UPPER TRIBUNAL (LANDS CHAMBER)

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UTLC Case Number: TMA/339/2019

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

TAX – Income Tax and Stamp Duty Land Tax – valuation of care homes – leasehold interests let at market rent – whether premiums paid form part of the value of the leasehold interests – trade related properties – trading potential – profits method of valuation – RICS Guidance – section 272, Taxation of Chargeable Gains Act 1992 – appeals allowed

IN THE MATTER OF AN APPEAL UNDER THE TAXES MANAGEMENT ACT 1970

BETWEEN:

(1) ZYRIEDA DENNING
(2) MH HANTS LIMITED
(3) MP HANTS LIMITED

Appellants

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

Respondent

Re: Manor Place Nursing Home,
116 Church Lane East,
Aldershot, GU11 3HN
and
Maple House Nursing Home,
23 Manor Road,
Aldershot, GU11 3DG

A J Trott FRICS and Diane Martin MRICS FAAV
8 December 2020
Royal Courts of Justice

Michael Firth, instructed by Morrisons Solicitors, for the appellants
John Brinsmead-Stockham, instructed by HMRC Solicitors, for the respondent

The following cases are referred to in this decision:

Arbib v Earl Cadogan [2005] 3 EGLR 139
Balloon Promotions Limited v Wilson [2006] STC (SCD) 167
The Leeds Cricket Football and Athletic Company Limited v HMRC [2019] UKFTT 568 (TC)
Mohammed v Newcastle City Council [2016] UKUT 415 (LC)

Introduction

1. This reference concerns a dispute on an appeal to the First-tier Tribunal (Tax Chamber) about the value of land and of leases in land. Under section 46D of the Taxes Management Act 1970 such a question in dispute shall be determined by the relevant tribunal, i.e. the Upper Tribunal. Under article 12(a)(iii) of the First-tier Tribunal and Upper Tribunal (Chambers) Order 2010 (SI 2010/2655) all functions related to the determination of questions of the value of land or an interest in land arising in tax proceedings are allocated to the Lands Chamber ("the Tribunal").

2. The issues for determination by the Tribunal are the market values of both the freehold and leasehold interests in two care homes in Aldershot known as Maple House Nursing Home ("Maple House") and Manor Place Nursing Home ("Manor Place").

3. The first appellant, Dr Zyrieda Denning ("Dr Denning"), acquired the freehold interest in Manor Place together with the business operating therefrom in April 2000 for £499,000. She acquired the business operating from Maple House in March 2001 and subsequently bought the freehold interest in the property in June 2006 for £1m. Dr Denning operated both care homes as a sole trader.

4. On 3 February 2010 ZD incorporated three companies: Jasmine Care Holdings Limited ("JCHL"); MH Hants Limited ("MHL"); and MP Hants Limited ("MPL"). MHL and MPL, who are the second and third appellants respectively, were wholly owned subsidiaries of JCHL and Dr Denning was the sole shareholder in JCHL.

5. On 22 March 2011 Dr Denning entered into three agreements with each of MHL and MPL to transfer one care home to each company. In summary the agreements provided for:

   (i) the sale and purchase of the businesses as going concerns in consideration for "the appropriate book amounts" and including "the goodwill of the Vendor in connection with the Business". The agreements also provided that Dr Denning would grant leases over the properties from which the businesses were operated for a term of 5 years at an annual rent (without review) of £225,000 for Manor Place and £175,000 for Maple House;

   (ii) the grant of the leases on the terms set out in (i) above with no premium payable ("the leases"). Dr Denning retained the freehold interest in both Manor Place and Maple House;

   (iii) Deeds of assignment of the goodwill of the businesses from Dr Denning to MPL and MHL for consideration of £1,125,000 and £675,000 respectively, i.e. a total of £1.8m.

6. This reference concerns the value of the leasehold interests granted by Dr Denning to MPL and MHL under the leases and the value Dr Denning's reversionary freehold interests in Manor Place and Maple House.

7. It is not necessary for the purposes of this reference to consider the history and background to the appellants' liability to tax. It is sufficient to note that on 27 October 2017 HMRC made various amendments to Dr Denning's tax return for the year ended 5 April 2011 and on 30 November 2017 issued Stamp Duty Land Tax discovery assessments against MPL and MHL regarding their acquisition of the leasehold interests. Dr Denning appealed against the amendments and the SDLT discovery assessments, the quantum of which depend to some extent on the value of the leasehold and freehold interests in Manor Place and Maple House. HMRC are the respondent to the appeal.

8. Mr Michael Firth appeared for the appellants and called Mr Mark Ellis BSc, FRICS, MCIArb, MAE, a Director and previously Chairman and Managing Director of Pinders, Chartered Surveyors, as an expert valuation witness.

9. Mr John Brinsmead-Stockham appeared for the respondent and called Ms Vanessa Rodrigues BSc(Hons), MRICS, Principal Surveyor in the Valuation Office Agency's District Valuer Services Team, as an expert valuation witness.

Agreed matters

10. The valuation experts helpfully agreed a large number of matters which has reduced the scope of the dispute and assisted the Tribunal in its determination. In summary the agreed matters are:

    (i) the valuation date is 22 March 2011, the date on which the relevant transactions occurred;

    (ii) the care homes to be valued are trade related properties ("TRP") for the purposes of the applicable RICS guidance and the leasehold interests are to be valued on the profits method of valuation;

    (iii) the profits method of valuation requires the assessment of the fair maintainable trade ("FMT") and fair maintainable operating profit ("FMOP") assuming the care homes were operated by a reasonably efficient operator ("REO");

    (iv) the FMT of Manor Place was £1.84m and the FMOP was £630,000;

    (v) the FMT of Maple House was £1.51m and the FMOP was £485,000;

    (vi) the FMOP figures should be adjusted by deducting the market rental value which it was agreed was represented by the passing rents under the leases. The adjusted FMOPs were therefore:

(a) Manor Place: £405,000 (£630,000 less rent of £225,000 pa);

(b) Maple House: £310,000 (£485,000 less rent of £175,000 pa).

(vii) the profits method of valuation requires the rent adjusted FMOP to be capitalised using a year's purchase multiplier. The experts (in effect) agreed a compromise year's purchase of 2.125 which gave what they described as a mid-point capital value for the leasehold interest in Manor Place of £860,000 and of £660,000 for the leasehold interest in Manor House, giving a combined value of £1.52m.

(viii) The value of the trade inventory was then deducted from these capital values. The experts agreed the following values for trade inventory:

(a) Manor Place: £130,000;

(b) Maple House: £117,500.

(ix) The capital values for the leasehold interests less the trade inventory were:

(a) Manor Place: £730,000 (£860,000 less £130,000);

(b) Maple House: £542,500 (£660,000 less £117,500).

(x) The freehold interests are to be valued on the investment basis and are agreed at:

(a) Manor Place: £2.725m;

(b) Maple House: £2.06m.

