[2014] UKFTT 396 (TC)

TC03525

Appeal number: TC/2011/05967

INCOME TAX – Relief for gifts of shares to charity – whether arrangement designed to enhance relief or create artificial tax losses – market value of shares on initial listing – whether company's main asset acquired shortly before listing at a reduced price – if so, impact on value of listed shares – relevance of market transactions on first day of listing – basis of valuation to be adopted – determination of market value – appeal allowed and disallowance of relief on claim re-determined

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR NICHOLAS GREEN — **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS — **Respondents**

TRIBUNAL: JUDGE MALCOLM GAMMIE CBE QC
MR RICHARD THOMAS

Sitting in public at Bedford Square, London WC1 on 29 & 30 April and 1 May 2013

Patrick Way QC and Michael Firth, counsel, instructed by Afortis Limited for the Appellant

Daniel Margolin instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents

DECISION

Introduction

1. This is an appeal by Mr Nicholas Green against a Closure Notice dated 27 June 2011 under section 28A Taxes Management Act 1970 ("TMA") amending his self-assessment return for the year 2007/08. The amendment disallowed in part his claim for relief in respect of two gifts of 118,750 shares of 0.1p each in Chartersea Limited ("the Gifted Shares" and "Chartersea" respectively) to each of the National Eczema Society and the Alzheimer's Society on 4 April 2008. Mr Green had claimed relief under section 431 of the Income Tax Act 2007 ("ITA") of £237,500 based on a market value of £1.00 per Gifted Share. The Respondents' officer did not accept that this amount reflected the market value of the Gifted Shares at that date. She considered that their market value was only 30p per Gifted Share. She restricted Mr Green's claim for relief to £71,250 (a disallowance of £166,250) and amended his return on that basis.

2. Mr Green appealed the amendment on 13 July 2011. He did not seek a review of the officer's decision and transmitted the appeal to the Tribunal on 2 August 2011. His grounds of appeal are that the Respondents ("HMRC") had provided no support for their valuation, that the price paid for the Gifted Shares was £1 per share, that the Gifted Shares were quoted on a Recognised Stock Exchange at a mid-market price of £1 at the time of the gift and that a value of £1 per Gifted Share was supported by an independent valuation obtained at HMRC's request. It was common ground before us that the only question for our determination is: what was the market value of the Gifted Shares on 4 April 2008?

3. In addition to the documents that the parties placed before us we heard factual evidence from Mr Green, and on his behalf from Geoffrey Dallimore, Gavin Johnson and Keith Salisbury. Stephen Johnson, an Inspector of Taxes in HMRC's Specialist Investigations team, gave evidence of certain matters for HMRC. We also had the benefit of expert valuation evidence from Lee Teste and Michael Ruse.

The Factual Background

4. HMRC summarised the factual background in their amended Statement of Case. Mr Dallimore confirmed that the summary was accurate and there was no dispute as to the basic transactions involved.

5. Chartersea was incorporated on 6 November 2007. Its authorised share capital on incorporation was £1,000 divided into 1,000 ordinary shares of £1 each. A single subscriber share was issued and on 24 January 2008 it was transferred to Keith Salisbury. Chartersea was the corporate vehicle chosen for the potential acquisition of the business of Warwick Development (North West) Limited ("WDL"). WDL had been formed in 1998 and had operated since then as a manufacturer and supplier of uPVC windows, doors, sealed glazed units and conservatories.

6. On 1 February 2008 it was resolved that each ordinary share (issued and unissued) of Chartersea should be subdivided into 1,000 ordinary shares of 0.1p each and that

the authorised share capital be increased from £1,000 to £25,000 by the creation of 24,000,000 ordinary shares of 0.1p each. Chartersea proceeded to issue 999,500 ordinary shares to Geoffrey Dallimore and 999,500 ordinary shares to Mr Salisbury, in each case at 0.1p (i.e. at par).

7. On 4 February 2008 Chartersea issued a private placing memorandum to raise up to £50,000 before expenses (estimated to be £40,000 net) through the issue and allotment of up to 5,000,000 new shares of 0.1p each at 1p per share. The closing date was 27 February 2008 (subject to the directors' right to extend the placing or close it at any earlier date). The new shares were to be issued by 17 March 2008 and share certificates were to be despatched by 31 March 2008.

8. On 29 February 2008, Chartersea issued 1,000,000 new shares at 0.1p to Brian Johnson. Brian Johnson was the acting managing director of WDL. He was the brother of Gavin Johnson who, with his wife, owned 100 per cent of WDL's holding company, Warwick Management Limited ("WML").

9. On 10 March 2008, as a result of the private placing, Chartersea issued 4,998,529 new shares to a total of 13 subscribers, including Mr Green. Mr Green subscribed for 279,412 ordinary shares of 0.1p for a total consideration of £2,794 (i.e. 1p per share). The subscribers for the private placing shares were invited to subscribe for a rights issue and, on 12 March 2008, a further 1,649,541 shares were issued at £1 per share. As a result Chartersea's issued share capital became 9,648,043 ordinary 0.1p shares. Under the rights issue Mr Green subscribed for a further 92,206 ordinary shares for a total consideration of £92,206 (i.e. £1 per share). He therefore held 371,618 Chartersea shares in total, amounting to approximately 3.85 per cent of the issued share capital, at a total cost of £95,000. In his valuation report Mr Ruse noted that, ignoring Chartersea's promoters and Brian Johnson, Chartersea's shareholders paid an average price for their shares of 25.6p each.

