargeable Gains Act 1992 **("TCGA 1992")** namely the price the shares could reasonably have been expected to fetch on the open market as at the date of the gifts to the relevant charities.

2. The appellants are members of a group of taxpayers who have claimed relief on the gifts of shares **("the shares")** in a company called Mount (York) Limited (the **"Company")** to charities. The appeals have been designated as lead appeals under Rule 5(3)(b) of the FTT rules.

3. In their tax returns for the tax year 2005/2006, the appellants claimed relief under section 587B on the basis that their shares in the Company were each worth £1.05 on the relevant date. Following enquiries into those returns, HMRC issued closure notices in April and May 2013 on the basis of a valuation report from Mr Daniel Ryan who had concluded that the market value of the shares on the relevant date was no greater than 25.6p per share. HMRC now accept, on the basis of Mr Lygo's valuation report that the value of the shares at the relevant date was 39p per share.

4. So the issue between the parties is the value of the appellants' shares at the relevant date. The factual background to the dispute is largely agreed as is the law. Case law, summarised later in this decision, indicates that when considering the price which assets might reasonably be expected to fetch on the open market, one looks at a hypothetical sale between a hypothetical vendor and a hypothetical purchaser. That hypothetical purchaser is a reasonably prudent purchaser. The issue in this case is thus what the hypothetical purchaser would have paid for the shares on the relevant date.

5. The parties have each lead expert evidence. Those experts agree that the conventional approach in valuing minority shareholdings for UK tax purposes is to apply a suitable adjusted multiple derived from a broadly similar listed company to the subject company's maintainable post tax profits. This is referred to as either the PE methodology or the earnings basis, and, simply stated, involves applying a multiple to the post tax profits of the Company at the relevant date. The experts differ very slightly in their view of the earnings/profits. They agree that the post tax profits were around £850,000. It is worth mentioning here that this is just about the only significant matter on which the experts agree.

6. The fundamental difference between the experts concerns the multiple. Simply stated, the appellants' expert has used a multiple of about 26, whereas HMRC's expert has used a multiple of 7. This has, of course, produced radically different results.

7. The appellants maintain, on the basis of their expert, that the market value of the shares at the relevant date was indeed £1.05. HMRC asserts on the basis of their expert that the shares were worth only 39p on the relevant date. We have to determine that value. It is worth pointing

out now that we are not bound by either valuation. It is not a question of choosing between the two experts. It is for us to decide what the market value of the shares was on the relevant date.

THE LAW

8. Under section 587B, where, otherwise than by way of a bargain made at arms length, an individual disposes of the whole of the beneficial interest in a qualifying investment to a charity, the relevant amount shall be allowed as a deduction in calculating that person's total income for the purpose of income tax for the year of assessment in which the disposal is made. The relevant amount, where the disposal is a gift, is an amount equal to the value of the net benefit to the charity at or immediately after the time when the disposal is made. The net benefit to the charity is the market value of the qualifying investment. The market value of any qualifying investment is determined in accordance with the TCGA 1992.

9. The parties agree that the relevant provision in the TCGA 1992 is section 272 of that Act which at the material time read as follows

> "272
>
> (1) In this Act 'market value' in relation to any assets means the price which those assets might reasonably be expected to fetch on the open market.
>
> (2) In estimating the market value of any assets no reduction shall be made in the estimate on account of the estimate being made on the assumption that the whole of the assets is to be placed on the market at one and the same time."

10. In his recent decision in the case of *Neil McArthur and Thomas Bloxham v HMRC* [2021] UKFTT 0237 ("*McArthur*") Judge Cannan set out a number of principles which he derived from the authorities which the tribunal should consider when identifying the market value of assets including shares. He stated as follows:

> "14. There are a number of authorities as to the basis on which a court or tribunal should approach the task of identifying the market value of assets including company shares pursuant to section 272. The following summary of the principles to be applied was common ground:
>
> (1) The sale is hypothetical. It is assumed that the relevant property is sold on the relevant day (see *Duke of Buccleuch v IRC* [1967] AC 506 at 543 per Lord Guest).
>
> (2) The hypothetical vendor is anonymous and a willing vendor, in other words prepared to sell provided a fair price is obtained (see *IRC v Clay* [1914] 3 KB 466 at 473, 478).
>
> (3) It is assumed that the relevant property has been exposed for sale with such marketing as would have been reasonable (*Duke of Buccleuch v IRC* at 525B per Lord Reid).
>
> (4) All potential purchasers have an equal opportunity to make an offer (*re Lynall* [1972] AC 680 at 699B per Lord Morris).

(5) The hypothetical purchaser is a reasonably prudent purchaser who has informed himself as to all relevant facts such as the history of the business, its present position and its future prospects (see *Findlay's Trustees v CIR* (1938) ATC 437 at 440).

(6) The hypothetical purchaser embodies whatever was actually the demand for the asset at the relevant time in the real market (*IRC v Gray* [1994] STC 360 at 372).

(7) The market value is what the highest bidder would have offered for the asset in the hypothetical sale (*re Lynall* at 694B per Lord Reid).

15. The parties made a number of submissions arising out of the application of these principles to the valuation of the BBG shares which I deal with in the discussion section of this decision.

16. The provisions of section 273 TCGA 1992 also featured in the expert evidence and in submissions and it is convenient to set them out here:

273

(1) The provisions of subsection (3) below shall have effect in any case where, in relation to an asset to which this section applies, there falls to be determined by virtue of section 272(1) the price which the asset might reasonably be expected to fetch on a sale in the open market.

a. The assets to which this section applies are shares and securities which are not quoted on a recognised stock exchange at the time as at which their market value for the purposes of tax on chargeable gains falls to be determined.

b. For the purposes of a determination falling within subsection (1) above, it shall be assumed that, in the open market which is postulated for the purposes of that determination, there is available to any prospective purchaser of the asset in question all the information which a prudent prospective purchaser of the asset might reasonably require if he were proposing to purchase it from a willing vendor by private treaty and at arm's length.

17. It was common grounds that CISX was a recognised stock exchange and that section 273 therefore had no direct application to the valuation of shares in BBG."

11. We are not bound by these sentiments but we agree with them. They were (broadly speaking) the principles which we were urged to adopt by the appellants and we do not believe that HMRC take issue with them. However, there was some further principles set out in Judge Cannan's decision in *McArthur* which we believe to be relevant and those are set out below:

"165. In my view the correct approach is straightforward. It is a case of identifying the highest price a reasonably prudent purchaser would pay. Not the highest price a range of reasonably prudent purchasers might pay. Expert evidence is a proxy for the reasonably prudent purchaser and different valuers might come up with different estimates. In that

case, it is necessary to consider on the balance of probabilities and based on the reasoning of the experts who is right or where in the range the highest price lies.

166. Mr Henderson made a fair point that the test can be looked at both ways. The valuer is looking for the highest price the hypothetical purchaser would pay and the lowest price the hypothetical vendor would accept. Where they meet, is the market value of the shares. It is also the case that section 272 envisages a single price which is the market value.

167. I do not accept Mr Firth's broader submission that different reasonably prudent purchasers might use different valuation methods. In my view, valuation is not simply a question of choosing one methodology and excluding consideration of other methods. In any particular case it is likely to involve looking at various methods, giving different weight to each method and arriving at a best estimate of the highest price the hypothetical purchaser would pay. Mr Firth accepted that proposition in his oral closing submissions. On that basis, the prudent purchaser would not simply look at one method of valuing a company's shares to the exclusion of all other methods. Indeed, Mr Bowes looked at certain averages of all the methods he considered in order to reach his conclusions. Mr Mitchell's approach was in fact closer to Mr Firth's submission, but even he used other methods by way of a reasonableness check. Having said that, I consider Mr Mitchell made an error in not taking into account his EBITDA approach at the first valuation date. I consider that the approach I am adopting is consistent with the authorities cited to me.

168. Mr Firth also submitted that in applying a methodology, if some reasonably prudent purchasers would take an optimistic view, for example as to maintainable earnings, then those views should be taken into account in applying the methodology. I do not accept the basis of that submission. It is not that different reasonably prudent purchasers might take different views as to maintainable earnings. I am concerned with the view of a reasonably prudent purchaser. If a reasonably prudent purchaser considered that there were a range of possible views as to the level of maintainable earnings, it is necessary to identify within that range what would be the highest price the reasonably prudent purchaser would pay, without being unduly optimistic or unduly pessimistic…………

177. Subject to that, the reasoning in *re Lynall* is applicable to the present appeal, although it concerned a private company not listed on a recognised stock exchange. The confidential information in that case included the fact that a flotation of part of the company's capital was being considered.

178. The Court of Appeal in *re Lynall* had held that it should be assumed that the prudent purchaser would make all reasonable enquiries and that he would receive true and factual answers to reasonable enquiries. Hence, information as to the flotation would have been available. The test was by reference to what a reasonable board of directors would disclose, and not what the particular board of directors would have disclosed.

179. The House of Lords held that a sale in the open market would not involve release of any confidential information to prospective purchasers. Such information was not to be taken into account in ascertaining the market value of the shares. A sale in the open market was contrasted with a sale by private treaty, where such confidential information might be available.

180. Lord Reid stated at p696A that there was no general rule that directors must be supposed to disclose information which they were not obliged to disclose. He continued:

The farthest we could possibly go would be to hold that directors must be deemed to have done what all reasonable directors would do. Then it might be reasonable to say that they would disclose information provided that its disclosure could not possibly prejudice the interests of the company. But that would not be sufficient to enable the respondents to succeed.

181. Having said that, Viscount Dilhorne at least did not treat as confidential information accounts of the company already prepared and awaiting presentation to the shareholders."

FINDINGS OF FACT AND EVIDENCE

12. We were provided with a substantial bundle of documents. Both of the appellants provided witness statements on which they were cross examined. Expert evidence was given on behalf the appellants by Mr David Bowes of Bruce Sutherland & Co **("Mr Bowes")** and on behalf of HMRC by Mr Stephen Lygo of Parmentier Arthur Valuation Services Ltd **("Mr Lygo").** Both experts provided valuation reports on which they were cross examined as well as a joint statement prepared by them following virtual meetings on 2 September and 15 September 2020 which set out the areas of agreement and disagreement between them.

The factual background

13. As regards the factual background, there is little dispute between the parties, and we find it to be as follows:

(1) The Company was incorporated in England and Wales on 3 August 2005, under the name 121 Mountco 055 Limited. By a resolution dated 19 September 2005 the Company changed its name to Mount (York) Limited.

(2) On incorporation it had an authorised share capital of £1,000, divided into 1,000 ordinary shares of £1 each. One subscriber share was issued to Matthew Neale Smith which was transferred to Ebor Nominees Limited on 21 September 2005.