11. There was a difference in the instructions given to the experts. Ms Rodrigues was instructed to value the leasehold interests apportioned on a just and reasonable basis from the market value of the leasehold property valued as a fully equipped operational entity having regard to trading potential. Ms Rodrigues commented in her expert report that:

> "4.2 I note that my instructions distinguish between the "leasehold properties" and the "leasehold interests". I understand "leasehold properties" to refer to Manor Place and Maple House as operational entities under the terms of the leases granted to MPL and MHL by Dr Denning. I understand "leasehold interests" to refer to the leasehold interests in land conferred under those leases. It is the value of the leasehold interests that are in dispute in the Appellant's appeals."

12. Mr Ellis was instructed to provide his opinion as to:

(a) the market value of each leasehold property and business as a fully operational going concern, on the assumption the business is trading; and

(b) the market value of each leasehold property and business on the assumption that there is no trading business.

Statutory provisions

13. The valuations of the leasehold interests are required for the purposes of the Taxation of Chargeable Gains Act 1992. Section 272(1) of that Act states:

> "In this Act "market value" in relation to any assets means the price which those assets might reasonably be expected to fetch on a sale in the open market."

14. The appellants say, and the respondent "broadly agrees", that the statutory question in this reference "is what price the 5-year leasehold [interests] at the designated rent would be reasonably expected to fetch on a sale in the open market."

Summary of the parties' positions following the experts' agreement

15. There is no remaining dispute about the value of the freehold interests.

16. There is a continuing dispute about what is comprised in the value of each leasehold interest, i.e. the appellant says that the value of the leasehold interest is restricted to the value of the right to occupy the property at the agreed rent, and that the figure which the valuers have agreed as the capital value of the leasehold interest relates solely to the value of the business goodwill. The respondent argues that the value of the leasehold interest comprises the value of the right to occupy the property at the agreed rent plus the agreed capital value, the latter reflecting the trading potential of a trade related property and not goodwill.

RICS Guidance

17. Both experts rely upon guidance from the RICS about the valuation of TRPs. Such guidance, so far as relevant to this reference, comprises Guidance Note GN1: Trade Related Property Valuations (2010); GN2: Valuation of Individual Trade Related Properties (2012); and Valuation Practice Guidance – Applications (VPGA) 4: Valuation of Individual Trade Related Properties (2014).

18. Mr Ellis thought VPGA 4, which was published after the valuation date, was "largely irrelevant" and that "earlier RICS guidance should be referred to". The respondent disputed this and argued that the Tribunal should primarily have regard to what is considered to be best practice in the valuation of TRPs as at the date of the hearing, i.e. VPGA 4.

Guidance Note 1

19. Paragraph 1.1 of GN 1 explains that the essential characteristics of properties that are normally sold on the basis of their trading potential is that they are designed, or adapted, for a specific use and that ownership of the property normally passes with the sale of the business as an operational entity. A trade related property is defined in 2.2 as:

> "Property with trading potential, … the Market Value of which may include assets other than land and buildings alone. These properties are commonly sold in the market as operating assets and with regard to their trading potential …"

20. The assessment of the value of the operational entity is said in 2.3 to include:

- The legal interest in the land and buildings;
- The plant and equipment, trade fixtures, fittings, furniture, furnishings and equipment;
- The market's perception of the trading potential, excluding personal goodwill, together with an assumed ability to obtain/renew existing licences, consents, certificates and permits; and
- The benefit of any transferable licences, consents, certificates and permits.

Consumables and stock in trade are normally excluded.

21. Personal goodwill is defined as:

> "The value of profit generated over and above market expectations which would be extinguished upon sale of the specialized trading property, together with those financial factors related specifically to the current operator of the business, such as taxation, depreciation policy, borrowing costs and the capital invested in the business." (Paragraph 2.5.1).

22. Trade related property is usually valued subject to specific assumptions. Where, as here, the property is trading and the trade is expected to continue, "a typical assumption would be" to assess its market value as a fully-equipped operational entity having regard to trading potential (paragraph 3.2).

23. Section 4 of GN 1 describes the valuation approach to be adopted and begins by emphasising the valuation of a TRP necessarily assumes the transaction will be of the property interest, together with all the equipment required to continue operating the business. A valuation on the basis of the market value should only reflect the transferrable goodwill that relates to the trading potential of the property (4.4). Transferable goodwill is defined in 2.5 as:

> "That intangible asset that arises as a result of property-specific name and reputation, customer patronage, location and similar factors, which generate economic benefits. It is inherent to the specialized trading property and will transfer to a new owner on sale."

The valuation should exclude any personal goodwill to the present owner or operator which, unlike transferrable goodwill, would not be passed to a purchaser of the property.

24. The valuer must assess the FMT and FMOP that could be achieved by a reasonably efficient operator. This assessment is described in 2.4 as:

> "A market-based concept whereby a potential purchaser, and thus the valuer, estimates the maintainable level of trade and future profitability that can be achieved by a competent operator of a business conducted on the premises, acting in an efficient manner. The concept involves the trading potential rather than the actual level of trade under the existing ownership so it excludes personal goodwill."

25. Paragraph 5.1 says that where a valuation of a TRP has been provided as a fully-equipped operational entity the valuer may be asked to provide an apportionment of the valuation between the elements listed in paragraph 2.3 (see paragraph 20 above).

26. Paragraph 6.1 states that GN 1 does not apply to going concern or business valuations.

Guidance Note 2

27. GN 2 sets out the principles of the profits (income) method of valuation. It is concerned with the valuation of individual properties that are valued on the basis of their trading potential and does not apply to the valuation of businesses.

28. The experts did not refer to GN 2 which was replaced in very similar form by VPGA 4 two years later and to which the experts referred in detail. We therefore give no further consideration to GN 2.

VPGA 4

29. VPGA 4 says at paragraph 1.3 that the value of a TRP interest "is intrinsically linked to the returns that an owner can generate" from a specific use. "The value therefore reflects the trading potential of the property."

30. The definitions of operational entity, personal goodwill and a reasonably efficient operator are similar to those in GN 1.

31. The definition of FMOP at paragraph 2.4 begins by noting that the level of profit is "stated prior to depreciation and finance costs relating to the asset itself (and rent if leasehold)."

32. "Trading potential" is defined in paragraph 2.13 as:

> "… the future profit, in the context of a valuation of the property, that an REO would expect to be able to realise from occupation of the property. This could be above or below the recent trading history of the property. It reflects a range of factors (such as

the location, design and character, level of adaptation and trading history of the property within the market conditions prevailing) that are inherent to the property asset."

33. The four steps of the profits method of valuation are set out in section 3. In summary these are:

Step 1: Assess the FMT that could be generated by an REO.

Step 2: Assess the potential gross profit where appropriate.

Step 3: Assess the FMOP based on the costs and allowances appropriate to an REO.

Step 4: (a) Assess the market value of the property by capitalising the FMOP at an appropriate rate of return "reflecting the risks and rewards of the property and its trading potential".

(b) In assessing market value adjustment should be made for the costs of any assumed improvements, repairs and/or decoration reflected in the FMT.