10. On 18 March 2008, Chartersea purchased the shares in WML for £4,112,267.90 (plus an amount of up to £235,567.32 in respect of book debts to be collected by WDL after completion). In addition to the equity that it had raised (£9,649 paid up share capital and £1,692,851 premium), Chartersea had the benefit of a loan facility from The Cooperative Bank plc of £2.5 million and an overdraft facility of up to £461,000 (of which £300,000 was utilised). Leaving aside the book debts, the purchase price for WML comprised £3,612,267.90 cash on completion plus a £500,000 loan note redeemable in instalments up to 18 March 2012.

11. An application was made for Chartersea's 9,648,043 shares to be listed and dealt with on the Official List of the Channel Islands Stock Exchange ("CISX") and on 4 April 2008 the shares were so listed at a bid price of 95p per share and an ask price of £1.05p per share. On 4 April 2008 two parcels of 7,000 shares were traded at 101p and 100p by Brewin Nominees Limited and Giltspur Nominees Limited.

12. Also on 4 April 2008 Mr Green made his gift of the Gifted Shares to the two charities. Following his gift Mr Green retained 134,118 Chartersea shares for himself.

13. As can be seen from the above, HMRC's objection to the arrangement is that Mr Green has claimed tax relief on the basis that shares in Chartersea for which he paid £60,714 (£95,000 x 237,500 (number of shares gifted) / 371,618 (number of shares subscribed)) in March 2008 were worth £237,500 in April 2008 following listing on the CISX. We observe that 40 per cent of £237,500 is £95,000 but because less than £237,500 of Mr Green's total income is chargeable at the top rate of 40 per cent, Mr Green stands to recover only £66,500 in tax (leaving aside a small unrelated adjustment to benefits and expenses) so that the net cost (assuming tax relief) of his remaining investment in Chartersea will be £28,500.

The factual evidence

Nicholas Green

14. Mr Green had made a witness statement in which he said that Mr Dallimore of Afortis Ltd had approached him early in 2008 to invite him to invest in a company that was sourcing acquisitions with a view to a subsequent flotation. Mr Green had known Mr Dallimore for several years and Mr Dallimore had introduced Mr Green to a number of other successful investment opportunities. He referred to investments made in 2004 and 2006 where, on both occasions, he had subscribed and gifted a substantial number of shares to the two charities in question. In each case the charities had subsequently sold the shares at a profit. Mr Green said that he decided to invest £95,000 in Chartersea and to make a gift of part of the investment to the two charities. He had retained the balance as a long term investment.

15. In response to Mr Way's questions, Mr Green explained his choice of charities and attested to the 'feel good' factor that he derived from being recognised as a benefactor. He produced a letter from the National Eczema Society in which the Society confirmed the three gifts of shares that he had made in 2004, 2006 and 2008 and that they had been able to sell the first two gifts in 2005 and 2007 at a profit. The letter indicated that the Society continued to own the Gifted Shares. The letter was undated but Mr Green indicated that his solicitors had received it shortly before the hearing.

16. Mr Margolin for HMRC suggested to Mr Green that his prime motive was to claim "gift aid" relief of £237,500 for an investment of £95,000. Mr Green said that he had viewed the transaction as a good investment opportunity. The two previous transactions had proved good investments and Chartersea offered a further opportunity with a good medium to long term outlook. He was not just looking for tax relief. He did not deny that he recognised the tax benefits but said that from his perspective the transaction had three facets: the charities benefitted, he could obtain tax relief and he had made a long term investment in the remaining shares. He denied that the tax relief was his principal consideration.

17. Mr Green said that he was not aware of any change in the Chartersea share price since 2008 and confirmed that he had not been a party to the setting of the share price on 4 April 2008. He also confirmed that there were no restrictions on a sale by the charities of the Gifted Shares. The National Eczema Society's accounts for the year ended 31 March 2009 stated that the Society ascribed no value to the Gifted Shares. The accounts also contained a statement to the effect that the Gifted Shares had been

received on the understanding that the Society would not dispose of them before the donor had found a buyer for them. Afortis Ltd correspondence indicated that Mr Green may have told the Society that he thought the shares were subject to a two year lock-in, as had been the case with his previous share gifts. Cross-examined on this point, it appears that Mr Green may have said something to the Society (based on what he had understood from Mr Dallimore) to the effect that the Gifted Shares were subject to a similar two year lock-in term as had applied to his previous gifts. However, he denied any knowledge of what the Society said in its accounts regarding disposal and said that he had had no involvement in their decision to ascribe no value to the Gifted Shares.