(3) On 21 September 2005, the Company:

(a) Sub-divided each of its existing shares (whether issued or unissued) into 1,000 shares of 0.1 pence each;

(b) Increased its authorised share capital to £25,000, divided into 25,000,000 ordinary shares of 0.1 pence each, which the directors of the Company were authorised to allot;

(c) Issued 5,399,000 ordinary shares (of 0.1 pence each), so that there were 5,400,000 ordinary shares in issue; and

(d) Allotted all the newly issued shares to certain individuals and Ebor Nominees Limited at par. None of the newly issued shares were allotted to Mrs Nice or Mr Robinson.

(4) On 28 September 2005 the Company issued a private placing memorandum (the "**Memorandum**") to raise £76,000 (before expenses) by the issue of 7,600,000 new ordinary shares of 0.1 pence each, to be allotted for a price of 1 penny per share. The

Memorandum stated that the Company had been formed to acquire companies and businesses operating in the "specialist engineering sector" that would "benefit from being combined into a group". The stated purpose of the placing was to raise funds which would be used for costs associated with the acquisition of such "potential target businesses". The placing was scheduled to open on 28 September 2005 and to close on18 November 2005 (although the placing period was later extended). It was expected that shares subject to the placing would be issued on 27 November 2005. The Memorandum also stated that the directors of the Company intended that shareholders who acquired shares as a result of the placing would be given an opportunity to participate in any further fundraising undertaken by the Company. The Memorandum also stated that the funds raised will be used to fund the due diligence and acquisition costs on potential target businesses and companies and as working capital for the Company. It also stated that the main criteria that the Directors have applied in identifying potential targets is to focus on small businesses which they believe have the capability to grow rapidly. It also warns investors that there is a risk that the anticipated growth might not materialise.

(5) On 29 November 2005:

(a) 97,765 shares in the Company were allotted to Mrs Nice in two tranches. The first tranche consisted of 73,500 ordinary 0.1 pence shares. Mrs Nice acquired these for £735.00 (i.e. for a price of 1 penny per share, as had been advertised in the Memorandum). The second tranche consisted of 24,265 ordinary 0.1 pence shares. Mrs Nice acquired these for £24,265.00 (i.e. for a price of £1 per share). It was HMRC's understanding that Mrs Nice acquired this second tranche of shares pursuant to a rights issue. As noted above, the Memorandum had indicated that subscribers for placing shares would be invited to invest further sums.

(b) 586,778 shares in the Company were allotted to Mr Robinson in two tranches. The first tranche consisted of 441,200 ordinary 0.1 pence shares. Mr Robinson acquired these for £4,412.00 (i.e. for a price of 1 penny per share, as had been advertised in the Memorandum). The second tranche consisted of 145,588 ordinary 0.1 pence shares. Mr Robinson acquired these for £145,588 (i.e. for a price of £1 per share). It was HMRC's understanding that, as in the case of Mrs Nice, Mr Robinson acquired this second tranche of shares pursuant to a rights issue.

(c) a firm of accountants, Garbutt & Elliott, produced a detailed financial due diligence report (the **"FDD report")** which had been commissioned in connection with a possible loan from Clydesdale bank to the Company. The FDD report included turnover forecasts for the Company for 2006 and 2007.

(6) Between 29 November 2005 and 16 December 2005 various other individuals acquired shares in the Company, either for 1 penny per share, or for £1 per share. It was HMRC's understanding that the shares acquired in this way for £1 per share were acquired pursuant to a rights issue (as had been anticipated in the Memorandum). The total number of shares allotted pursuant to the Memorandum for a price of 1 penny per share was 7,600,000 (as advertised in the Memorandum) and the total number of shares allotted for a price of £1 per share was 2,500,000. In the case of most individual subscribers the ratio of shares acquired for 1 penny to shares acquired for £1 was about 3:1. Following the issue of these additional shares the total number of issued and allotted ordinary 0.1 pence shares in the Company stood at 15,500,000.

(7) The placing period was extended so as to continue until 31 December 2005 by a resolution made on 18 November 2005.

(8) Prior to 30 November 2005, the Company was not trading and held no other assets apart from the cash raised from the share issues. On or about 30 November 2005, the Company acquired from third parties the entire issued share capital of a company called Redapt Engineering Company Limited ("**Redapt**"). Redapt carried on a business which involved manufacturing and distributing "thread conversion components" used in items such as electrical adaptors and plugs utilised within hazardous environments. The consideration for this purchase was £3,525,000.

(9) On or about 2 December 2005, the Company acquired from third parties the entire issued share capital of a company called Hi-Flow Valves Limited **("Hi-Flow").** Hi-Flow carried on a business which involved the distribution of industrial valves for the oil and related industries. The purchase price for Hi-Flow was a maximum of £3 million with £2.4 million in cash paid on completion. A further £100,000 was held in an escrow account subject to certain warranties on net asset value and up to a further £500,000 in cash was payable subject to Hi-Flow meeting profit targets in the two financial years following the acquisition.

(10) The Company financed its acquisitions of Redapt and Hi-Flow by means of (i) the funds raised from the allotment of shares to investor; and (ii) two loans from Clydesdale Bank totalling £3,500,000.

(11) On 8 December 2005, Ogier Corporate Finance Limited **("OCF")** wrote to the Company confirming their capacity to advise the Company in their listing of 15,500,000 ordinary shares of 0.1 pence each on the Channel Islands Stock Exchange (the **"CISX")**. On 19 December 2005, the Company's board of directors resolved that the documents for the purposes of listing on the CISX and the letter of engagement with OCF be approved. On 20 December the Company applied to the CISX for admission of all of its 15,500,000 shares to the "Official List" of the CISX (the "**listing application**"). Admission to the Official List brings with it an obligation to comply with the CISX Listing Rules (the **"Listing Rules").**

(12) The application was accepted and on 21 December 2005 the entire share capital of the Company was placed on the CISX.

(13) The listing application has, appended to it, an illustrative proforma statement of combined net assets of the Company, Redapt and Hi Flow. The total fixed assets are valued at £4.978 million of which £4.418 million is goodwill. The total net assets amount to £2.5 million. It also identifies a number of documents which would be available for inspection during normal business hours on any weekday at the offices of OCF. These included the accounts of High-Flow and Redapt but did not include the FDD report.

(14) Listing Rule 6.9.3 sets out a general obligation of disclosure for issuers (which would include the Company). It provides (relevantly) "Generally and apart from compliance with all the specific requirements of these Listing Rules, the issuer shall keep the public, the Exchange, the holders of the securities of the issuer and other holders of its listed securities informed as soon as reasonably practicable of any information relating to the group (including information on any major new developments in the groups sphere of activity which is not public knowledge) which "……. might reasonably be expected materially to affect market activity in and the price of its securities." Listing Rule 6.9.4

provides that "Information that is required to be disseminated pursuant to Rule 6.9.3 or otherwise under these Listing Rules must not be given to third party before it is notified to the Exchange except as permitted in this Rule. [It is common ground between the parties that the exception does not apply to the circumstances of this case]. Listing Rule 6.9.9 is headed "Equality of treatment" and reads "an issuer must ensure equality of treatment for all holders of securities of the same class who are in the same position."

(15) On 20 December 2005, the Company applied for listing of and permission to deal in its 15,500,000 ordinary shares of 0.1p each on the Official List. The application was accepted and on 21 December 2005 the entire share capital of the Company was placed on the CISX.

(16) Following the Company's admission to the CISX, Winterflood Securities Limited (**"Winterflood"),** an independent financial consultancy group, was appointed to act as a market-maker in the Company's ordinary shares. Winterflood, was bound by the CISX Membership Rules **("the Membership Rules")** in force at that time (dated April 2000).

(17) Paragraph 5.13(2) of the Membership Rules states that the market-maker must "enter and maintain at all times two- sided quotations on the trading system; and actively offer to buy and sell a security at a price and in a size up to that displayed by it". Paragraph 5.14 of the Membership Rules provides that the market-maker's quotation "must be at least in the minimum quoted size for the security, as specified by the [CISX]". Paragraph 5.24 states that the Market Authority (the body which operated the CISX) shall publish a list of the minimum quotation size for each listed security, which shall be decided upon in consultation with trading members which are registered as market-makers in those securities but shall initially be set to equate to a value of approximately £5,000. Due to the passage of time, the parties to this appeal are unable to find any evidence of the size of the shares that Winterflood committed to buy and sell. The relevance of this is discussed later in this decision.

(18) Following the listing of the shares in the Company, some limited trading of them occurred on the CISX. The CISX trade price data for the Company for the relevant period was as set out in the following table. The identity of the participants in these transactions is not known. It was HMRC's understanding that the shares were bought and sold almost instantaneously.

Buy/Sell	Price (£)	Size	Date
Buy	1.040	2,500	21.12.05
Sell	1.050	2,500	21.12.05
Buy	1.040	2,500	22.12.05
Sell	1.055	2,500	22.12.05

(19) On the relevant date Mrs Nice donated all 97,765 of her shares in the Company to the charity Street Kids Community Village Children's Trust (the **"Children's Trust").**

(20) In her tax return for 2005/06, Mrs Nice claimed relief under section587B in respect of her gift of her shares in the Company to the Children's Trust. Mrs Nice claimed relief on the basis that the value of her shares was £102,653, which was derived from the price at which the shares were listed on the CISX (i.e. £1.05 per share).

(21) On 4 October 2007, HMRC opened an enquiry into Mrs Nice's tax return for the year 2005/06. On 23 April 2013, HMRC issued a closure notice in respect of their enquiry into Mrs Nice's tax return and reduced the amount in respect of which she could claim relief under section 587B from £102,653 to £25,028. The closure notice was upheld on review on 6 November 2017. On 21 November 2017, Mrs Nice notified her appeal against the conclusions in the closure notice to the FTT. She appealed on the grounds that the share valuation used for the purposes of the closure notice was below the correct value and did not represent the net value received by the charity following the gift of the shares.

(22) On 11 January 2006, Mr Robinson donated all 586,788 of his shares in the Company to The Manchester Camerata Trust and Tall Ships Youth Trust (the **"Robinson Charities"**).

(23) In his tax return for 2005/06, Mr Robinson claimed relief under section 587B in respect of his gift of his shares in the Company to the Robinson Charities. Mr Robinson claimed relief on the basis that the value of his shares was £616,128, which was derived from the price at which the shares were listed on the CISX (i.e. £1.05 per share).

(24) On 19 June 2007 Mount Engineering launched an offer for the Company at 70p per share to be satisfied either in cash or by the issue of one Mount Engineering share for every share in the Company. The offer was declared unconditional on 2 July 2007 and valued 100% of the Company at £10.85 million.