(c) To assess the market rent for a new letting, rent review or the reasonableness of the actual rent passing "an allowance should be made from the FMOP to reflect a return on the tenant's capital invested in the operational entity – for example, the cost of trade inventory, stock and working capital. The resultant sum is referred to as the divisible balance. This is apportioned between the landlord and tenant having regard to the respective risks and rewards, with the landlord's proportion representing the annual rent."

34. Section 8 considers the occasions where it may be necessary to provide an indicative apportionment of a valuation or a transaction price. Any such apportionment of market value would usually relate to:

" • The lands and buildings reflecting the trading potential and;

• The trade inventory." (Paragraph 8.2)

35. Paragraph 8.3 says that:

"When considering the apportionment of a transaction price, particularly where the sale is through share transfer in a limited company, the valuer should proceed with caution as the transaction may in addition to that listed in paragraph 8.2 reflect the following:

• the trading stock, consumables and cash;

• intangible assets; and

• liabilities such as salaries, taxes, debts etc."

The case for the appellants

36. The appellants say the capitalised value of the FMOP net of rent (and less trade inventory) does not represent the value of the leasehold interest. Mr Ellis, unlike Ms Rodrigues, considers the leasehold interest and the leasehold property to be the same thing. Since it is agreed the care homes were let at their market rent the appellant said that nothing further would have been paid by the purchaser by way of a capital sum for the leasehold interest.

37. But in cross-examination Mr Ellis repeatedly accepted that the agreed valuations were valuations of the leasehold interests. However, he said he had "included the business as part of my valuation".

38. Mr Ellis said his valuation related to the leasehold interest, together with the business and the trade inventory required for the effective operation of the business. The valuation was then adjusted (reduced) for the trade inventory, as agreed. During cross-examination Mr Ellis emphasised he had included more than just the leasehold interest and the trade inventory in his valuation, it also included what he described as business goodwill. Trading potential was reflected in the rental value of the leasehold interest but the capitalised value of the FMOP net of that rent was not part of the value of the leasehold interest. Mr Ellis said he thought the valuation was for "more than just the property … the idea is that there was a business in there that is trading and that in part is responsible for the profits that are generated."

39. After prolonged questioning Mr Ellis accepted that the agreed valuations in the experts' joint statement were valuations of the leasehold interests, albeit the valuations were arrived at by having regard to the business that would be carried out by an REO. Mr Brinsmead-Stockham put it to Mr Ellis that the valuation figures for Manor Place and Maple House:

> "Q. … are the agreed figures between you [and Ms Rodrigues] for the valuation of the leasehold interests. That is right?
>
> A. Yes." (Transcript, page 24)

40. Mr Firth submitted that the respondent had conducted a narrow linguistic analysis of parts of the joint statement in order to try and establish Mr Ellis's acceptance of the agreed valuations as representing the value of the leasehold property interests. In fact, the joint statement confirmed at paragraph 2.8 that there remained a "contentious issue" between the experts:

> "• [Ms Rodrigues] considers that the valuations relate to the leasehold interests in the care homes (having regard to the trading potential of those properties) and the trade inventory;
>
> • [Mr Ellis] considers that the value relates to business goodwill, to include the benefit of the trade inventory".

This outstanding difference of opinion was acknowledged in the respondent's skeleton argument and Mr Firth argued that the substance of the dispute was clear and should be addressed by the Tribunal.

41. Mr Firth submitted that the respondent was wrong to assume that because the value of a TRP was found by reference to the trading potential of the property, the whole of the trading potential had to be attributed to and reflected in the property value.

42. VPGA 4 defined trading potential at paragraph 2.13 as the future profit that an REO would expect to be able to realise from occupation of the property, i.e. the FMOP. Step 4 of the profits method of valuation said that to assess the market rent of the property an allowance should be made from the FMOP to reflect a return on the tenant's capital invested in the operational entity. What is left is the divisible balance which is apportioned between the landlord and tenant having regard to respective risks and rewards, with the landlord's proportion representing the annual rent. That being so, while the value of the TRP reflected the property's trading potential it did not attribute all of it to the landlord.

43. It was common ground between the experts that there would be a difference in what a hypothetical purchaser would pay for a care home with an established business and one with no such established business, what Ms Rodrigues described as the difference between the "hot start" and the "cold start". Given a choice between the two, a hypothetical purchaser would pay more for an established business than just a bare property interest. Mr Firth said the difference between the two was, as a matter of law, the goodwill of the established business and it was that which Mr Ellis said formed the subject of the premium, i.e. the capitalised FMOP less the market rent. Ms Rodrigues on the other hand said the tenant was paying nothing for the business. That could not be right since an established business had value and would not be given away for free.

44. Trading potential reflected factors inherent in the property but that did not entitle the landlord to all of the future profit that the REO would expect to generate. Profits did not arise *simply* from the inherent characteristics of the property, somebody (the REO) had to carry on the business and the trading potential also reflected the risk and effort required to do so. That was why VPGA 4 required the apportionment of profit between the landlord (property) and tenant (business).

45. The appellants said that if the respondent was right that all the future profit of the REO should go to the landlord, then the market rent should be equal to the FMOP. That was contrary to VPGA 4 and was obviously wrong. It would mean the REO would pass all of its FMOP to the landlord as rent and receive nothing as reward for taking the risks of carrying on the business. There was no reason or incentive for the REO to do that. It made no difference that the FMOP would be achievable by any REO operating a business from the TRP; whoever conducted the business would want a fair return.

46. Mr Firth submitted that the respondent had failed in its attempt to reconcile VPGA 4 with the existence of a valuable business/goodwill being operated from a TRP. The respondent said such a valuable business/goodwill would only arise where the business was being operated more profitably than that by an REO. Where that happened, the respondent said "the average market participant" would be prepared to pay an additional sum to acquire the existing business that was actually operating from the TRP. But if the actual business was out-performing that of an REO it would mean there was personal goodwill which was not transferable in any event and was not something that a hypothetical purchaser would (or

could) pay to acquire. Such personal goodwill would be specifically excluded by paragraph 6.3 of VPGA 4.

47. The respondent submitted the appellants had been ambiguous in their case about what business the supposed goodwill related to; sometimes looking at the actual business being carried on at the valuation date and at other times looking at the hypothetical business of an REO for the purposes of the profits method of valuation. The appellants said this criticism, which implicitly amounted to saying one can only value the actual asset by using the actual profit, was misguided. In the same way as one valued the actual interest in land by reference to the hypothetical profit it could generate, so too one could value the actual business by reference to the hypothetical profit it could generate. It could not be argued that use of hypothetical profits meant one could not be valuing the actual business/goodwill. In any event it was a non sequitur for the respondent to argue about whether the figures related to actual or hypothetical goodwill since that did not bear upon the respondent's entirely different point that, in fact, the figure is part of the value of the land.