Stephen Johnson's evidence

18. Mr Stephen Johnson for HMRC provided a witness statement and was called and gave evidence. The questions put to him by Mr Way in cross-examination, however, were limited on the basis that his witness statement was largely opinion, not fact. He confirmed that he was not a valuer and that he had no valuation experience. He accepted that the relief relied upon was a statutory relief, which it was perfectly acceptable for taxpayers to make use of and that, to do so, quoted shares were necessary.

19. Mr Dallimore in his first witness statement had noted (as we record in paragraph 25 below) that the market maker for Chartersea shares, Winterflood Securities Limited ("Winterflood"), was prepared to make a market on listing at a price of £1 per share and had subsequently confirmed that the market was "orderly". In his witness statement on behalf of HMRC, Mr Johnson reported a conversation that he had had in February 2012 with Mr Simon Rafferty of Winterflood. Mr Rafferty had informed Mr Johnson that Winterflood had only committed to make a market at £1 per share in respect of 1,000 Chartersea shares. HMRC had subsequently requested a copy of the agreement pursuant to which Winterflood had agreed to make a market in Chartersea shares at the stated prices. In response Afortis Ltd produced a two line letter of 14 March 2008 from Winterflood to Volaw Corporate Finance Limited (the sponsor for Chartersea's application to list its shares on the CISX) confirming that, "Winterflood Securities Limited will act as Market Maker in [Chartersea] when admitted to the CISX". There was also an e-mail of 1 April 2008 from Keith Salisbury to Winterflood asking that it reconfirm its willingness to act, to which Winterflood replied on 2 April 2008, simply, "Winterflood Securities accepts the role of market maker". On this matter we note that the application for listing stated that Winterflood had agreed to be the market maker for the shares.

20. Stephen Johnson said that his understanding following his conversation with Mr Rafferty was that although Afortis Ltd had asked Winterflood to make the statement that Mr Dallimore included in his witness statement (namely, that Winterflood had subsequently confirmed that the market in Chartersea shares was orderly), Winterflood had declined to do so. Mr Johnson produced an e-mail of 2 February 2012 from Mr Rafferty to Mr Johnson to which Mr Rafferty had attached the letter that the Chairman of Chartersea had asked Winterflood to sign but which Mr Rafferty had declined to do. In addition to confirming that Winterflood were the market maker at the time of Chartersea's flotation, the letter also required Winterflood to confirm that at the time of the flotation there was no evidence of false activities; there were no

irregular transactions and there was a fully functioning regular market. We can attach no particular significance to Winterflood's refusal to provide that confirmation. Their refusal does not demonstrate that there were false activities, irregular transactions or a non-functioning market.

21. Referring to Mr Teste's supplemental report, Mr Johnson noted in his statement that Mr Teste had been informed that the share transactions on 4 April 2008 took place at arm's length. He also noted that Mr Dallimore in his first witness statement had described these transactions as "independent trades". The trades were effected between nominees but in his supplemental report Mr Teste had identified the beneficial sellers as a Mr Maloney and a Mr Quinn. Stephen Johnson indicated that HMRC had been able to identify from information obtained through the Financial Services Authority part of the surnames of the beneficial purchasers, namely "Tille" and "Sadle" (see further paragraph 32 below). Mr Johnson stated that HMRC had initially found no information to connect the purchasers with Mr Green. However, HMRC had been able to identify that the sellers, Mr Maloney and Mr Quinn, were directors of a company, Hovington Limited, by which Mr Green was employed at the time that he made his gift to the charities on 4 April 2008. On the same day each of Mr Maloney and Mr Quinn had also made gifts of Chartersea shares to charity and subsequently claimed the same relief as Mr Green.

22. Stephen Johnson suggested in his witness statement that the connection between Messrs Green, Maloney and Quinn raised serious doubts as to whether the trades on 4 April 2008 (which had proved to be the only trades to date in Chartersea shares) could properly be characterised as genuine arm's length trades between third parties. He expressed the view that it could just as easily be inferred that the two trades were pre-ordained and/or orchestrated in an attempt to confer an appearance of legitimacy on the price of £1 per share. Our conclusions on this matter are at paragraph 119 below.

Geoffrey Dallimore's evidence

23. Mr Dallimore (whose main occupation was as a director of Afortis Ltd but who was also a director of Chartersea) provided two witness statements, the second of which commented specifically on Stephen Johnson's evidence. In his first witness statement and in oral evidence, Mr Dallimore explained that at the beginning of 2008 he had been asked by Keith Salisbury and Brian Johnson to become involved in a potential transaction to acquire WDL. He had known Mr Salisbury since University and subsequently in a professional context. Mr Salisbury had introduced a number of investment transactions to Mr Dallimore since 2003. He said that Mr Salisbury and Mr Brian Johnson had agreed an attractive price for WDL with Gavin Johnson and were looking for equity investors. Mr Dallimore had experience of the window fabricating sector (described as "extensive knowledge" in the draft Chartersea listing application) and he thought that the price was an attractive one.