(25) On 28 December 2007, HMRC opened an enquiry into Mr Robinson's tax return. On 16 May 2013, HMRC issued a closure notice in respect of their enquiry into Mr Robinson's tax return, and reduced the amount in respect of which he could claim relief under section 587B from £616,128 to £150,218. The closure notice was upheld on review on 27 October 2017. On 23 November 2017, Mr Robinson notified his appeal against the conclusions in the closure notice to the FTT. According to his grounds of appeal, he was not in agreement with HMRC's independent valuer's report (see below) valuing the shares at 25.6p per share and was of the opinion that the value per share was far higher.

(26) For the purposes of issuing closure notices, HMRC commissioned a preliminary valuation report from Mr Daniel Ryan (FTI Consulting LLP). Mr Ryan concluded that the correct market value of the shares in Mount York at 11 January 2006 was no greater than 25.6 pence per share, indicating that the various claimed gifting prices, and the transaction prices of £1.05 per share, represent a significant overvaluation. The share value used in the closure notices came from this report.

(27) Under cover of a letter dated 31 March 2008, HMRC received an undated valuation analysis (the **"Afortis report"**). This is a two page document ostensibly compiled by Afortis Ltd, a tax consultancy which was dissolved in July 2017. It contains projections for the Company's financial performance for 2006 and 2007, and projects post-tax profits in 2006 of £896,000 and in 2007 £1,183,000.

The factual evidence

Mrs Nice

14. Mrs Nice had made a witness statement in which she said: before she retired in 2008, she was a financial adviser with St James Place Partnership; she had considerable experience as a

financial adviser; she has considerable experience in investing in shares and other personal investment opportunities; at the time of investing in the Company, she had knowledge of the CISX; the opportunity to invest in the Company was presented to her by a financial management company **("Champion");** Champion had a good track record in picking shares which would grow in value; she had purchased shares in a company **("F2G")** recommended by Champion; her experience of the people who were behind the Company was a positive one; when she originally invested she understood that the Company would invest into subsidiary companies and would then look to list on a stock exchange; her experience as a financial adviser enabled her to recognise the benefits of listing; based on her previous experience of F2G which had grown considerably in value following her investment and the people involved in this venture, she believed there was a good chance of success and that her investment in the Company would rise in value; she knew that if she gave her shares to her chosen charity she would benefit from tax relief based on the value of her gift; her charity had benefited from the gift of her shares in F2G and she thought that by giving the charity her shares in the Company, both she and her charity would benefit; she has been heavily involved in the works of her charity since its registration in 1994 and in addition to her personal donations, she was a trustee of the charity and had worked to secure funding for the charity; so she has a considerable emotional investment in the charity and did not see it as something to provide her with a means of tax relief; she has found the enquiry over the last 10 years very stressful.

15. In cross examination Mrs Nice added: she was not concerned that the shares were to be listed on the CISX, rather than on AIM or the London Stock Exchange; she presumed that the Company had its reasons for this; she was not concerned that she was asked by Champion to include a DOTAS number on her return and did not ask them why she had to do so.

Mr Robinson

16. Mr Robinson had made a witness statement in which he said: he is an accountant, and amongst other professional qualifications, is a Fellow of the Institute of Chartered Accountants in England and Wales; he has specialised in corporate affairs for over forty years and has been involved in the valuation and negotiated sale of several hundred businesses; many of these companies were involved in engineering and manufacturing; when conducting these negotiations he was advised by specialist valuers; he regarded such valuations as a necessary starting point but was always aware that there could be substantial differences between those valuations and the actual prices which could be negotiated with specific buyers; he was always aware of both the process and the advantages of flotation; Champion had advised him for some years in relation to his accounting and tax affairs; he invested in F2G; he made a considerable profit from the sale of the shares on which he paid capital gains tax; Champion made him aware of the opportunity to invest in the Company; at the time when the Company purchased the two subsidiaries, he knew that the sectors in which those subsidiaries operated were undergoing strong growth and expansion; he understood that the owners of Redapt were anxious to sell and that the Company might therefore be able to acquire the shares at a bargain price; he believed the market sentiment would help obtain a premium on a sale of his shares over any "nuts and bolts" valuation since the shares were to be floated on a stock exchange, the people behind the Company would drive the business, and that Redapt was likely to be acquired at an advantageous price; he thought the flotation price of £1 or so was conservative and on this basis he invested; he was at the relevant time a director of a charity which ran the Camerata Orchestra in the North West of England; the orchestra did much work in the community, as well as putting on concerts, and needed funds; he believed that Gift Aid was designed to encourage individuals to give some of their wealth to help charities; he decided to give half of his shares in the Company to this charity in the belief that they would provide the charity with substantial

income when the shares were sold and the tax relief which he would receive enabled him to give a larger proportion of his shares to the charity than would otherwise have been the case; when the shares in the Company were sold at 70p per share, the amount realised by the charity was over £200,000; he had also given a number of shares in the Company to a second charity who also benefited by approximately £200,000 when the shares were sold; his view is that valuation on flotation of 25p per share puts no value on the Company's market niche, its prospects, its new management team, and the fact that as a listed company, there would be a better market for its shares than would be the case if it were a private company; he has found the enquiry, the litigation, and the length of time it is taken to resolve these appeals, very stressful;

17. In cross examination Mr Robinson added: he accepted that the relevant tax return included a DOTAS number but could not remember putting it there or seeing it on his return; his view of DOTAS was it applied to a wide range of schemes some of which were avoidance and some of which were not; he had always understood tax evasion to be illegal and avoidance to be legal; he could not remember where he obtained the information that one of the Company's targets was Redapt, nor where he obtained the information that its owners were keen to sell; he was not aware that most of the companies which were listed on the CISX were investment companies and even if he had known, it would not have worried him; what concerned him most were restrictions on his ability to sell, and there would be no such restrictions on whatever stock market the shares were to be listed on; he could not remember taking any advice from anyone concerning the value of the shares in the Company when he was being asked to invest in it; he was given no information about the market-maker; he would not have accepted 70p per share as he felt, in his bones, that that undervalued the Company;

The expert evidence

Mr Bowes

18. In his report, Mr Bowes said that the information which would have been available to the reasonably prudent purchaser comprised:

(1) details of all transactions in any relevant securities to date;

(2) details of its then current assets and liabilities;

(3) any available financial information relating to the Company.

(4) The historical trading performance of the MYL subsidiary companies;

(5) Whether the Company produced forecasts or budgets and if it did, copies thereof to be provided if appropriate;

(6) Details of the underlying assumptions upon which those forecasts were based;

(7) A comparison between forecasts and actual results, to establish, where appropriate, why differences had arisen;

(8) Information as to the sector or industry in which MYL operated at the time.

19. This information would have included the FDD report.

20. His view was that although relatively little information might have been in the public domain, all this information was already in existence and would have been both requested by a purchaser and provided to that purchaser. Without such knowledge and information it is difficult to see how any hypothetical purchaser would have been able to make any sort of informed judgment as to whether he or she should purchase shares in the Company.

21. He valued the Company on a number of bases and his conclusions are set out in the table below:

Valuation methodology	Value per share
Transaction price	105 pence
PE ratio – Comparables as listed company	132 pence
PE ratio – Comparables as unlisted company	80 - 93 pence
PE ratio - Transactions	118 pence

22. The average of the foregoing is £1.06 per share

23. Since the shares were listed on the CISX, it was his view that subject to exceptional circumstances, market value could be determined as the listed price. This is because the best indicator of market value is the price achieved in sales of the same or similar assets. Evidence of that listed price were the four trades which took place on 21 December 2005. Given that there were no restrictions on the transfer of the shares and that there was a market-maker, any lack of liquidity, if it existed at all, could not be a compelling argument against valuing the shares on this basis.

24. He stated that the conventional approach is to use the PE methodology in other words to apply a suitably adjusted multiple derived from broadly similar listed companies to the maintainable post-tax profits of the Company. He provided a list of companies which he believed to be broadly comparable in activity or operated in the same sector as the Company at the relevant date. These are set out below:

Comparables			
	Market	**Historical**	
	Capital	**PE**	**PBT**
		Multiple	**Multiple**
Renold	41.90	N/A	N/A
Avingtrans	N/A	N/A	N/A
Goodwin	43.70	17.20	12.04
Spirax Sarco	670.50	18.50	12.95
IMI	1769.00	N/A	N/A
Fenner	271.50	23.20	16.24
Rotork	594.70	26.20	18.34
Weir	802.40	33.80	23.66
Melrose	360.00	N/A	N/A
Renishaw	N/A	N/A	N/A
Bodycote	712.80	20.50	14.35
Severfield	205.20	20.60	14.42

25. Three of these companies namely Rotork, Spirex Sarco and Weir carry out activities which were close to those carried out by the Company and were therefore better comparables. The average multiples of these three companies were 26.17 (PE) and 18.32 (profit before tax) ("**PBT**"). Application of those multiples to the 2006 and 2007 forecasts in the FDD report would indicate that the Company should be valued as follows:

	2006 Forecast	2007 Forecast
PBT	£1,084,000	£1,029,000
Multiple	18.32	18.32
Company Value	**£19,859,000**	**£18,851,000**
PAT	£758,800	£846,300
PE Ratio	26.17	26.17
Company value	**£19,858,000**	**£22,148,000**

26. This will give a range of prices to the shares between £1.22 and £1.43. The midpoint is £1.32.

27. One justification for using a higher rather than a lower PE ratio is the fact that the Company was looking to grow. It was funded by a mixture of debt and equity, it was operating in a growth sector, it had a management team with a proven track record of growing businesses, and it was not intending to pay dividends. Smaller companies which start from a lower base are often perceived by markets to have greater growth potential, and one example of this was a company called Tasty plc whose shares were listed on AIM at a placing price of 52p per share. Its profits in the previous year had been only £110,000. At the end of trading on the day of listing its shares had doubled in price to £1.04 resulting in a PE ratio in excess of 200. This is clear evidence of the potential value in smaller companies which are perceived to have potential for fast growth and that will be recognised in its rating by the markets and by investors.

28. If HMRC is right and the price should be discounted for lack of liquidity, the discount should be between 30 and 40%. A 30% discount would result in the value range of 85-100p per share, the median being 93p and a 40% discount would produce values of 73-86p per share, the median being 80p.

29. He thought the earnings to which the multiples should be applied should be based on the forecasts set out in the FDD report. These forecasts predicted turnover of £6,010,000 in 2006 and £6,366,000 in 2007. On his calculations this meant that the Company would make post-tax profits of £758,800 in 2006 and £846,300 in 2007.