48. The appellants submitted that, depending how one uses the profits method of valuation, one can derive a value for the land interest in a TRP, a value for the business or both. If, as here, one is concerned to find the value of a leasehold interest then one proceeds as far as step 4(c) of VPGA 4. But the guidance does not then say the valuer should in addition capitalise the FMOP net of rent as part of the value of that leasehold interest. That further step produces a value for the business. If one was valuing a freehold of a TRP rather than a leasehold, Mr Ellis explained in answer to questions from the Tribunal that he would apply a multiplier of 7 to 7.5 to the FMOP (with no deduction for rent) to give the combined value of the freehold and the business. Of that multiplier Mr Ellis said about 2 would be attributable to the value of the business with the remainder being used to calculate the value of the freehold interest.

49. This approach was said to be consistent with the approach in *Mohammed v Newcastle City Council* [2016] UKUT 415 (LC) where the Tribunal, Mr A J Trott FRICS, said at [79], in the context of a claim for compensation following the compulsory acquisition of a TRP (a fish and chip shop):

> "The profits method of valuation combines the value of the business with the value of the property from which it is conducted. Its outcome is, in effect, a composite of these two values. The value to the owner cannot be less than the open market value, but it can be more if the capitalised profits that are actually achieved exceed those which are considered in the market to be fairly maintainable. The value of any such excess represents the current operator's personal goodwill and it is that which I think Mr Horton seeks to exclude when considering the open market value of the reference property under rule (2). But the profits method of valuation does not produce a separate freehold value distinct from the value of the business use which is conducted from the property. The two are inextricably linked and together give the value of the land to the owner."

50. Mr Firth submitted that the respondent had failed to explain how a TRP let at its open market rental value could additionally command a capital value. He denied the experts

had agreed that a market rent lease had such additional market value. Mr Ellis had consistently said that any additional amount was paid for the goodwill of the business. Ms Rodrigues had accepted that, according to VPGA 4, the guidance she relied upon, the market value of a lease let at a market rent was nil:

> "Q. Try again. Given this guidance [VPGA 4], and what we have – what we have just read and what you have understood, the value of a market rent lease, according to this guidance, is going to be nil, is it not?
>
> A. According to this guidance." (Transcript, page 78).

51. The respondent's reliance on transactions to show that an additional sum would be paid was unreliable since nothing was known about the details of the transactions, what was being acquired or whether the rents were at market rental value.

52. The respondent asserted that a person would pay a premium to acquire the economic opportunity to carry on a business at the property and to make the FMOP. But the payment for such an opportunity was already reflected in the market rent (landlord's share of the divisible balance). The landlord could not have two bites of the cherry; firstly, by way of market rent, and, secondly, by attributing the capitalised value of a FMOP net of rent to the landlord's share of the trading potential of the leasehold interest. This was not provided for in VPGA 4 and did not explain what additional interest of the landlord was taken into account at the second division which was not already reflected in the market rent.

53. Mr Firth submitted that the respondent's approach involved giving all the net present value of future profits to the landlord thereby denying the tenant his share of the divisible balance as provided for in VPGA 4 and economically equivalent to the tenant paying an annual rent which was equal to the entire maintainable profit. That was unrealistic. According to the respondent's argument, because the landlord owned the property from which the business was conducted, it should be entitled to all the maintainable profit from the business without having to do the work or take the risk. The tenant meanwhile would get nothing for the effort of carrying on the business until it achieved more than the FMOP. If VGPA 4 had intended the tenant to break even it would not have apportioned the FMOP between the landlord and tenant but instead would have attributed everything to the landlord and equated market rent with FMOP. On the respondent's argument it made no difference what one said the market rent was; the landlord was entitled to all the FMOP in any event, whether paid to it as rent or a premium.

54. Mr Firth said the respondent no longer attributed to VPGA 4 the authority that it did originally. It now sought to rely on the introduction to that guidance which said it "cannot cover every circumstance". But Mr Firth said it was inconceivable that if the landlord of a TRP would be expected to receive a premium as well as the market rent VPGA 4 would not have said so. Mr Firth concluded that either the RICS in VPGA 4 had overlooked a fundamental feature of practice in relation to the valuation of leasehold interests and without which, according to the respondent, the valuation "does not accord with economic reality or common sense", or, as Mr Firth submitted, the respondent was wrong.

The case for the respondent

55. Ms Rodrigues said that even where the passing rent equated to the market rent of the TRP, purchasers may nevertheless be prepared to pay a capital sum to acquire a TRP as an operational entity capable of generating the potential income stream. She said such a premium was, in effect, a payment to acquire the ready-made trading opportunity inherent in the TRP and also reflected an element of marriage value created by selling the premises and other associated assets such as chattels as an operational entity.

56. Ms Rodrigues said that paragraph 8.3 of VPGA 4 (apportionment of a transaction price), by identifying trading stock, intangible assets and liabilities as being ingredients of a transaction price other than land, buildings and trading inventory, confirmed that on the transfer of a TRP as a going concern "trading potential (which forms part of the value of the land and buildings) and intangible assets (such as goodwill) are distinct concepts." In her opinion VPGA 4 was "absolutely clear" that a valuation of a TRP should include the trading potential of that property as part of the value of the land and buildings and was to exclude any additional value in the business attributable to the personal goodwill of the operator.

57. The experts agreed that premiums existed in this case and Ms Rodrigues said the only question was whether they were paid in respect of the properties, and specifically their inherent trading potential, or in respect of goodwill, i.e. an intangible asset. Ms Rodrigues noted that Mr Ellis considered the premiums to represent the goodwill of the business but she thought that was in conflict with the accepted guidance contained in VPGA 4. Ms Rodrigues considered her valuation had been conducted in accordance with that guidance and said it was clear to her that the trading potential of the property was inherent in the property and would transfer to a new owner on sale. The premiums were not paid in respect of goodwill in the business.

58. Ms Rodrigues developed this theme in her supplementary expert report where she noted that VPGA 4 made it very clear that the profits method of valuation related to the valuation of properties, e.g. the wording of step 4(a) twice referred to "property" and did not mention "business". She expressed the fundamental disagreement between the experts thus:

> "I consider that trading potential is part of the value of a trade related property, whereas Mr Ellis considers that trading potential should be regarded as business goodwill. I consider that the RICS guidance clearly supports my view." (Supplementary report, paragraph 5.2).

59. Ms Rodrigues identified what she described as two important principles within VPGA 4 that supported her view that trading potential of a TRP should be included in the value of the property and not in the value of intangible "business goodwill":

(i) the assessment of FMOP assumed a hypothetical REO and not the actual operator; and

(ii) VPGA 4 specifically excluded the value of intangible assets (such as goodwill) from the value of trade-related properties.

60. With regard to (i) Ms Rodrigues said that the definitions of a TRP and of trading potential in VPGA 4 "clearly states that the profit that a hypothetical REO of a property would be able to derive from occupation of the property is part of the value of the property itself."

61. Any personal goodwill was excluded by using the FMT and FMOP that could be achieved by an REO. Given the experts agreed that a hypothetical REO would generate higher levels of FMT and FMOP than the actual operators of Manor Place and Manor House, Ms Rodrigues said it was difficult to see what intangible value there could be in the actual businesses in this case.