24. Mr Salisbury had proposed the structure for the transaction. The idea was to use a newly incorporated company (Chartersea) with investors subscribing sufficient shares to provide the funds to enable due diligence on WDL to be completed. The shares would be listed to provide some liquidity and to enable Chartersea to raise further funds on the market should future acquisition opportunities present themselves. Mr Dallimore referred to possible acquisitions of another window business and of a

roofing company. Equity funding of £1.7 million was required for the WDL transaction and this was raised from a small group of private investors, pension schemes and non-residents in March 2008. Mr Dallimore accepted that it was always envisaged that a rights issue to raise the balance of the funds would follow the private placement. He noted, however, that it was entirely possible that the sale of WML would not materialise and that the monies initially contributed on the private placement would be lost.

25. Mr Dallimore's witness statement covered various points made in the course of correspondence with HMRC after they had decided to enquire into the transaction. Given the single issue that we have to determine, it is not necessary for us to record those points here even though Mr Margolin cross-examined Mr Dallimore on some of them. Regarding the market value of the Gifted Shares, Mr Dallimore noted the listing of the Chartersea shares and said that the market maker, Winterflood, had confirmed to Mr Salisbury that it was prepared to make a market at a price of £1 per share. He claimed that Winterflood had subsequently confirmed that the market was "orderly". In cross-examination he said that he had derived this understanding from Keith Salisbury following Mr Salisbury's discussions with Winterflood. Trades had occurred at prices of £1 and £1.01 and Mr Dallimore produced a letter from Brewin Dolphin (the broker who acted in the market transactions on 4 April 2008) confirming that 7000 Chartersea shares were traded at those prices. Brewin Dolphin said that these prices were considered close to the middle market price based on the levels quoted on the CISX screens.

26. We have previously recorded Mr Stephen Johnson's evidence on Winterflood's role (see paragraph 19 above) and his views as to the nature of the two trades on 4 April 2008. Mr Dallimore's second (supplemental) witness statement commented on Stephen Johnson's evidence and took issue with the views that he had expressed on the trades. Much of his second statement has the flavour of submissions designed to make the point that the views or inferences that Mr Johnson had expressed or drawn were not necessarily correct given what was known of the facts of the two trades. We refer to some of what Mr Dallimore said below (see paragraph 31) and draw our own conclusion based on the known facts in due course (see paragraph 121 below).

27. The essential background by reference to which Mr Dallimore was cross-examined by Mr Margolin for HMRC was that Chartersea's only significant asset was its holding of shares in WML, for which it had paid just over £4.3 million on 18 March 2008. By 4 April 2008, however, Chartersea's newly listed 9 million plus shares were suggested to have had a market value of £1 per share. As a result of the transactions ending with the listing, Mr and Mrs Gavin Johnson had sold their interest in WML and Brian Johnson, Mr Dallimore and Mr Salisbury had each acquired a 10.36 per cent interest in Chartersea. Brian Johnson had been operations manager of WDL since 1998 and had become acting managing director in 2006. At the time of the listing he was employed by Chartersea under a contract of employment dated 18 March 2008 terminable on 12 months' notice.

28. Mr Dallimore in cross-examination characterised this arrangement as a management buy-out by Brian Johnson. Brian Johnson was the key person and without his involvement the transaction would not have gone ahead. Mr Dallimore did not agree that it was implausible that Mr and Mrs Gavin Johnson would sell their

company in March 2008 for a price of £4.3 million but that two weeks later the company's value as represented by the Chartersea shares would have doubled. Mr Dallimore considered that Gavin Johnson had particular reasons for selling at the price that he did and without those considerations he could have achieved a higher price.

29. Mr Dallimore therefore considered that £1 per share represented an appropriate value for the shares on listing and denied that a major driver of the transaction was the tax benefits that were derived, in the example of Mr Green's case, from investing £95,000 and claiming "gift aid" relief on £237,000. He accepted that the transaction structure enabled investors to claim relief if they wished but said that this was not the primary motive for the investment or the listing. He agreed that there might be other, possibly more obvious exchanges on which to seek a listing where the listing was designed to provide market liquidity and the ability to raise further capital. He said that alternative listings were not, however, his area of expertise.

30. Mr Margolin challenged Mr Dallimore on the reality or practicality of the further acquisitions that Mr Dallimore claimed Chartersea had in contemplation and suggested that the only purpose of the listing was to secure tax relief for investors such as Mr Green. Mr Dallimore denied that the tax relief was the sole purpose of the listing and considered it an absurd generalisation to describe the arrangement as a tax avoidance arrangement: the transaction might have been put together in a way that enabled investors to benefit from "gift aid" relief if they wished but WML had not been sold to Chartersea solely for the fiscal benefits involved. He also said that the price that the shares would command on first listing could not be known in advance.

31. Mr Dallimore said that he was not involved in the share trades that had taken place on 4 April 2008. He had characterised the trades as "independent trades" in his first witness statement. He accepted that this had been his assumption. He said that he had no reason to mention Messrs Maloney and Quinn in his first witness statement. In his second witness statement, in response to what Stephen Johnson had said about Messrs Maloney and Quinn, he suggested that it was not uncommon for colleagues to invest in the same company and that there was no reason why Maloney and Quinn should not have chosen to sell to unconnected purchasers. He also said that he was unable to say how the purchasers became aware of the listing and the opportunity to purchase shares immediately they were first listed.