30. He also used the technique of transaction multiples to value the shares. This is because some valuers prefer to adopt multiples that might operate when there are sales of majority interests in companies which are not listed. He had been able to identify a number of transactions but acknowledged that neither the activities of these companies nor the date of the transactions were ideal for comparability purposes. Taking away two outliers, the average PE ratio was 22.7 which when applied to the aforesaid earnings would result in values of between £1.11 to £1.24 per share which he averaged to £1.18 per share.

31. When Hi-Flow had been acquired, based on the post-tax profits, it appeared to have been acquired on a multiple of 6.84. When Redapt was acquired, at face value the post-tax profits imply the transaction multiple of 11.89. However, directors remuneration had to be added back in order to determine maintainable earnings which resulted in the implied multiple of 4.38. This is considerably lower than those set out in the table at [25] above, and his conclusion was that these two businesses were required for low prices thus offering a great opportunity to the Company to grow their value.

32. He considered the role of Winterflood, the market-maker. In his view this supported his opinion that no discount should be given for lack of liquidity. As part of his research for the preparation of this report, he went online to see what was said about Normal Market Size. He found the following on Yahoo!:

> "The Normal Market Size is the maximum number of shares in a listed company that can be traded in a single transaction at the price quoted by the market-maker. The Normal Market Size is normally set at 2.5% of the total volume of shares for a given company. This stops very large trades from affecting the share price as market-makers are not obliged to provide quotes for transactions which fall outside of the normal market size."

33. When considering whether a discount for lack of marketability should be applied, he said there was no set rule but in his experience it is likely that a discount of 30% might be appropriate in the case of smaller companies but that it did not seem to him that such a discount would be appropriate in the case of the Company. He cited an extract from an International Valuation Standard which states that "a DLOM should be applied when the comparables are deemed to have superior marketability to the subject asset. A DLOM reflects the concept that when comparing otherwise identical assets, a readily marketable asset would have a higher value than an asset with a long marketing period or restrictions on the ability to sell the asset. For example, publicly traded securities can be bought and sold nearly instantaneously while shares in a private company may require a significant amount of time to identify potential buyers and complete a transaction……" It was his view that the shares in the Company were listed on a recognised stock market at the relevant date and were therefore publicly traded securities. He could see no reason therefore why any discount for lack of liquidity or lack of marketability would be appropriate save perhaps where the market-maker was asked to provide bid and ask prices for holdings in excess of the Normal Market Size, which was not the case here.

34. In cross examination, Mr Bowes added: it is possible that a listing on the London Stock Exchange would have a greater impact on a share price than a listing on the CISX, depending on the perception of the company; he accepted that if you are trying to buy shares in a company listed on the London Stock Exchange it was unlikely that a purchaser would be provided with the document set out at [18(3)] above by the Company; he accepted that the FDD report fell within the ambit of Listing Rule 6.9.3; he took the view that confidential information would be made available to a potential purchaser; the information issue is however very complicated and opinions on it vary but that the FDD report would have been made available and so took it into account in his valuations; it is easier to grow a small business from, say, £1 million to £2 million than it is to grow a larger business from £100 million to £200 million; he was unsurprised that there were only four trades in the shares between listing and the relevant date given that it was Christmas/New Year, and so there were nine missing trading days due to holidays; he would not disagree with the proposition that the benefits of the synergies anticipated by the Company which would enhance the value of the subsidiaries would not have materialised by the relevant date; but they might have been put in train; Winterflood, as an experienced market-maker, must have appreciated that they might have to buy Mr Robinson's shares at £616,000 and Mrs Nice's at £245,000; the evidence from the Companies House records regarding the issue of the shares simply shows that the issues were notified to Companies House on the same day but does not necessarily mean that the issues happened on the same day; he accepted that his three comparables of Rotork, Spirex Sarco and Weir were much bigger and diversified than the Company; and that they paid dividends; but he offset these differences by the growth prospects which were greater for a smaller firm; it is not possible to get a perfect comparison; he has not manipulated the numbers, it is just the way that they fell; there was not an enormous increase in value between the date on which they were traded in December 2005 and the date on which the capital was raised since the shareholders had subscribed for shares at £1 and they had only gone up to £1.05 on the day they were traded; he cannot remember how he identified the transactions when valuing the shares on the basis of transaction multiples; there was no need to exclude outliers from the comparables for the PE multiples since they were much closer in activity than the transaction multiple transactions; listed company shares are always valued on a minority basis; his methodology of applying an historic multiple to the 2006 and 2007 projections was consistent with the profits which had been achieved historically; he did not take one year in isolation; he had not undertaken a valuation of the shares prior to listing; it was his view however that the share price was more than 16p per share at the time of listing; he values the shares in an earnings basis; he did not directly address the uplift in value (which Mr Lygo had put at 558%) which resulted from his valuation; he interpreted the word "should" in the IVS as discretionary rather than mandatory; it is hard to disagree with the proposition that the liquidity of shares on the CISX is less than the liquidity of shares on the London Stock Exchange; but the Company was still a listed company and the liquidity of its shares had improved substantially as a result of the listing; it is commonly the case that there are material differences between using pre-tax and post-tax profits, as is the case for the Company in 2007, so he was not unduly concerned about this difference; it was an unfortunate coincidence that his values came out close to the transaction price of £1.05; if his results had come out at less than this he would have used that lower figure; he did not check the implications of that value to verify his conclusions.

35. On re-examination he listed the relevant factors for growth as being; there was debt funding, the engineering sector was a growth area, the Company was not planning to pay any dividends, and the board of the Company comprised directors who had already enjoyed successful careers and were people whom investors could trust. He also added that the listing was undertaken by way of an introduction of existing shares into the market rather than by the issue of new shares.

Mr Lygo

36. Mr Lygo summarised his conclusions as follows:

i) The £1.05 price on two share sales on CISX in December 2005 was not a reliable guide to value as the Company's shares were traded too thinly for a proper market price to have been established;

ii) The Appellants purchased their shares at an average cost of approximately 25.6 pence per share less than one month prior to the CISX share listing.

iii) While the price that the Company paid for Redapt may have been below market value, the implied fourfold increase in Mount's share price on admission to CISX was unrealistic.

iv) The Afortis valuation was based on profit forecasts that cannot be substantiated from the documents available and applied an unrealistically high profit multiple which gave the Company the same market rating as much larger, longer established companies with a history of paying shareholder dividends;

v) The Company was bound by the Listing Rules and the provisions they contained, which require that all investors and holders of the same class of security are treated equally;

vi) He considered it highly unlikely that unpublished and confidential information such as financial forecasts and due diligence reports concerning Mount would have been made available to a potential purchaser of either of the valuation holdings;

vii) In his opinion the most appropriate methodology to use in valuing the valuation holdings is the earnings basis which applies a market derived multiple to the subject company's after tax earnings per share:

viii) He estimated the Company's notional earnings per share for 2005 at 5.5p and considered that a price earnings ratio of 6.3x – 7.6x was the most a prudent purchaser would have paid given the information assumed to be available on the valuation date.

ix) In the light of the above, he considered that the market value of the Company's shares at the relevant date did not exceed 42 pence each and may have been as low as 35p. On that basis he concluded that the market value of the shares reflected the mid-point of that range, i.e.39p per share.

37. As mentioned above, he accepted that the shares in Redapt may have been undervalued. He analysed the relevant data and came to the following conclusion:

	£	**£**
Underlying earnings (per FDD)	1,033,000	1,033,000
Less management cost	(85,000)	(85,000)
Adjusted operating profit	948,000	948,000

Multiple	5.6x	6.5x
Indicative value range	**5,308,800**	**6,162,000**

38. His view on the basis of the above analysis is that the price which the Company paid may have been below Redapt's market value, which was plausibly in the approximate range £5,000,000 - £6,000,000 at that time.

39. He did not think that Hi-Flow had been undervalued. On his calculations, using adjusted operating profit, Hi-flow had been bought on a multiple of between 6.3 and 9.5 using the March 2005 figures which, if annualised to September 2005 meant a multiple of between 8 and 9.5.

40. Mr Lygo took the view that the FDD report would not have been available to the reasonbly prudent purchaser for the reasons briefly summarised above and which will be dealt with in greater detail later.

41. He then took, as his "straw man" the Afortis report, and this is dealt with below. However, the criticisms which he levelled at that report are, in his view, equally apt to the methodology adopted and conclusions reached by Mr Bowes in his report. They are therefore of considerable relevance even though the appellants do not rely on the Afortis report save to the extent that it includes forecasts which are more optimistic than those set out in the FDD report. More of this below.

42. We set out below extracts from Mr Lygo's report since his comments are best made in his own words. "Mount" is the Company. The factors set out at 4.29 of his report are referred to later in this Decision as "the depreciatory factors".

> "4.29 The £1.05 share price quoted on CISX implies PERs of 18.95x in relation to my estimated post tax profit and 20.04x using the slightly lower Afortis figure. Given the minor difference of 0.3 pence between the respective EPS figures, the principal question to be addressed in valuing Mount's shares on the valuation date under the published information assumption is whether or not PERs in the approximate range 19.0x – 20.0x could be considered realistic for Mount in the light of the following:
>
> a) Mount was a new venture combining two small private companies and did not have a track record of profitable trading as a group.
>
> b) Mount had just taken on significant external debt which would have to be serviced, requiring both interest and capital payments to be made quarterly to the Bank out of its operating cash flow.
>
> c) There was no present prospect that a dividend would be declared on Mount's shares given other demands on cash.
>
> d) A prospective purchaser would have to estimate historical profit based on the limited available information, which included unaudited accounts in the case of Redapt, and could not rely on a statement of notional Group earnings from Mount.

e) Without access to forecast financial information, the purchaser would not know how Mount's directors expected the Group to perform in the short-medium term.

f) The purchaser's knowledge from the CISX Application that Mount's shares had been subscribed for at an average cost of approximately 25.6p each.

g) The two share trades that had taken place prior to the valuation date involved only 2,500 shares on each occasion at a combined traded value of less than £5,300.

h) CISX was dominated by companies operating investment funds, with very few trading companies such as Mount. That being the case, it would be reasonable for a prudent purchaser to proceed on the assumption that the CISX listing would not necessarily provide an active market for Mount's shares…………..

4.33 In the light of the above, it is surprising that the prior year PER of 19.0x Afortis applied did not incorporate any discount from the average calculated from the five companies selected. The question of the discount appropriate in any situation is a matter of valuer judgement arrived at given the facts of the particular case and the benchmark used as a reference point. In my opinion, Mount's smaller size, its lack of an audited trading record as a group, uncertainty as to when it would be in a position to begin dividend payments and the reasonable presumption that a CISX listing would give much less liquidity that a listing on the LSE would result in a PER significantly lower than 19.0x – 20.0x at the valuation date.