62. With regard to (ii), Ms Rodrigues said VPGA 4 had clarified the concept of "transferrable goodwill" that was found in GN 1. She said such goodwill constituted the "market's perception of the trading potential" of a TRP and formed part of the value of that property. In any event GN1 which Mr Ellis relied upon, specifically did not apply to going concern or business valuations and did not deal with the valuation of intangible assets.

63. Paragraph 6.5 of VPGA 4 said that for many trading entities, the vehicle for the transfer of a business would be the sale of a freehold or leasehold interest in the property. The guidance said such transactions could be used as comparable evidence to value TRPs so long as the valuer excluded the value of the component parts of the transaction that are not relevant. Examples include stock, consumables, cash, liabilities and intangible assets (such as brand names or contracts, to the extent they would not be available to the REO). Ms Rodrigues said both experts had excluded stock, consumables and cash liabilities from their valuations but Mr Ellis had not adjusted for intangible assets.

64. Paragraph 8.2 of VGPA 4 said that an apportionment of market value would usually relate to the land and buildings reflecting the trading potential and the trade inventory. But the apportionment of a transaction price needed to proceed cautiously because in addition to the matters referred to in paragraph 8.2 such a transaction might reflect trading stock, consumables and cash; intangible assets; and liabilities. Ms Rodrigues said this made it "absolutely clear" that intangible assets, not being referred to in paragraph 8.2, were not included as part of the market value of an interest in the TRP.

65. During cross-examination Ms Rodrigues said that for an established care home the market rent would not be enough to acquire the leasehold property interest; she would expect a premium to be paid as well. Ms Rodrigues said that in general the market rent related to a non-operational building and not an operational entity, although she accepted that that approach did not appear in VPGA 4. She accepted that paragraph 6.9 of the guidance stated that where, as here, the property is trading and trade is expected to continue, the valuation should be reported as "market value (or market rent) as a fully equipped operational entity having regard to trading potential …" That being so, Ms Rodrigues agreed the assessment of market rent under step 4(c) of paragraph 3.1 of VPGA 4 was of an operational entity, albeit she distinguished between mature operational entities and those in their infancy.

66. Ms Rodrigues explained her valuation approach in the following passage from the transcript:

> "Q. So you are saying just for the interest in land, not for the business, the – the tenant pays 35 per cent of the operating profit every year, plus a sum designed to capitalise the remaining 65 per cent of the operating profit?
>
> A. Yes
>
> Q. That – this is a 100 percent of the operating profit, one way or another, goes to the landlord. …
>
> A. I – I – I am sorry. He is paying two times that – he is getting the benefit for five years, and he is paying two times that up front so there is three years – three year's purchase left that is for him. So that is just out of the five year lease. There is obviously the prospect that – that this will continue, and he can get a new lease after that." (Transcript, pages 69-70)

67. There followed further cross-examination about whether Ms Rodrigues' use of a year's purchase of 2 to capitalise the remaining 65 percent of the FMOP after the deduction of market rent at 35 per cent, gave the net present value of that income stream. Ms Rodrigues said that she had not considered it in those terms, but accepted that the net of rent FMOP (65 per cent) multiplied by the year's purchase of 2 gave the net present value of that income stream, bearing in mind the associated risks. This passage of cross-examination concluded:

> "Q. Thank you. And just to follow that through then, you are saying that the tenant is paying over 100 per cent in net present value terms of the income – the profit of this business, just for the – for the leasehold and land – the building. Is that right?
>
> A. Yes." (Transcript, page 74)

68. Ms Rodrigues said that the term "transferrable goodwill" was no longer referenced in the guidance but instead "it's called trading potential which relates to the property". She accepted that this moved with the transfer of the operational entity.

69. Mr Brinsmead-Stockham said the respondent's primary case was that the experts had agreed the market valuations of the leasehold interests in Manor Place and Maple House which was enough to determine the reference in favour of the respondent. The experts agreed that the RICS guidance applied and Mr Ellis had accepted he would obtain the same answer whether the appropriate guidance was GN 1 or VPGA 4. The guidance related solely to TRPs, i.e. properties not businesses. At the hearing it was common ground that the agreed valuations related to the leasehold interests in land.

70. Mr Ellis's agreement to the valuations as being of the leasehold interests was expressed in terms in several places in the experts' joint statement and he had repeated this view during cross-examination. Ms Rodrigues had expressly sought to define the meaning of leasehold interests and to distinguish it from leasehold properties in her expert report and both experts should be taken to have a mutual understanding of the basis of their agreement. Even if the Tribunal accepted Mr Ellis's claim during the hearing that leasehold interests

and leasehold properties were the same thing it was obvious that both expressions related specifically to the properties at Manor Place and Maple House.

71. On the basis that the experts had expressly agreed the valuation of the leasehold interests, the Tribunal should endorse those valuations. It was therefore unnecessary for the Tribunal to consider the nature of "trading potential" in the context of valuing TRPs since the experts must be taken to agree that on the facts of the case at the valuation date the value of the trading potential in question was included in the value of the leasehold interests. Nonetheless the respondent wished to consider the point and asked the Tribunal to provide definite guidance on it since the question had a much wider significance.

72. The debate between the parties was whether the trading potential reflected in the agreed valuations constituted part of the value of the leasehold interests (as the respondent maintained) or "business goodwill" (as the appellant maintained).

73. The definition of trading potential in VPGA 4 paragraph 2.13 was unambiguous. It referred to the valuation of a property and to the future profit that an REO would expect to be able to realise from occupying that property and reflected factors that were inherent to the property asset. The emphasis on property was clear. Mr Brinsmead-Stockham cited several further references from VPGA 4 and GN 1 which supported this view, including the definition of a TRP at paragraph 1.3 of VPGA 4 and the exclusion of personal goodwill at paragraph 6.3. VPGA 4 was concerned with (and only with) the valuation of TRP properties (and not businesses) and such a valuation reflected and was made on the basis of trading potential.

74. Trading potential was value attributable to factors that are "inherent" to the TRP as a property asset, i.e. land (VPGA 4 paragraph 2.13) and it followed from the RICS guidance that *all* of the trading potential of the TRP fell to be attributed to and reflected in the value of the land, as the respondent argued. The appellants disputed this view but were unable to point to any of the RICS guidance which stated that trading potential should be reflected in anything other than the value of the TRP (land) being valued.

75. The respondent also drew support from *Mohammed v Newcastle City Council*, which it described as currently the leading decision on the valuation of TRPs, where the Tribunal said at paragraphs 76-77:

> "… the value of the freehold reflects the opportunity for a purchaser to establish a going concern rather than the established going concern as it exists in the hands of the vendor.
>
> … I think a better distinction is between open market value (reflecting the trading potential of the reference land to a reasonably efficient operator) and the value to the owner (reflecting the actual trading potential as established in the hands of the claimants). The valuation for open market value should be of the property as a place to do business and not a valuation of the business itself."