32. Information obtained from Brewin Dolphin by Afortis Ltd and provided to HMRC indicated that the purchasers were a Mr Keith Sadler and Mr and Mrs Lee Tilley. Further investigation by HMRC (and recorded in correspondence) indicated that Mr Sadler, Mr Gavin Johnson and Mr Salisbury were directors of Vista Group plc ("Vista") at the same time in 2007/2008, from which HMRC had inferred that they were known to each other as at 4 April 2008 and that Mr Sadler was aware of Chartersea's acquisition of WML and of its listing. Mr Tilley was a director on 4 April 2008 of Patterson and Rothwell Holdings Ltd together with a Mr Alan Rothwell. Mr Rothwell was also a director of Vista and therefore said to be known to Messrs Salisbury, G Johnson and Sadler. In this way HMRC had inferred that Mr Tilley was aware of Chartersea's acquisition of WML and of its listing. Mr Dallimore was unable, however, to cast any more light on these matters.

Keith Salisbury's evidence

33. Keith Salisbury explained that he had known Gavin Johnson for over 10 years and had first met him when Mr Salisbury worked for Brewin Dolphin. In 2003 he had sought to convince Mr Johnson to float WDL but Mr Johnson was not interested. At the time Mr Johnson had said that he would want in excess of £8 million for WDL. Subsequently in late 2007, Mr Salisbury had approached Gavin Johnson again and at that stage Mr Johnson was more amenable to a deal provided that it allowed his brother, Brian Johnson, to remain managing director and to take a share in the business. Gavin Johnson was prepared to contemplate a deal at a cheaper price on a basis that allowed his brother to participate fully. Another factor that had contributed to Mr Johnson's change of heart was the imminent abolition of Capital Gains Tax taper relief: he was keen to complete the sale of WML shares while the sale would qualify for full relief and would only attract an effective 10 per cent CGT rate. As a result Mr Salisbury had been able to negotiate a substantial discount to the real value of the WDL business. Thereafter Mr Salisbury had contacted Mr Dallimore to see if his clients would be interested in equity funding the deal.

34. Mr Salisbury did not consider the differential between the price agreed with Gavin Johnson and the price on flotation as unusual. He cited a number of other deals in which there had been a significant price differential between the purchase and flotation prices. The price that he was prepared to agree with Mr Johnson had to be one that made the transaction attractive to Mr Salisbury. He was there to identify value and the opportunity for profit.

35. He described the process by which he had agreed that Winterflood would act as market maker for Chartersea shares. Winterflood had requested and had been given all the relevant information they needed to make the decision to act in this capacity. He noted that it was for the market maker to decide what size/number of shares (the "Normal Market Size") they were prepared to deal in a listed company. He also said that his understanding was that Mr Dallimore had been contacted by some investors who wanted to sell some of their shares and Mr Salisbury had told him that they could only do so through a broker. He understood that they had approached Brewin Dolphin to handle the trades. None of Afortis Ltd, Chartersea or himself had been involved in those trades. He noted that the CISX had power to suspend trading in Chartersea shares but had never had any reason to do so. He agreed with Mr Ruse's conclusion that the CISX had little equities trading and was, at best, a secondary market for UK equities.

36. In answer to Mr Margolin for HMRC Mr Salisbury said that he regarded the trades that had occurred on 4 April 2008 as perfectly normal trades on the CISX. He agreed that CISX listings do not "go to premium" as there is not much trading on it. As he was not involved in the trades he could not say whether it was correct to describe them as "independent trades". He said that he knew Alan Rothwell but that he had never heard of Mr and Mrs Tilley and could not say how they had come to buy Chartersea shares on the first day of listing. Mr Salisbury and Mr Sadler knew each other well and Mr Sadler had expressed an interest in investing in Chartersea, as he had previously done in earlier transactions. Mr Salisbury could not recall whether he had mentioned Mr Sadler's interest to Mr Dallimore (who in any event had raised the necessary money through his clients) or whether Mr Sadler had invested in previous

transactions on the first day of listing. He could not recall whether or what information he might have given to Mr Sadler about WML but the listing particulars would have been available. The listing particulars would have given the rights issue price and Mr Salisbury thought that it would have been sensible for Mr Sadler to buy immediately.

Gavin Johnson's evidence

37. Gavin Johnson confirmed that he had initially indicated to Mr Salisbury in 2003 that it would take a deal of over £8 million for him to consider a sale and even then he might not be interested. At the end of 2007, however, Mr Salisbury had approached him again and on that occasion Mr Johnson had indicated that he would be prepared to consider a deal that included his brother as managing director and gave him a shareholding. Mr Johnson said that he had lost interest in the business. He had split up with his wife and there were difficulties at home. He felt that it was time to go and to leave his brother to take the business forward. As Mr Johnson put it, "If I could secure my brother's future I would deal at a lower price than the business was worth". It was also important to him that the position in the business of other family members (his father, sister, sister-in-law and a nephew) and long term employees was secured, although he accepted that the deal he had struck did not achieve this objective. He considered that he could have demanded a great deal more for the business given its profitability at the time. He was happy not to do so because, "once the industry knows you are up for sale, it only leads to problems and besides I was happy to sell it to Brian."