4.34 Allowing for those factors, and also the lack of information concerning current trading and expected future profit levels, I consider that a prudent purchaser would have discounted the average PER of these companies by 65% - 70%. The indicated PER range on the valuation date would then be approximately 5.9x – 6.8x, giving a possible value of 32.7 pence – 37.7 pence for each Mount share assuming EPS of 5.54 pence.

4.35 As explained above, the use of FTSE share indices is an accepted alternative source of market evidence concerning the PERs of publicly listed companies. In my experience the FTSE All-Share Index is the most commonly used of the general share indices. As the FTSE All-Share Index is broadly based, including smaller companies, the discounts applied may be lower than in the case of, say the FTSE 100 or FTSE 250 which comprise the largest companies listed on the London Stock Exchange. Sector specific indices are also available, although only the largest companies operating in the sector are included and the index is computed using the average of the constituents' data weighted by their respective market capitalisations. As such, the sector indices have an in-built bias towards the largest companies in a given sector, so that the discount applied in determining the PER applicable to the subject company may be greater than if the FTSE All-Share Index was used as a benchmark. Although the companies contributing to the sector indices is not published, it is highly likely that Bodycote, Rotork and Spirax-Sarco were included as they were three of the seven largest companies by market capitalisation in the Industrial Engineering sector grouping in January 2006……

4.36 The Industrial Engineering sector PER was higher than the FTSE All-Share, and was also at a premium to both the FTSE 100 and FTSE 250, which suggests that the market considered it had strong growth prospects. Taking into account the factors which I believe would cause a prudent purchaser to approach an investment in Mount with caution (identified above in 4.29), I considered that a discount of 60% - 65% was realistic

in the case of the FTSE All-Share PER. I increased this to 70% - 75% for the Industrial Engineering index PER, which was calculated using the share prices of the largest companies in the sector. The discounted PER range on that basis is 5.2x - 7.6x as shown below.

Table 38

Source	**PER**	**Discount %**	**Discounted PER**
FTSE All-Share	15.20	60% - 65%	5.3 – 6.1
FTSE All-Share excluding investment companies	14.93	60% - 65%	5.2 – 6.0
FTSE All-Share excluding multinationals	15.48	60% - 65%	5.4 – 6.2
Industrial Engineering	25.28	70% - 75%	6.3 – 7.6

4.37 Applied to my estimate of Mount's pro forma prior year EPS of 5.54 pence, this gives a potential market value range for each Mount Ordinary share of broadly 28.8 pence – 42.1 pence. The implied market capitalisations are shown in the next table.

Table 39

	Low	**High**
EPS	5.54p	5.54p
PER	5.2x	7.6x
Share value	28.8p	42.1p
Shares in issue	15,500,000	15,500,000
Market capitalization	£4,495,000	£6,510,000

Conclusion

4.38 In the light of the above analysis, the market value of Mount's Ordinary shares was plausibly in the range 29 pence – 42 pence on the valuation date, reflecting a price earnings ratio of between 5.2x and 7.6x applied to estimated prior year earnings per share rounded to 5.5 pence. Allowing for the higher average PER for the Industrial Engineering sector, the grouping most relevant to Mount's business activities, I considered that value was between 35 pence and 42 pence on the valuation date reflecting a discounted PER range of 6.3x – 7.6x. In my opinion, the approximate mid-point of that narrower range, 39 pence, fairly represents the market value of Mount's Ordinary shares on 11 January 2006.

4.39 The Appellants paid an average price of 25.6 pence per share for their shareholdings and my opinion of market value implies an uplift of around 52% on their acquisition cost in November2005. I consider that increase reasonable in circumstances where the initial acquisitions had been completed, £3,500,000 of new bank debt had been taken on, and Mount's shares had obtained a public listing, albeit on a stock exchange likely to offer only limited trading opportunities. Conversely, I cannot envisage that these developments could possibly have supported an increase of over 310% in the value of Mount's shares compared to the price paid by investors prior to the listing and consider that unrealistic.

4.42 A share value of 39 pence would equate to a market capitalisation for 100% of Mount of £6,045,000 compared to Mount's pro forma net asset value of £2,500,000 shown in the CISX Application. The implied premium over the cash value of the Redapt and Hi-Flow transactions is therefore approximately 142%. I believe that is consistent with my view that Redapt may have been acquired at a favourable price (see 3.46) and the directors' stated intention to achieve "a significant premium" on the cash value on a future public listing of Mount's shares."

43. Based on the financial information in the listing application in which the net asset value of the Company had been identified as being £2,500,000, Mr Lygo computed the net asset value per ordinary share of the Company as being 16.1p at the time of the Memorandum. He simply divided that asset value by the number of shares in issue.

44. He also took the view that the post-tax profits of the Company to which the multiple should be applied is £859,348.

45. In cross examination, Mr Lygo added: his position was that the forecasts in the FDD report would not have been available to the prudent purchaser; he had however come up with a share valuation on the basis that he was wrong on this and, given that the valuation showed that the profits of the Company would fall in 2006, had valued the shares at 33p on that basis; he agreed that the listing application, the Memorandum and the Hi-Flow and Redapt accounts would have been available to the prudent purchaser; he could not see why if the FDD report was not provided to the public as part of the listing application, it would have been provided, later, to a prudent purchaser; there would be no motivation for the Company to provide the FDD report to a prudent purchaser; he used the FDD report since it neatly packaged contemporaneous facts; this was not hindsight; he had considered the Afortis report since it was his understanding that the appellants were relying on it, but had only recently discovered that they were not; but much of what he says about Afortis is also relevant to his views on Mr Bowes' report; he denied using hindsight but considered that subsequent events might provide a useful sense check for his initial conclusions; he accepted that the 1p shares and £1 pound shares were intended to raise money for separate purposes but the intended two-stage process became blurred; the 1p shares were issued only two days before the decision to buy Redapt; he accepted that smaller companies have a greater potential for growth than larger companies but that does not mean that the growth will happen; he had not said that Redapt had been acquired cheaply, he said that it may or might possibly have been acquired cheaply which would have given comfort to a purchaser; but that was not enough to bridge the gap between 16p and £1.06; in the pro forma balance sheet in the Memorandum there is approximately £4.4 million of goodwill which reflects the price paid for the subsidiaries over their tangible asset value; this goodwill will reflect the future profitability of the subsidiaries; if the transaction price of £1.05 per share is multiplied by the number of shares, that gives a net asset value of the Company of £16.27 million; deducting the £2.5 million but adding the existing £4.4 million means that

goodwill would have gone up to over £18 million; it would seem incredible that this additional value would have been created by the acquisition of the two subsidiaries; he thought it implausible that the value would have increased that much between the date on which the shares were issued and their listing on 20 December 2005; the multiple depends on growth, but also depends on paying dividends; a company's dividend policy would be taken into account by the prudent purchaser; it would have been implausible to a prudent purchaser to use a multiple of 20–25; the three comparable companies used by Mr Bowes were all growing, paying dividends, and there was an active market in their shares; the multiples would have been lower if there had been less trading and they had not been paying dividends; he did not believe that the forecasts used in the FDD report were unrealistically cautious and that the Company was not setting out a realistic position; in his experience when seeking borrowing, a company would put its best foot forward and provide the best realistic figures; it would not talk down its creditworthiness; it is unlikely that the Company would have produced two forecasts, one for the bank and one for investors; borrowing brings with it an obligation to pay back capital and interest; cash in the Company would have been needed to do this even if the Company was not going to pay dividends; not all stock exchanges are equal; the total value of all shares traded on AIM in 2005 was £42 billion; trading on the CISX in the same period was only £22 million of which £19 million was trading in investment funds; a prudent purchaser would consider how easy it would be to sell any shares that he or she acquires; it would be an important factor; the prudent purchaser would ask whether they could actually trade their shares once bought even if there is a theoretical market; the prudent purchaser would also be interested in dividends; if the four trades on 21 and 22 December 2005 were in the public domain and the shares had traded at (on average) £1.05 then he was very surprised that a large number of shareholders had not taken the opportunity to sell, having purchased the shares at an average price of 25.6p; it was a fantastic investment return; the sale of one share would cover the cost of buying four shares; the cash could then be given to a charity who might appreciate that more than shares in companies listed on an illiquid market; he was very surprised, therefore, that there had not been more activity once these prices were in the public domain; it made no sense that not a single person took advantage of this opportunity; when considering Normal Market Size, volume is trading activity not total share capital; we do not know whether the four trades in December 2005 were between arm's-length or connected parties; a prudent purchaser would not take the trades at face value especially given the prices compared with the balance sheet values of the Company on listing; the prudent purchaser would also consider whether that price was expensive compared with shares on the London Stock Exchange; his method of valuing the shares is set out at paragraph 4.37 of his report; in his view that is what a prudent purchaser would do; his starting point was the published indices and not the Afortis report; he would have done the same even if he had not needed to consider that report; the prudent purchaser would have considered the engineering sector and given it greater weight, but would have also understood that the multiples reflected the characteristics, including the size, of the companies which made up that sector; having taken the multiples as a starting point, they need to be adjusted for scale, lack of liquidity, lack of information and absence of dividends; his discount of 60 to 75% against the value of the shares listed on the London Stock Exchange is simply a judgment call on his part; he defended the depreciatory factors; the hypothetical prudent purchaser would want both capital growth and dividends even though these particular investors might have wanted capital growth; a prudent purchaser would manage the risk posed by lack of information by adjusting the price; he sense checked his valuation against the real deal which took place in July 2007; the Company had acquired another subsidiary after listing and before the sale took place in July 2007 and this acquisition was a reason why he thought that the shares might have increased in value between 39p on the relevant date and July 2007; so the real deal gave him comfort that his valuation was appropriate; he could not see why the shares might have reduced in value from £1.05 between the relevant date and the sale in July 2007.

46. In re-examination Mr Lygo added: he would not have expected the prudent purchaser to have undertaken the extensive analysis which he and Mr Bowes had undertaken; in his view the prudent purchaser would have done what he had done namely made an attempt to best estimate the historic earnings of the Company and then found an appropriate benchmark for its market value given its small size and the other depreciatory factors; he agreed with Mr Bowes regarding some of the information which would have been available to the prudent purchaser; but disagreed that any financial information relating to the Company would have been available; he was not certain what the [18(8)] information meant but thought that that sort of information was something that a prudent purchaser would look to find out before acquiring the shares; he thought that the calculation which had been carried out by the appellants at paragraph 79 of their skeleton argument mixed and matched calculations and that the maths was wrong; in his calculations the uplift of the shares arising from the revaluation of Redapt meant an uplift from 26p to 32p and that the removal of a discount giving a further uplift by 50% on the basis of Netley was not justified since Netley involved shares which were listed on AIM which is a much more liquid market than the CISX; in his view even if the shares are uplifted to 32p because of Redapt, a further uplift to 39p is justified by the increased liquidity; so the uplift to the original value at the date of subscription of 16p is 142%, which seems justifiable to him.