This passage emphasised that the method of valuing TRPs related to the valuation of land and not the value of the business conducted from that land, and that the value of the land included its trading potential.

76. Mr Brinsmead-Stockham submitted that the appellants were confused in their understanding of the profits method of valuation as described in VPGA 4 and failed to recognise the fundamental significance of the fact that TRPs were valued by reference to the profits that a hypothetical REO would expect to generate from the land. Such profits would be available to any and every REO operating a business from the TRP. So any purchaser of the land would factor these expected future profits (the trading potential of the land) into the price they would pay for the TRP and they would rightly be regarded as constituting part of the value of the land.

77. The appellants had wrongly made continual references to the valuation of businesses and "business goodwill" but the only issue before the Tribunal concerned the valuation of interests in land. Mr Ellis's diversion, under instruction, into valuing not just the interests in land but "the business as a fully operational going concern" meant he had failed to address directly the question in issue in the reference.

78. It was unclear whether the "business goodwill" that the appellant referred to was that of the actual business being carried on at the valuation date or the hypothetical business of an REO. It appeared from the appellants' submissions that they were asserting, albeit not directly, that the agreed valuations related to the appellants' actual businesses. That was wrong and should be rejected by the Tribunal for three reasons:

(i) it was inconsistent with the valuation principles in VPGA 4 and GN 1 which required the valuation of TRPs to be undertaken by reference to the FMOP of an REO, and there was no necessary connection between those and the actual business;

(ii) it was directly contradicted by Mr Ellis during cross-examination where he accepted he was referring to a hypothetical business carried on by an REO; and

(iii) it was contrary to the analysis in *Mohammed*.

79. But a valuation of the business goodwill of a hypothetical business operated by a hypothetical REO was itself a flawed concept because:

(i) such a business is, by definition, the average business that could be carried on from a TRP and therefore would be indistinguishable from any other such business. Consequently there was no basis to assume such a business would have any goodwill; and

(ii) it was incoherent to maintain that goodwill could attach to a hypothetical business that did not exist.

80. The appellants' positive case that the agreed valuations related to business goodwill was therefore untenable.

81. Mr Brinsmead-Stockham then addressed the appellants' criticism of the respondent's positive case. The first of these criticisms was described as the market rent argument and took two forms. Firstly, the appellants said that where a lease was subject to a market rent there could, by definition, be no further value in the leasehold interest. Secondly, whereas VPGA 4 provided for the determination of a market rent at step 4 it made no provision for the payment of a premium in respect of a leasehold interest.

82. With regard to the appellants' definitional argument the respondent said that although the experts had agreed the leases were at a market rent, they had not agreed that this prevented the leases from having any further value for which a purchaser would pay a premium. Ms Rodrigues had stated this as her position in terms in her expert report and in cross-examination. Mr Ellis said that in agreeing the leases were subject to an annual market rent he did not understand Ms Rodrigues to be agreeing that the leasehold interests had no further value for which a purchaser would be prepared to pay. Both experts agreed that the leases were subject to a market rent and that a purchaser of the leasehold interests would be prepared to pay a premium in addition. The dispute was about what the premium was for.

83. Also, such transactional evidence as existed although it lacked detail, suggested it was quite normal to provide for both an annual market rent and the payment of a premium.

84. Mr Brinsmead-Stockham argued that the appellants' definitional argument was not economically sound. Taking Manor Place as an example he said the agreed FMOP net of rent was £405,000 pa. Over the 5-year term of the lease this meant the purchaser would make total FMOP of £2,025,000 for which it would pay the agreed valuation of £730,000 to purchase the leasehold interest and acquire the opportunity to make those profits. The appellants, however, said that nobody would pay anything for that opportunity which was nonsensical.

85. Ms Rodrigues accepted in cross-examination that the agreed valuations represented the net present value of the FMOP (net of rent) that an REO would expect to derive from the leasehold interest. But those profits were reflected in the value of the land as trading potential and so the net present value of those profits was simply another way of describing the market value of the leasehold interests. There was no reason to doubt that a purchaser would pay such a sum to acquire an interest in a TRP. Mr Brinsmead-Stockham illustrated his argument with a simple example. The appellants would query whether a purchaser would pay £1,000 (in capitalised form and up front) for a 5-year income stream with an expected net present value of £1,000. But that was a paradigm example of a transaction at market value.

86. The appellants' VPGA 4 argument was that the guidance only provided for the assessment of a market rent of a leasehold interest in a TRP; it did not provide for the assessment of the value of any additional premium. Ms Rodrigues had accepted this in cross-examination. But the introduction to VPGA 4 made it clear that the guidance did not cover every circumstance and was not concerned with the detailed approach to the valuation. Leasehold care home transactions were rare and it was not surprising the guidance did not cover these particular facts and circumstances.

87. The experts had agreed (i) that a premium was payable for the trading potential of the TRP; (ii) the method of valuation of that premium and (iii) the resultant valuation. In doing so they had applied a modified form of step 4(a) in VPGA 4 paragraph 3.1 which was correct in principle and entirely consistent with the terms of VPGA 4 and GN 1.

88. Mr Ellis had been instructed to provide a valuation of the leasehold property and business on the assumption there was no trading business. Mr Ellis said that in those circumstances the leasehold interests would have no value. The respondent's primary argument against this valuation is that to value Manor Place and Maple House on the assumption there was no trading business was irrelevant on the facts of the case. In general, valuations of TRPs (and all land) should be made on the basis of the land as it stood on the valuation date and both Manor Place and Maple House were operational on the valuation date and had to be valued accordingly. Mr Brinsmead-Stockham referred to the cross-examination of Mr Ellis and submitted this had further undermined the creditability of this approach, including Mr Ellis' acceptance that one could not simply say Manor Place and Maple House would have no value had they closed without looking at all relevant circumstances. These included the need to take account of any value attributable to the properties operating with a "warm start" on the valuation date.

89. The respondent rejected the appellants' argument that:

> "What is subsumed within the asset to be valued (the lease) and what is treated as a separate asset are questions of law and have already been determined [in the case law cited by the appellant] … the RICS guidance can have no bearing on that issue."

The respondent said that none of the authorities relied on by the appellant helped her case and three of them, being decisions of the First-tier Tribunal, were not binding on the Tribunal. None of the cases was concerned with the valuation of land, let alone the valuation of TRPs. Some concerned the valuation of goodwill rather than land. None of these cases provided a basis for maintaining that the respondent's analysis in this case was wrong in law.

90. The appellants' argument that RICS guidance was either irrelevant to the question before the Tribunal or should be given little weight was said to be supported by reference to a passage in *Arbib v Earl Cadogan* [2005] 3 EGLR 139 at [77]:

> "A valuer preparing a valuation under the 1967 Act, or any statutory valuation, must however value to the statutory definition as explained by the relevant case law and not to the Red Book [i.e. the RICS Guidance] which is not usually of assistance or relevance."