38. Questioned by Mr Margolin on the significant reduction in sale price from a target of over £8 million on Mr Salisbury's first approach in 2003 to the £4.3 million realised in 2008, Mr Johnson explained that he was in a much better financial position in 2008 than he had been in 2003. He was wealthy enough to retire so that for him the differential between £4 and £8 million was not as great as it might seem. £4 million was sufficient to maintain his lifestyle. He said that the £8 million figure was just a figure conjured from his own mind and had not been based on advice. He thought that he had probably received advice on valuation prior to the sale in 2008 but he could not recall who was involved in giving the advice or what the advice was. If he had delayed the transaction to see if he could achieve a better price he would have risked paying tax at a higher rate with the abolition of taper relief. He also wanted to ensure that his brother continued to be involved in the company, which the transaction achieved. He accepted that his brother's future position with the business was not guaranteed. He was only a minority 10.36 per cent shareholder in Chartersea with an employment contract terminable on notice. He noted, however, that his brother was central to the business: he ran the business completely and in Mr Johnson's view the business would not operate without him or would soon run into problems if he ceased to be involved.

39. We set out our conclusions regarding Mr Johnson's evidence on this aspect of the matter at paragraph 132 below. Mr Johnson had no recollection of the CISX listing or the trades in Chartersea shares. He confirmed that he knew Mr Sadler well but Alan Rothwell was less well known to him. He might have mentioned the possibility of investing in Chartersea to Mr Sadler but not to Mr Rothwell.

The expert evidence

40. We were provided with expert share valuation reports from Mr Michael Ruse, instructed by HMRC, and Mr Lee Teste, both of whom were called and gave evidence. We summarise the basis of Mr Teste's instructions starting at paragraph 59 below.

41. Mr Ruse produced three share valuation reports. The first (main) report set out his valuation of the Chartersea shares, and the basis for it, but also commented on certain aspects of Mr Dallimore's first witness statement and on a desktop valuation by TMG Corporate Finance LLP ("TMG"), which had been prepared in June 2010 by Mr Teste while a partner of TMG ("the 2010 Report"). Mr Ruse's second (supplemental) share valuation report commented further on the 2010 Report once it had become clear that Mr Teste was adopting the 2010 Report as his expert share valuation report. Mr Ruse's third (second supplemental) share valuation report dealt specifically with the acquisition in March 2008 of the whole issued share capital of Vista (see paragraph 32 above). Mr Ruse also produced at the hearing a "Quick PER valuation for WDL".

42. In addition to the 2010 Report, Mr Teste produced a supplemental report in which he commented on Mr Ruse's valuation methods and responded to a number of Mr Ruse's criticisms of the 2010 Report.

43. In the following paragraphs we summarise each of Mr Ruse's and Mr Teste's valuation methods and their results. Thereafter we summarise the evidence that we received regarding the Vista transaction, including that of Gavin Johnson and Keith Salisbury, each of whom was a director of Vista at the relevant time.

Mr Ruse's first (main) and second (supplemental) expert reports

44. Mr Ruse had extensive valuation experience, having worked initially (in the 1970s) in the Inland Revenue's Shares Valuation Division before moving into private practice with Deloitte (with responsibility from 1987 for its valuation group) and Baker Tilley (with responsibility for valuations and capital taxes) and finally (in 1997) establishing himself in independent practice. He had been asked to provide a market valuation for a minority interest of Chartersea 0.1p shares on 4 April 2008, 30 April 2008 and 7 May 2008. These were the dates on which individual Chartersea shareholders had gifted shares to charity. We are only concerned with 4 April 2008 for Mr Green.

45. In response to Mr Way's question, Mr Ruse said that he was completely happy that he had fulfilled his overriding duties to the Tribunal: to be independent, objective and unbiased. He said that he would have given the same opinion if asked by the taxpayer. He had worked at HMRC between 1973 and 1977 and had been contracted to them since 2001 as an expert adviser and expert witness. The amount of work he derived from them varied year to year. HMRC were important to his business in terms of marketing but not financially.

46. Mr Ruse had produced a preliminary report for HMRC before the one that had been produced for the Tribunal. Following an application by the Appellant for disclosure, the Tribunal directed that HMRC should disclose Mr Ruse's preliminary

report. Mr Way drew Mr Ruse's attention to certain comments that were in his preliminary report but which he had omitted from the Tribunal's version. The former indicated that Mr Ruse considered that the listing of Chartersea's shares was a "rigged" share capitalisation designed to "exploit" gift aid relief and that the trades on 4 April 2008 were "window dressing" to the same end. The language of his final report for the Tribunal was more anodyne, excluding any reference to "rigging" (other than by reference to *Crabtree v Hinchcliffe* [1972] AC 207) or "exploiting" and merely stating that the trades were "unrepresentative of market value".