Joint Statement of Experts

47. The experts held meetings via Microsoft Teams on 2 September and 15 September 2020 and their areas of agreement and disagreement were set out in a joint statement dated 19 November 2020 (the "joint statement"). We briefly summarise the areas of agreement and disagreement below.

48. The experts agreed on the following:

(1) The appellants acquired their shares in the Company on 29 November 2005 at an average price of 25.6p per share. Other investors subscribed for shares on different dates and at different prices. As the reasons for the differing prices are unknown, Mr Bowes did not consider that the average amount which the appellants paid for their shares was a material factor in the valuation;

(2) The Company was bound by the Listing Rules. These require that all holders of the same class of share must be treated equally and, as a consequence, if unpublished financial information such as profit forecasts were to be provided to the Company to a prospective purchaser, the information would first have to be disclosed to the CISX and then made available to all shareholders;

(3) Winterflood was bound by the CISX Membership Rules;

(4) The conventional approach in valuing minority shareholding for UK tax purposes is to apply a suitable adjusted multiple derived from a broadly similar listed company to the subject company's maintainable post-tax profits. Mr Bowes refers to this approach as the "PE Methodology" while Mr Lygo refers to it as the "earnings basis". Mr Lygo uses the earnings basis to value the shares, while Mr Bowes additionally considers other valuation methodologies in his report.

49. The experts fundamentally disagree on the profit multiples, or PE ratio, which should be applied, and to a lesser extent on the level of profits to be assumed for valuation purposes.

50. They also disagree on the value of the shares on the relevant date, the relevance of the transaction prices to the value at the relevant date, the maintainable post-tax profits, the effect of the liquidity of the shares caused by the listing on the CISX, the use of hindsight, the application of discounts to quoted company profit multiples, the availability of information for valuation purposes, the role of the market-maker and the Normal Market Size, the appropriate EBITDA for valuation of whole companies and the PE for minority shareholders, the discount which should be applied to the transaction multiples, and the use of historical multiples being applied to prospective profits.

SUBMISSIONS

51. Miss Brown and Miss Choudhury made clear helpful and eloquent submissions, both orally and in writing. We are very grateful for those submissions which have helped us considerably, and we have taken those submissions into account (along with all of the evidence) even though, in reaching our conclusions we have not necessarily referred to each and every argument and item of evidence in detail.

52. Miss Brown fully supported the evidence given by Mr Bowes and made the following submissions: the points between the parties are the available information, the applicable earnings and multiple, and the relevance and application of any discount; the correct approach is set out in paragraph [165] of *McArthur*; there is no evidence that either appellant had a tax avoidance motive for subscribing for and then gifting the shares; motive is irrelevant, in any case, in considering market value; the hypothetical purchaser would have been able to request further information from the Company, which includes the forecasts which were set out in the FDD report; this would not have been difficult for the directors of the Company to provide; the forecasts in the Afortis report would also have been made available, and these were more optimistic than those in the FDD report since these were prepared for the purpose of attracting borrowing whereas the Afortis report valuations were for the purpose of attracting investment; in *Netley* the judge had considered that prudent buyer information would have been available which was public information supplemented by information to be assumed pursuant to section 273(3) TCGA 1992 ;the experts are not, however, far apart on the earnings of the Company even though they have used different information standards; Mr Bowes uses £846,300 as the applicable earnings in 2007 to which the appropriate multiple should be applied, whereas Mr Lygo uses £859,348 in 2005; Mr Bowes approach to the multiple was to carry out research into a number of potential comparators and choose the ones he considered were most closely aligned with the Company by reason of their activities; since the Company was involved in a growth sector, his multiples are understandably high; Mr Lygo sought to undermine the comparables in the Afortis report rather than start with a list of potential comparables and narrow it down; Mr Lygo also used FTSE indices which included irrelevant sectors; Mr Bowes thought that it was not appropriate to apply a discount for lack of liquidity since the shares were listed on the CISX, whereas Mr Lygo thought that a discount of between 60% and 75% should be applied to the multiple to take into account the depreciatory factors; there is no legal commercial or economic justification for this approach; the depreciatory factors are, and in any event, disputed and indeed are not necessarily depreciatory; investors looking for growth with confidence in the sector and the people behind the Company would not have seen these factors as depreciatory; they would not have worried about a lack of dividends; nor would lack of a track record have caused investors a concern; smaller companies have a greater potential for growth than larger ones; the subsidiaries evidenced promising financial results; debt is a positive factor; the appellants were not interested in payment of dividends, but for growth as promised by the Company; the information which Mr Lygo lists as a depreciatory factor would have been available; the average price of 25.6p is not the correct starting point; at the relevant

date the hypothetical purchaser would have been aware of the placing shares that had been purchased for 1p each, the subscription shares that had been purchased for £1 each, the four transactions at £1.04 -£1.05 and the listing price of £1.05; the share ledgers at Companies House record the dates on which the entries were made in the ledger rather than the date on which the shares were issued; the usual discount for a lack of marketability is 30% to 50% and not 60% to 75%; given that the Company was involved in a "buy and build" exercise, the prudent purchaser would recognise that the shareholders were not looking to sell their shares but to keep them in the hope of future growth; that prudent purchaser would not view the market in which the shares were traded as illiquid; the CISX was an appropriate exchange for the Company to be listed on; the market-maker created liquidity and was obliged to trade in values of shares which were £5,000 or more (as opposed to only being able to trade up to a maximum value of £5,000); whilst is not accepted that any discount should be given for lack of liquidity, if such a discount is applicable Mr Lygo's methodology would result in a PE range of between 7.5 and 17.7 with a potential market range of 50.5p-95.6p, the midpoint being 68p; the prudent purchaser would have used a larger multiple than that used by Mr Lygo; Mr Lygo uses 16p as his starting point based on the net asset value in the pro forma balance sheet in the listing application which records £4.4 million of goodwill at that point but net assets of 2.5 million; any valuation based on balance sheet does not take account of hope value created by the synergies of the acquired companies, streamlining processes, new management, growth prospects and does not, furthermore, take into account the realistic value of Redapt which the experts agree may have been purchased cheaply; in any case, if the true value of Redapt is factored into Mr Lygo's balance sheet calculation, the value of the shares immediately following the acquisition of the subsidiaries is 38.5p, which uplifted by 100% to reflect liquidity gives a value of up to 78p per share; whilst the hypothetical prudent purchaser would not have undertaken all of the analysis undertaken by the experts in this case, the hypothetical purchaser would have given weight to the fact that the subsidiaries were very profitable companies in a growth industry, Redapt was undervalued and purchased cheaply, high multiples in the industrial engineering industry, lack of restrictions once the Company was listed on the CISX, and the four trades which took place before the relevant date; the prudent purchaser would not have made the adjustments made by Mr Lygo; Mr Lygo relied on hindsight; he asserted that the shares were thinly traded, but that was an assertion that could only be made on information after the relevant date since at that date there had only been the four trades in December 2005; it was unsurprising that there had been only these four trades given the time of year; the fact that the Clydesdale bank was prepared to lend the Company more than the tangible net asset value of the subsidiaries based on a prudent evaluation suggests that the Company was a good investment with future growth prospects; if the value is 39p, the appellant will have to pay a considerable amount of interest on the additional tax; Mr Ryan, on whose report the closure notices were based, says a reasonable uplift arising from the liquidity generated by listing on the CISX is 50%; HMRC's assertion that if the calculated share price of 39p is compared to the share price before listing of 16p, this is an uplift of 142%, cannot be right; they have used figures for calculating different things for different purpose.

53. Miss Choudhury supported Mr Lygo's position. She submitted: tax motivation is relevant to the extent that it provides context; the shares for which the appellant subscribed were all issued on the same day at an average price of 25.6p; whilst Mr Lygo accepts that Redapt might have been bought at a favourable price, he did not say that it was bought at a favourable price; neither party can say what the size of shareholding that the market-maker committed to buy and sell was; all that can be said is that under the Membership Rules, the minimum quotation had to be at least £5,000; there is no evidence that it was more than that; there was no obligation on the market-maker to buy shares with a quotation size of more than £5,000; the evidence that the market-maker had to commit to purchasing 2.5% of the total shareholding is not right; the

requirement is to purchase 2.5% of the volume of the company's shares; the four trades which took place on 21 and 22 December 2005 do not represent significant evidence of open market value; the FTT had reached a similar conclusion in the case of *Green (Nicholas Green v HMRC* [2014] UKFTT 396; Mr Lygo was a more convincing witness than Mr Bowes; he answered the questions put to him whereas Mr Bowes was unable to answer many questions; he was not influenced by the fact that he had been instructed by HMRC; in *Green* the Tribunal held that the prudent purchaser would have resorted to the information that was available about a company through the listing of its shares on the CISX; the forecasts in the FDD report would not have been made available by the Company even if so requested by the prudent purchaser; as Mr Lygo said in his report "*...compliance with the obligation to treat all investors equally would require disclosure of confidential and potentially price sensitive information such as profit forecasts to all holders of Mount Ordinary shares. Bearing in mind that the MBI forecasts were evidently not provided to either the retail investors who participated in the November and December finance rounds or CISX, I do not consider that a realistic proposition.*"; there is no evidence that there were more optimistic forecasts than those set out in the FDD report; the CISX is a small regional market specialising in investment funds and not trading companies; it was not a liquid market; listing was not sufficient to produce the uplift relied on by the appellants; this uplift starts with the price of 25.6p not £1; the synergistic benefits arising from the acquisition of the subsidiaries would not have manifested themselves by the relevant date; a 100% uplift to the original price at subscription of 16p would result in a share price of 32p not £1.06; Mr Lygo's calculation represents an uplift of 142% whereas Mr Bowes calculation implies an uplift of 558%; these calculations should be seen as a sense check which would have been applied by a prudent purchaser; Mr Bowes had not carried out this sense check; Mr Bowes has used multiple of 26.17 whereas Mr Lygo has used a multiple of 7; the three comparables used by Mr Bowes are not sufficiently comparable to the Company to justify their use without significant adjustment to the average profit multiple for various depreciatory factors which would have made an investment in the Company a far riskier proposition; as set out in the joint statement by Mr Lygo: "*DB applied a P/E ratio of 26.17, which he derived by averaging the P/E ratios of three LSE listed engineering groups selected from a longer list of twelve listed companies with a lower average P/E ratio of 22.86 (DB 14.12 – 14.13). A P/E ratio of 26.17 suggests that the market would have rated MYL at approximately the same level as Rotork (26.20 on DB's figures) and higher than Spirax-Sarco (18.50), two of the three companies he selected as comparable. All three companies had seen substantial increases in turnover and profit in 2004 and 2005 and this growth continued in the financial year ended December 2006 (source: Capital IQ system), whereas MYL's 2006 forecast assumed turnover and profit would both fall (SHL 4.55). In addition, these companies were far larger and more diversified than MYL and all paid substantial shareholder dividends for the 2003, 2004 and 2005 financial years averaging from 47% of profit in the case of Spirax-Sarco to 73% for Weir Group (source: Capital IQ system). In contrast, there was no indication as to when MYL might begin to distribute profit to shareholders or how substantial dividends would be (SHL 3.80). Dividend amount and growth prospects are significant factors in quoted company share prices and it is likely that Weir Group's particularly high rating (P/E ratio of 33.8 in DB 14.22) reflected this. These positive factors did not apply to MYL and SHL considers DB's P/E ratio of 26.17 to be excessive and wholly unrealistic in valuing the Appellants' shares.*" ; although Mr Lygo considered the Afortis report and the multiples used in relation to the companies identified in the report, these served as a sense check and in his report, he identified 29 relevant companies; sector specific indices have a built-in bias towards larger companies and that might be a reason why a prudent purchaser would look not only at the industrial engineering sector but also other sectors; he thought the prudent purchaser would adopt a similar strategy; Mr Bowes valuation of up to £1.43 per share give a market capitalisation for the Company of over £22 million which implies an additional £19 million or