But read in context that passage referred to a situation where the applicable RICS guidance provided for a different approach to the valuation than that required under the relevant statutory test. Where there was a conflict between the relevant statutory test and the RICS guidance it was correct that the Tribunal should not rely on the guidance, but there was no such conflict in this case since there was no material difference between the statutory market value test to be applied and the definition of market value contained in the RICS guidance. The appellants had not identified any rule of law which required a different valuation approach to that contained in VPGA 4. *Arbib* did not provide a basis for raising doubt about the relevance of the RICS guidance on the facts of this case.

Discussion

Overview

91. The parties have effectively asked the Tribunal to explain to them what they have agreed. But that is something only they can answer. The experts have agreed the market rent and ostensibly have also agreed the market value of the leasehold interests. Insofar as there is still a dispute in this appeal it therefore reduces to the question: what do the agreed valuations of the experts represent and which of them has adopted the correct approach? The appellants submit the agreed valuation of each care home relates to the lease and business value combined and is not the value of the lease alone. Given the experts' agreement that the leases were at market rent, the appellants invite the Tribunal to find that the leases, at those market rents, had no market value. The respondent submits the agreed valuations represent the value of the leasehold interests in Manor Place and Maple House at the valuation date and that in the context of valuing TRPs "trading potential" forms part of the value of the land and is not referable to business goodwill.

92. The statutory requirement in this reference is to value the two leasehold interests in accordance with section 272 of the Taxation of Chargeable Gains Act 1992, i.e. to market value. There is no dispute between the experts about what that, and the concept of the open market, means. It has been fully explained in well-established case law. The question is, the market value of what?

Preliminary matters

93. Before considering this question we address four preliminary matters. Firstly, the respondent's primary case is that the experts have in fact agreed the market valuations of the leasehold interests in the form of the agreed valuations. They did so by valuing on the basis of the principles set out in the RICS guidance relating to TRPs (GN1 and VPGA 4). The respondent says, and we agree, that Mr Ellis accepted that the agreed valuations related to the leasehold interests. Ms Rodrigues noted that her instructions distinguished between "leasehold properties" and "leasehold interests" (see paragraph 11 above) and placed importance upon the difference between them. Mr Ellis, during cross-examination, said they were "one and the same thing". Mr Brinsmead-Stockham found it difficult to understand how Mr Ellis could possibly believe this and submitted that "on any view" Mr Ellis must be taken to have accepted that the agreed valuations relate to the leasehold interests as interests in land. Mr Firth submitted that the respondent had conducted a narrow linguistic analysis on this point and that it was clear from paragraph 2.8 of the joint statement that this remained a contentious issue between the parties.

94. Although Mr Ellis accepted the valuations related to leasehold interests we do not think that constituted acceptance of the respondent's position. It is clear that the experts have different opinions about what the agreed valuations represent and at no point did Mr Ellis say otherwise than that the valuations reflected business goodwill. (His instructions were

to provide his opinion of the "market value of the leasehold property and business"). He accepted the term "leasehold interest" but did not attribute the same refinement of meaning to it that Ms Rodrigues did. We do not consider that by agreeing the amount of the valuations Mr Ellis accepted the respondent's view of what they comprised. We do not find Mr Ellis' evidence to be contradictory to the appellants' position that the leasehold interests had no value.

95. Secondly, Mr Ellis was additionally instructed to consider the market value on the assumption that there was no trading business. There is agreement that as a matter of fact both Manor Place and Manor House were fully operational entities at the valuation date. We are concerned to value the properties in the condition and circumstances they were in at the valuation date and not what they might have been worth had they been empty. They were not empty, they were trading and we have valued them as such.

96. Thirdly, there was a difference between the experts about which RICS guidance to use. At the hearing attention focussed on VPGA 4 and we think it was appropriate to do so. The valuations were prepared for this hearing and should therefore reflect the guidance in force at the time we considered the matter. But we consider it necessary to refer to GN1 as well and we note that Mr Ellis said his valuation would not have changed whether he used GN 1 or VPGA 4. GN 2 is the predecessor to VPGA 4 and is similarly worded, but it did not feature in the reports or cross-examination. We would add, for the avoidance of any doubt, that the RICS guidance can neither be substituted for, nor supplement, the statutory direction to ascertain the market value of the relevant asset.

97. Fourthly, the experts have agreed the value of the retained freehold interests, subject to the leases, and we accept those valuations.

The legal nature of the dispute

98. The respondent argues that the matter in issue, namely the determination of the value of the leasehold interests in Manor Place and Maple House is a question of fact to be determined on the evidence. The appellants submit that what is subsumed within the asset to be valued (the leases) and what is treated as a separate asset are questions of law which have already been determined in the cases they refer to. The appellants say that RICS guidance can have no bearing on that issue.

99. We see no conflict between the parties' positions which we think are both correct. What constitutes the land asset to be valued is a matter of law but how much that asset is worth is a matter of fact. The appellants seek to show that the law recognises goodwill as a separate asset, distinct from the land asset. If that is so, then a valuation made on the basis that the goodwill is part of the land asset would be wrong in law.

100. The appellants support their argument by reference to several cases including *Balloon Promotions Limited v Wilson* [2006] STC (SCD) 167 in which several propositions about the nature of goodwill were set out and HMRC's argument that adherent goodwill should be subsumed in the value of property was rejected. In *The Leeds Cricket Football and Athletic Company Limited v HMRC* [2019] UK FTT 568 (TC) the tribunal was concerned

with the sale of Headingley Cricket Ground to Yorkshire Cricket Club and, according to the contract, the goodwill of the business carried on there. HMRC argued that the whole purchase price was for the property because there was no separate adherent goodwill asset. The FTT rejected this argument because splitting goodwill into inherent and adherent categories was an artificial exercise and also because the cricket business could be sold separately and carried on elsewhere.

101. The appellants submit the respondent is trying to re-argue that goodwill, in particular adherent goodwill, is not a separate asset as a matter of law and, therefore, its value should be subsumed within the value of the land interest. The appellants say the case law shows that position is wrong.

102. We do not accept that the law as to what is to be treated as a separate asset has been determined so as to bind the Tribunal. We have due regard to the cases referred to by the appellants but we do not accept that the respondent is barred in law from arguing the agreed valuations relate solely to the leasehold interests. The respondent does not refer to adherent (or any other) goodwill but expresses its argument in terms of what trading potential means and how it should be reflected in the value of the leasehold interest when using the profits method of valuation to value a TRP. That seems to us to be a matter of fact and valuation principle rather than a matter of law.

The valuation of a TRP

103. The valuation of a TRP is concerned with the value of the property in its use in the business which is conducted there. Businesses in TRPs cannot be sold separately from the property; they are mutually dependent and "inextricably linked" (*Mohammed* at [79]).

104. In *Mohammed* the Tribunal said of a TRP valuation:

> "The valuation for open market value should be of the property as a place to do business and not a valuation of the business itself." [77].

So the actual business that is conducted from a TRP is not relevant in an open market valuation; one must consider the property as a place for an REO to do business. Any personal goodwill attaching to the actual operator should be excluded (VPGA 4 paragraph 6.3 and *Mohammed* at [79]).