47. Mr Way suggested that Mr Ruse was aiming to conceal his bias and lack of independence. Mr Ruse said that his preliminary report was for HMRC and was more candid. His report for the Tribunal was more anodyne but he considered that there was no material difference between that and his preliminary report on the issue for which his expertise was required. He said that some of the comments in his preliminary report were provocative but he did not think that they showed bias. He had been employing candour for the benefit of the persons instructing him. He did not think it was appropriate to leave the comments in his report to the Tribunal given the privilege of the preliminary report. He thought his comments were compatible with his declaration regarding independence. He had removed from his report for the Tribunal those comments that were controversial and provocative. This did not alter his conclusion or his reasons for reaching it. He would have given the same advice to anyone who had asked for it.

48. Having outlined the transactions with which he was concerned, the relevant legislative basis for the valuation and the materials to which he had had regard, Mr Ruse's first (main) report made a number of points—

(1) The bid/ask range of 95p to 105p was not supported by any open market transactions. (Mr Ruse ignored the two share trades of 4 April 2008.)

(2) There appeared to have been no attempt prior to listing (as he considered would be normal) to ascertain potential investor interest or for the listing to be publicised.

(3) Neither the initial subscription at 1p per share under the private placement nor the £1 rights issue offering to those shareholders could be taken as indicative of market value. The subscription and rights issue must have been in contemplation at the outset (a point that Mr Dallimore accepted), so that in reality the average share price of 25.6p per share is the only relevant price to be gleaned from those transactions.

(4) The price that Chartersea paid for WML should represent a true value for WDL, in particular given the third party finance involved, the due diligence, the existence of a third party lender and the fact that Gavin Johnson must have been satisfied that the price was adequate for him to agree to sell. This approach gave a value of 26.9p per share.

49. Mr Ruse went on in his main report to produce a discounted cash flow (DCF) valuation of the business. This made some use of revenue and earnings projections provided by Afortis Ltd even though they would almost certainly not have been available in the open market. Mr Ruse explained that he had been careful to classify

the information with which he had been provided, whether it was relevant open market information or other information, and had indicated the information to which he had had regard in valuing the shares. He would ordinarily exclude information that was not generally available. In the present case, however, he had found the CISX website rather opaque and it provided little information about Chartersea. A prospective prudent purchaser of the Gifted Shares at the listed price of £1 per share would in his view have wanted further information and practical necessity dictated that he would have gone to the company: there was nothing to back up the price of £1 per share on the CISX exchange. Special circumstances required special steps and the practical exclusion of the ordinary rule.

50. Mr Ruse outlined the basis of the DCF calculation, including the various assumptions made, to arrive at a valuation on this basis of 27.1p per share. Thus, his three bases of valuation produced a range of 25.6p to 27.1p per share, to which he accepted that there could be added a small premium for long term hope value. **His conclusion was that the market value of the Gifted Shares at the relevant date was not less than 25p per share but not more than 30p per share.** He regarded this as generous given that it did not seek to discount for a minority holding.

51. In response to Mr Way's questions, Mr Ruse accepted that it was not possible to rely on the money put into a company to determine its market value. He also agreed that he had looked at the value of Chartersea at the time of its acquisition of WML and accepted that value could change following subscription and acquisition. He was familiar with the idea that there may be an increase in value where a buyout vehicle makes an acquisition, e.g. marriage value, but he said that there was no marriage value involved in the present case. Mr Way suggested that his conclusion was flawed because he had not allowed for the possibility that WML might have been sold cheaply. Viewed alone Mr Ruse considered it correct to say that the price that Chartersea paid for WML should represent a true value for WDL for the reasons he gave but he explained that in reaching his conclusion he had looked at all three valuation approaches adopted.

52. In terms of the DCF method, Mr Ruse said that DCF was perfect for capital projects and the valuation of intellectual property rights. He accepted that it was not always perfect for share valuations and that most share valuations were done using the PER method, which was a one year proxy for DCF. PER is based on the most recent profit figures and provides a financial analyst's estimate for the next financial year. DCF is a proxy on profits to infinity and where more information is available, DCF is the better method. .

53. Mr Ruse's attention was drawn to statements in *Eastaway's Practical Share Valuation* (fifth edition) ("*Eastaway*") that a DCF-based valuation has not been used in any UK reported case and that it may not provide a value that corresponds with open market value, whether for taxation or any other purpose. He said, however, that there were plenty of cases in the US and Canada in which it had been used. He had no problem with *Eastaway's* description of the difficulties of a DCF-based valuation and accepted that it can be overused. However, this was a perfect case where DCF could be used as a basis for valuation. In this case, he had the necessary budgets and forecasts to do so, which he would not normally have had. Although this was

information that could not normally be taken into account, it was what a prudent purchaser would have required.