so over the goodwill value of £4.4 million set out in the listing application; both of the subsidiaries were purchased on a PE ratio of 5 to 6 which is more in line with the ratio used by Mr Lygo; Mr Bowes also erred in applying a historical multiple to prospective profits; nor did he take into account the forecasts indicated that the profits of the Company were expected to fall in 2006; the depreciatory factors were just that and would have been taken into account by the prudent purchaser when considering the multiple; the Company did not have a proven track record; debt is not always a good thing; an investor will be interested in both capital growth and payment of dividends; HMRC are asking for a higher valuation than that contained in the closure notices.

DISCUSSION

54. As Judge Gammie said in *Green* our task is to decide what price the shares might reasonably have been expected to fetch on a sale on the open market on the relevant date. "The question is straightforward; the answer is not."

55. The way that the courts have approached this is to posit a hypothetical sale between a hypothetical purchaser and a hypothetical vendor. The characteristics of the sale, the purchaser, and the vendor, have been set out at paragraph [10]-[11] above. The hypothetical purchaser is a reasonably prudent purchaser who has informed himself as to all relevant facts. The market value is what the highest bidder would have offered for the asset. We must identify the highest price the reasonably prudent purchaser would pay. The hypothetical vendor would sell if he is offered a fair price. The task for us is to apply these principles to the particular facts of this case. We have been taken to a number of authorities where these principles have been applied, and there are lessons to be learned from them. However each case turns on its own facts.

56. We have had the benefit of expert evidence from two experts. They have undertaken detailed investigations into the relevant matters, applied their expert knowledge to the results of these investigations, and yet have come to wildly different conclusions. The parties agree that the reasonably prudent purchaser would not have undertaken the detailed analysis which these experts have undertaken. One of the issues which we must decide is what analysis the reasonably prudent purchaser would have undertaken.

57. Both experts identified a number of methodologies which they have used to value the shares which they say a reasonably prudent purchaser might have used to value the shares. We agree with Judge Cannon in *McArthur* that valuation is not simply a question of choosing one methodology and excluding consideration of other methods. In any particular case it is likely to involve looking at various methods, giving different weight to each method and arriving at a best estimate of the highest price the hypothetical purchaser would pay. The experts have done this. Mr Bowes considered that the four transactions in December 2005 were a good indicator of the value of the relevant date. He also applied a PE ratio using comparables with listed companies. He also took the unlisted PE and grossed up for the liquidity caused by the listing. Mr Lygo approached things somewhat differently in that he adopted a "preferred view" using listed company comparables to which he then adjusted the multiple because of the depreciatory factors. He then sense tested his results against a number of matters including the

subscription price paid by the investors and the market capitalisation consequences of his valuation and the valuation proposed by Mr Bowes.

58. We are not bound by the valuations which have been suggested by the experts and we are free to come to a completely different conclusion from those valuations.

59. In our judgment, the reasonably prudent purchaser would not have jumped through all the hoops that have been jumped through by these experts but would have adopted the conventional view suggested by the experts of applying a suitably adjusted multiple derived from broadly similar listed companies to the Company's maintainable post-tax profits. In other words, the PE method. However, it is our view that having set out down that path, the reasonably prudent purchaser would have found a real difficulty in coming up with reasonably relevant comparables. At that stage the purchaser would have switched his primary method of valuation and considered the multiples on which the two subsidiaries were bought. These were actual transactions for which it is possible to calculate an actual multiple. Having undertaken that exercise the purchaser would have been better equipped to reconsider the PEs of the listed company comparables and the sector in which they operated. The purchaser would then apply the appropriate multiple to the maintainable post-tax profits, and having come up with a tentative figure for the value of the shares, then tested that against a number of facts which would have been known to him, or available to him, at the time.

60. We agree with Miss Brown that motive is not relevant to our consideration of market value (even though, as Miss Choudhury suggests, it might provide context) and in this case there is no evidence to suggest that either of these appellants had a tax avoidance motive in subscribing for or gifting the shares.

61. The hypothetical purchaser is just that, hypothetical, and we cannot attribute the personal qualities and experience of these appellants to that purchaser. So, for example, much was made of the fact that the appellants were not interested in dividends but subscribed on the basis that the Company would grow, the implication being that cash which might otherwise have been available for dividends would be ploughed back into it to support that growth. But the hypothetical purchaser when considering comparables, would take into account the fact that companies which pay dividends are more likely to trade on a higher multiple than those which do not. And thus would reduce the multiple for a company which is not intending to pay dividends if he knew that to be the case.

62. We start by considering the information which would have been available to the reasonably prudent purchaser. The appellants say that it would have included the forecasts which are set out in the FDD report which the directors would have made available on request to an enquiring purchaser. In simple terms, for the reasons set out by Mr Lygo above, HMRC do not think that the forecasts would have been available. We agree with HMRC. Judge Cannan in *McArthur* referred to the judgment of Lord Reid in *re Lynall*. Directors would not disclose information if its disclosure could possibly prejudice the interests of the Company. The Listing Rules require a company listed on the CISX to inform the CISX of any information which might reasonably be expected materially to affect market activity and the price of its securities. The parties agree that the forecasts fall into this category of information. The Listing Rules then prohibit a company from giving that information to a third party before it is given to the Exchange. So the Company would not have been permitted to give the forecasts to an enquiring purchaser without notifying the Exchange, who is then obliged to ensure equality of treatment for all shareholders which would have involved giving the forecasts to all shareholders. This would have meant sharing confidential and price sensitive information with the shareholders

and which would have increased the risks of that information falling into the hands of competitors who might be able to use it to the competitive disadvantage of the Company. Evidence of the reluctance of the Company to publish the forecasts is gleaned from the fact that it did not put those forecasts into the public domain by including them in the list of information and documentation which was made available on listing in the listing agreement, notwithstanding that those forecasts clearly predated that document. In our view had the potential purchaser sought the forecasts from the Company, they would not have been supplied. Given our conclusion on this, we do not have to come to any conclusion on the optimism or otherwise of the forecasts contained in the FDD report compared to those in the Afortis report. But we do not accept Miss Brown's submission that the forecasts in the former were likely to have been more pessimistic than those in the latter. Firstly we know nothing about the Afortis forecasts and so have no idea about the basis on which they were made and whether they were intended to attract investment or otherwise. Secondly when making an application for a bank loan, our experience is, like that of Mr Lygo that the putative borrower would wish to put forward a realistic forecast for turnover given that the bank will take this into consideration when analysing whether the borrower will be able to service the debt. Finally on this point, Miss Brown pointed out that in *Netley* the judge had said that the information which would have been available would have been that in the public domain and supplemented by the information available under section 273 (3) TCGA 1992. But, as Miss Choudhury has correctly pointed out, *Netley* was a case involving shares listed on AIM, to which the provisions of section 273(3) apply since AIM is not a recognised stock exchange. The CISX is a recognised stock exchange and so these provisions are not relevant.

63. However we agree that the other documents which Mr Bowes says would have been available to a prudent purchaser, which are largely in the public domain, would have been so available. Importantly, these included the accounts for the two subsidiaries and their respective purchase agreements.

64. In applying the PE method, the first issue that the prudent purchaser would have to decide is the Company's maintainable post-tax profits. As things have turned out, even though Mr Bowes used the forecasts set out in the FDD report, he used a lower earnings figure (£846,300) compared to the figure used by Mr Lygo based on the 2005 figures (£859,438).

65. In coming to these figures both experts recognise that there was a possibility that Redapt had been acquired relatively cheaply. Mr Lygo thought that the price paid by the Company might have been below Redapt's market value which was plausibly between £5 million and £6 million at that time**.** He came to this view having taken financial information which was in the public domain and which would have been available to the prudent purchaser, and adjusted it by, essentially, adding back a management salary cost of £85,000. This resulted in an adjusted operating profit of £948,000. We believe the reasonably prudent purchaser would have done the same analysis. This meant that using a multiple of between 5.6 and 6.5, the indicative value range for Redapt was between (approximately) £5.3m and £6.2 million. These ratios are derived from the Price Earnings Ratio Database published by an association of professional firms which provide accounting financial tax and business advisory services globally, and, in our view, would have been available to and made use of by the reasonably prudent purchaser.

66. So the prudent purchaser, now armed with the maintainable post-tax profit of £859,438, then needs to decide on the multiple which needs to be applied to that profit. Once the multiple has been decided on, the price per share calculation is simple. The post-tax profit is multiplied

by the multiple and then the resulting sum (which is the market capitalisation of the Company) is divided by the number of shares in issue (in the case of the Company, 15,500,000).

67. It is here that the prudent purchaser might find life a little less easy. It was Mr Bowes' view that the correct method is to take a number of listed companies which carried out broadly comparable activities. He listed those in his report. He then identified three of them which in his view carried out activities which are closest to those carried on by the Company, which had multiples of 18.5, 26.2 and 33.8 which averaged out to 26.17. He thought there was no need to discount these multiples for a lack of marketability since a combination of listing on the CISX and the activities of the market-maker meant that, in essence, the shares were as marketable as those listed on the London Stock Exchange. Mr Lygo's trenchant criticism of this methodology is set out in our review of Miss Choudhury's submissions above. In his view these were not comparable companies given the differences between them and the Company in terms of dividend policies, size, diversification, and profitability and turnover. In our view the reasonably prudent purchaser would have come to the same conclusion.