105. The Tribunal in *Mohammed* continued at [79]:

> "The profits method of valuation combines the value of the business with the value of the property from which it is conducted. Its outcome is, in effect, a composite of these two values … The profits method of valuation, unlike the investment method, goes straight to the value of the 'single whole.'"

Mohammed was concerned with the determination of compensation for the compulsory purchase of a fish and chip shop and was therefore assessing the value to the owner (and thus the actual realised trading potential) rather than simply open market value.

106. Although this case is not concerned with value to the owner the parties agree that the profits method of valuation is appropriate. As its name suggests the profits method is concerned with the trading potential of the property being valued and in this case we need to consider whether the premium resulting from its application, excluding any personal goodwill, is solely indicative of the trading potential inherent in the leasehold interest or whether it also reflects other trading potential originating from the business conducted on the property.

The leasehold interests

107. The experts were in broad agreement that step 4(a) of the profits method of valuation as set out in paragraph 3.1 of VPGA 4 applied to the valuation of freehold interests and step 4(c) applied to leasehold interests.

108. Step 4(c) is concerned with the assessment of the market rent. An allowance for interest on tenant's capital is first deducted from the FMOP to give a divisible balance. This is apportioned between the landlord and the tenant having regard to the respective risks and rewards, with the landlord's proportion representing the annual rent.

109. The market rent was determined in this case by taking a percentage of the FMOP and as such it reflects the trading potential of the property. One would expect the tenant's proportion of the FMOP to represent the amount it would require from the business to induce it to take a lease at the market rent and make sufficient return on its risk and for profit (interest on capital having already been allowed for). And yet the tenant in this case has paid a premium in addition to the market rent. What is that for?

110. In our judgment the agreed market rent must *fully* reflect the trading potential available to the tenant under the terms of the 5-year lease which it was granted. If that were not the case, as the appellants argue, it would not be the market rent but something less. The premium reflects the fact that the tenant is leasing a fully equipped operational entity and, from a business viewpoint, is accepting a lower risk than having to start from scratch. That is a business advantage for which the tenant will be prepared to pay over and above the market rent.

111. The premium as calculated by the experts comes out of the tenant's proportion of the divisible balance but it does not form part of the value of the leasehold interest that is being granted. That value is fully represented by the market rent. In this case the profits method of valuation is being used to ascertain market rent, not market value.

112. The respondent says that in valuing TRPs "trading potential" is (entirely) attributable to the value of the TRP (i.e. land) and not "business goodwill". The rental value of the leasehold interests in this case should and do "relate to", "have regard to", "reflect", and "be intrinsically linked to" trading potential, all expressions to be found in VPGA 4 and GN 1, but nowhere in any of the RICS guidance does it say such trading potential is exclusively and wholly reflected in the value of the interest in land. To assume that is the case is to ignore the fact that the profits method of valuation, when used to value a TRP, produces a composite value reflecting both property and business aspects.

113. Although GN1 did not apply to going concern or business valuations it nevertheless recognised at paragraph 4.4 that a valuation of a TRP on the basis of market value "should

only reflect the transferable goodwill that relates to the trading potential of the property." It is clear from that statement that a market valuation of a TRP could include transferable goodwill and that a property's trading potential was not necessarily only reflected in the value of the interest in land. This passage is not repeated in VPGA 4 which we note does not refer to transferable goodwill.

114. GN 1 (paragraph 4.10) and VPGA 4 (paragraph 6.5) refer to the use of transactional evidence as comparables in similar terms. VPGA 4 says:

> "For many trading entities, the vehicle for a transfer of the business will be the sale of a freehold or leasehold interest in the property. Such transactional evidence can be used as comparable evidence in the valuation of trade related properties, so long as the valuer is in a position to exclude the value of the component parts of a transaction that are not relevant. Examples include stock, consumables, cash, liabilities and intangible assets (such as brand names or contracts, *to the extent they would not be available to the REO*). (Our emphasis)

We take the italicised passage to mean intangible assets that are available to the REO, such as the transferable goodwill referred to in GN 1, can be reflected in the valuation of TRPs.

115. In *Balloon Promotions* the Special Commissioners held at paragraphs 159 to 170 that, among other things, goodwill:

(i) is a type of property;

(ii) should be looked at as a whole;

(iii) realises profits for the business;

(iv) cannot subsist independently but must be attached to a business;

(v) distinguishes an established from a new business; and

(vi) exists as a question of fact.

116. Looking at the valuation of Manor Place and Maple House as fully equipped operational entities in the light of these characteristics we consider their trading potential is not all attributed to and reflected in the value of the land, as the respondent suggests. The definition of trading potential contained in VPGA 4 says it is future profit that "reflects a range of factors … that are inherent to the property asset." But the definition does not state in terms that trading potential is *only* comprised of such factors. GN 1 defines transferable goodwill as being inherent to the specified trading property and will transfer to a new owner on sale (paragraph 2.5). It goes on:

> "In relation to a trade related property valuation, goodwill is either capable of transfer with the property interest or it is not."

117. We are satisfied that the trading potential of Manor Place and Maple House that is reflected in the agreed valuations cannot reasonably be attributed solely to the leasehold interests and that the appellants are correct to say that those valuations must also include transferable goodwill.

118. The subdivision of goodwill into different types is generally no longer considered helpful, e.g. inherent (or locational) goodwill, personal goodwill, free goodwill - which in turn can be further subdivided into adherent (or adaptational) goodwill and transferable goodwill. In *Balloon Promotions* the Special Commissioners said at [169] that:

> "The authorities caution against an over analytical approach to goodwill."

119. This reluctance to pursue definitional refinement of goodwill might help explain, at least in part, why VPGA 4 no longer refers to transferable goodwill. Ms Rodrigues said in cross-examination that the concept of transferable goodwill "was causing confusion" and that "the term…is no longer referenced, instead it's called trading potential which relates to the property" (Transcript, page 82).

120. The nature of such confusion was not explained but Ms Rodrigues confirmed how she had approached her valuation in the light of this new terminology. She accepted that she had excluded non-transferable (personal) goodwill but had not excluded transferable goodwill, i.e. trading potential, which she accepted was just a difference in name. But it was her view that all such trading potential was part of the leasehold interest and did not form part of a separate asset (see the transcript at page 83).

121. TRPs and the method used to value them did not change between 2010 (GN 1) and 2014 (VPGA 4). We think Mr Ellis was right to say his valuation would not have been any different whichever guidance he had relied upon, because in either event business goodwill was included as part of the trading potential. That being so, and having given due regard to the detailed arguments of the parties, we are satisfied that the valuation of Manor Place and Maple House did not represent the trading potential of the leasehold interests.

Determination

122. The values of the freehold interests are:

    (i) Manor Place: £2,725,000

    (ii) Maple House: £2,060,000

123. The value of the leasehold interests in both Manor Place and Maple House are £nil.

Dated 8 April 2021

A J Trott FRICS | Mrs Diane Martin MRICS FAAV