68. Mr Lygo had undertaken a similar exercise albeit in the context of reviewing the Afortis report. Afortis appear to have used a multiple of about 13 which Mr Lygo considered to be significantly above the sector median (7.88) and (7.22) excluding outliers. However, these were not post-tax profit multiples they were EBITDA multiples. Two of the three comparables used by Mr Bowes appear in Mr Lygo's list, Spirex and Rotork. Mr Bowes attributes an historical multiple to Spirax of 18.5 and to Rotork of 26.2, whereas in Mr Lygo's table, Spirex has a multiple of 9.94 and Rotork of 15.81. It is here that the prudent purchaser might start to get a little confused.

69. Mr Lygo thought that the prudent purchaser would start out by looking at the FTSE indices to see what sort of multiples were used for companies listed on the London Stock Exchange, to get a feel of the sort of multiples which applied to such listed shares and then delved down into the specific sector, namely industrial engineering, to consider the multiples which applied in that sector. This analysis can be seen at table 38 extracted from his report, above. We agree the prudent purchaser would have adopted this approach. We also agree that having considered the headline multiple, the prudent purchaser would have recognised that it was likely to have been affected by the weight given to larger companies which might not have carried on directly comparable activities to those carried out by the Company. The prudent purchaser would then have to consider to what extent a discount should be given to the headline multiple given that the shares in the Company were listed on the CISX and thus might be less marketable than those listed on the London Stock Exchange, and whether any further discount should be given for any other depreciatory factors which might be relevant to the shares in this particular company. It was Mr Lygo's view that the prudent purchaser would discount that headline PE of 25.28 by between 70 and 75% to reflect the lack of marketability and the application of the depreciatory factors. This was simply his professional judgment. It is here that the prudent purchaser might find himself in difficulty in that although we feel it is fair to attribute to that purchaser a certain amount of experience of buying shares, we certainly cannot attribute to that purchaser the professional experience which Mr Lygo has called on when coming to his conclusion regarding the foregoing percentage discount.

70. As far as liquidity or marketability is concerned we do not accept the appellants' submission based on Mr Bowes evidence that there is no justification for any discount to the multiples applied to companies listed on the London Stock Exchange for shares listed on the CISX. One of the primary concerns of the prudent purchaser would be the ability to sell any shares that it acquires in the hypothetical purchase. Mr Lygo's evidence was that in 2005, the

value of trades on AIM was over £42 billion whilst trading on the CISX in the same period was only £22 million. And in our view it is likely that trading on the London Stock Exchange would be a great deal larger. A purchaser looking to acquire shares in an engineering company who again would be concerned about resalability, would not look to companies traded on the CISX as a first port of call. They are far more likely to consider shares listed on the London Stock Exchange. The reasonably prudent purchaser would recognise this and would thus be concerned that if he or she bought shares listed on the CISX, they would not be as readily resalable as those listed on the London Stock Exchange. This is Mr Lygo's view and we agree with it. The difficulty faced by the prudent purchaser, however, is to identify the discount that should be applied for this lack of marketability.

71. We also agree that the depreciatory factors are depreciatory and would have been considered to be so by the prudent purchaser. As a matter of fact, the company was a new venture and did not have a track record of profitable trading; it had taken on debt but there was no evidence of it being able to service that debt; it was not intending to declare dividends, and whilst we accept that this might not have been relevant to these particular appellants, it is a depreciatory factor given that, generally, a company which pays dividends is seen as more valuable than one which does not, and thus the multiple of a non-dividend paying company should be discounted compared with the multiple of a dividend paying company; the forecasts for 2006 and 2007 would not have been available to the prudent purchaser; the purchaser would have known that the average subscription price for the appellant's shares was 25.6p each (we consider this in more detail below).

72. But once again, the prudent purchaser faces the difficulty in quantifying the discount which should be applied having considered these factors.

73. It is at this stage that we think the prudent purchaser would have changed tack and reviewed the multiples on which the subsidiary companies were acquired, given that these were real multiples for real acquisitions for the real companies. There is no need in the circumstances to worry about comparables with companies that carry on a similar trade, since we are looking at the actual trade carried on by the actual companies.

74. Both experts thought that Redapt may have been bought cheaply. It was Mr Lygo's view that the appropriate multiple, based on his research (which we judge would have been available to the prudent purchaser and which he or she would have taken into account) was between 5.6 and 6.5. Hi-Flow was purchased on a multiple of 6.3 to 9.5 times the adjusted operating profit for the period ended March 2005 or 8 to 9.5 times for the annualised adjusted operating profit to September 2005. The prudent purchaser would have come to the same conclusion.

75. These multiples however are for unquoted shares and it was both experts view that these would be uplifted for the increased liquidity which would arise on a listing on a public exchange. It was suggested by Mr Bowes that the uplift which takes place on listing is rarely less than 30% although it can often be significantly more.

76. That there should be an uplift is common sense. The purchaser would be willing to pay more for a share if it is readily resalable which will be the case where the share is listed. However, the purchaser would also be alive to the fact that a listing on the London Stock Exchange is going to make the share more tradable than a listing on the CISX. So whilst an uplift of in excess of 30% might be appropriate to a listing on the London Stock Exchange, we do not think it is appropriate to listing on the CISX. In our view the prudent purchaser would take the same view. The maximum uplift that the purchaser would attribute would be 30%.

This takes into account the role of the market-maker, Winterflood. The evidence concerning Normal Market Size is a Google search undertaken by Mr Bowes, recently, when compiling his report. There is no evidence that this information would have been available to the prudent purchaser at the relevant date. We therefore disregard it. As Miss Choudhury has submitted, the Membership Rules simply oblige the market-maker to actively offer to buy and sell securities in a minimum quotation size of approximately £5,000. Our reading of this, unlike Miss Brown's is that there is no obligation on the market-maker to purchase shares in excess of this minimum quotation size. We suspect that this quotation size was more to do with administrative convenience than anything else, but that is speculation. What is clear to us, however, is that the market-maker would not have any significant impact on the general liquidity of the CISX.

77. Armed with this conclusion, the prudent purchaser would then apply this uplift to the multiples on which the acquisition of the subsidiaries were made. The prudent purchaser is prudent, and so would have taken the lower end of the multiples in each case. Mr Lygo's computation of the post-tax operating profits of £859,438 is based on a contribution by Redapt of about £934,000 and by Hi-Flow of about £628,000. Taking the lower range of the multiples and weighting them to reflect the different contributions, the average multiple is 6.56. This would then need to be uplifted, given that these are unlisted companies, by 30% to reflect the uplift on listing, resulting in a PE ratio of approximately 8.53.

78. The prudent purchaser would then go back to the listed company analysis and see what level of discount would need to be applied to the industrial engineering sector PE of 25.28 to reflect the lesser liquidity conferred by a listing on the CISX and taking into account the other depreciatory factors set out above.

79. A PE of 8.53 reflects a discount of approximately 66% to the industrial engineering sector PE. Our view is that the prudent purchaser would consider that to be an appropriate discount.

80. A multiple of 8.53 applied to the post-tax profits of £859,438 gives a market capitalisation of the Company at the relevant date of £7,331,006. This reflects an increase to the capitalisation of the Company based on the pro forma valuation in the listing application, but, as submitted by the appellants, the prudent purchaser would consider this had arisen as a result of the acquisition of the subsidiaries, one of which was acquired at a good price and the listing on the CISX. These were wholly justifiable reasons for the increase.

81. These figures would put the price per share at 47.3p.

82. The hypothetical purchaser would want to check whether he is being asked to pay considerably in excess of the price at which the shares were acquired. If the price that the prudent purchaser is now being asked to pay is massively over and above the subscription price, then the prudent purchaser may well review the methodology that has led to his conclusion the price per share is 47.3p. There was much debate about the timing of the subscriptions and whether the date of entry in the relevant registers was the date of issue and allotment of the shares, or the date on which the application was made to register those issues and allotments in the register. In our view nothing turns on this. The subscription price was a matter of public register and thus available to the prudent purchaser. The prudent purchaser would have seen that there was only one class of shares in issue, namely ordinary shares with a nominal value of 1p, and that the subscribers had subscribed on average 25.6p per share. The prudent

purchaser would therefore test the price of 47.3p against the 25.6p and would in our view conclude that, for the reasons set out at [80] above, that increase is explicable and reasonable.

83. This is to be contrasted with the valuation of £1.06 per share which is being put forward as the market value of the shares, by the appellants. A price of 47.3p is a 185% uplift to the price of 25.6p. A price of £1.06 is an uplift of 558%. The prudent purchaser would not have considered that such an uplift was justified on the basis of buying Redapt cheaply, synergies, a strong management team and listing on the CISX.

84. The prudent purchaser would also have tested his price of 47.3p against the price at which the shares were traded in December 2005, as set out at the table at [13(18)] above. It was Mr Bowes view that this was good evidence of the value of the shares as at the relevant date. We do not agree. We do not think that prudent purchaser would agree either. The prudent purchaser would treat these trades with considerable suspicion given that nothing is known about the counterparties. It seems clear from the parties' submissions that they consider that the information about these trades was in the public domain. And would have been so once the trades had taken place. We would attribute to the prudent purchaser the characteristic of recognising a bargain. The prudent purchaser on seeing the transaction price of about £1.05 per share would do as Mr Lygo has suggested, namely question why, if that information was in the public domain, and the subscribers had acquired their shares at an average price of 25.6p, other shareholders have not sought to take advantage of an opportunity to sell their shares at four times the price they paid for them. Or at least sell sufficient shares to cover their subscription costs and retain the balance. As far as these particular appellants are concerned, then that balance could have been gifted (as too could the cash received from the sales) which would have benefited their charities. But we are concerned about the reasonably prudent hypothetical purchaser, who in these circumstances having seen that no one has taken the opportunity to make a spectacular profit, would have questioned the relevance of the trades and their reliability as an indication of the market value of the shares. He would certainly not have attributed the price of those trades to the value of the shares and paid that price to the hypothetical vendor.

85. Having undertaken these sense checks, the prudent purchaser would have concluded that the tentative conclusion that he had reached that the maximum price that he would pay for the shares is 47.3p, based on the PE methodology, is consistent with the other factors set out above, and would have been prepared to pay that to acquire the shares from the hypothetical vendor.

DECISION

86. For the foregoing reasons it is our decision that the market value of the shares at the relevant date was 47.3p per share.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

87. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

NIGEL POPPLEWELL
TRIBUNAL JUDGE
RELEASE DATE: 01 MARCH 2022