54. Mr Ruse had also produced a "Quick PER valuation for WDL". This was based on Mr Ruse's calculation of sustainable earnings for 2008, which produced a post-tax earnings figure of £520,000. Mr Ruse said that a PER multiple was a matter of opinion and that he had used a multiple of 6 in his calculation, which he considered to be commercially justified and justified by the Vista transaction (see paragraph 76 below). Mr Way referred Mr Ruse to an article he had written in 2005 in which he said that for a large (£3m+) trading company, HMRC would find a PER of 10+ acceptable. Mr Ruse said that the article was for a general audience and designed to provide a starting point. He had updated the article since the financial crash with lower PERs. As regards the window fabrication sector in which WDL was engaged, Mr Ruse said that he had done some research and had concluded that the sector was not highly rated in terms of PER. In terms of corporate finance experience, Mr Ruse had been involved in about 12 transactions and had advised on the price at which people should sell their companies. He accepted that he was not an expert on CISX listing and that his comments on the CISX were based on observation. He agreed that a listing on the CISX could benefit a share's value but he thought that there would have to be an active market in the shares before this happened.

55. Mr Ruse had addressed certain aspects of the 2010 Report in his first (main) and second (supplemental) reports. He stated that he had two fundamental criticisms—

> (1) The first related to the six specific transactions referred to in the 2010 Report. Mr Ruse criticised these as comparators on various grounds: too early to use as a comparator; too large to be a comparator; involved the manufacture and supply of non-comparable products; entered into on undisclosed transactions terms. At the time of preparing his first two reports Mr Ruse had been able to trace only one other potentially relevant transaction in the fifteen months to 31 March 2008, which was a purchase out of administration on undisclosed terms. The valuation ignored the reality of the arm's length price of £4.3 million paid for WDL's business on 18 March 2008.
>
> (2) The average market capitalisation of the eight quoted companies referred to in the 2010 Report for PER purposes was £575 million, at which level of capitalisation there was no direct relationship between those quoted companies and WDL, nor any rational basis on which their PER's could be adjusted for application to WDL. The adjustment made in the 2010 Report was in Mr Ruse's view wholly insufficient.

56. Mr Ruse found the 2010 Report's references to "Market Value", "Enterprise Value", "fair market value" and "Business Value" (see paragraph 66 below) extremely muddled and he was unable to make sense of certain statements. Although he considered Mr Teste's approach in the 2010 Report in essence acceptable, he regarded the multiplier adopted as excessive and that a PER in the order of 6 was commercially justifiable.

57. In his second (supplemental) report Mr Ruse clarified that these comments were directed to the main body of the 2010 Report rather than to its appendices that

contained the valuation workings. He explained that at the time of his first (main) report he did not know whether Mr Teste would produce a new or amended valuation for the Tribunal. Mr Ruse regarded the appendices to the 2010 Report to be muddled and incoherent. However, he chose not to comment on them in detail and had not attempted to reconcile the figures with other information because, as he saw it, this would not assist the Tribunal in reaching a better understanding of the valuation. At a general level, therefore, Mr Ruse drew attention to certain unexplained adjustments and to some discrepancies between the figures appearing in the 2010 Report and the audited figures or the due diligence figures that had been prepared in connection with the acquisition of WML.

58. In Mr Ruse's view this meant that Mr Teste's maintainable pre-tax profit range of £934,000 to £983,000 was too high and he repeated his view that the multiples were on any empirical basis unjustifiable. Adjusting Mr Teste's sample for the high 'outlier', seven companies remained with PER's between 7.8 and 15, with an average of 11.4. This would warrant an adjustment of around 50 per cent for WDL's size. This amount plus a control premium would suggest a PER of 7.4, which applied to Mr Ruse's assessment of sustainable profits of £520,000 (an annualised figure for 2008), produced a valuation of £3.85 million. A slightly more generous PER of 8 produced a value of £4.16 million, which was consistent with Mr Ruse's other valuation results and suggested that the combined effect of both earnings and multiple in Mr Teste's valuation had overvalued WDL by more than 100 per cent.

Mr Teste's 2010 Report and supplemental report

59. Mr Lee Teste had been asked in June 2010 by Messrs Dallimore and Salisbury to value the Chartersea shares. Mr Teste had previously worked in some capacity with The Co-operative Bank when Chartersea was in discussion with the bank about debt funding for the WML acquisition. Mr Teste said that he therefore had, "quite a bit of the financial and background information necessary to perform the valuation". We can observe at this point that this would be likely to go beyond the information that would be available to a purchaser in the open market (see paragraph 128 below). Mr Teste's June 2010 valuation report (the 2010 Report) had been provided while he was a partner of TMG. He had subsequently left TMG to run his own business of providing advice on management buy-outs and buy-ins, corporate fund raising and merger and acquisition activities.

60. Mr Teste was unable to produce any written instructions providing the basis for his valuation. The 2010 Report referred to Terms of Reference of 24 May 2010 and a 'Hold Harmless' letter of 25 May 2010. The introduction to the Report indicated that it had been produced, "to provide a guide as to the market value of the Company's entire share capital during March 2008" and that it was a desktop valuation and "as such is limited in its scope". The introduction continued with various caveats (which we regard as usual 'boilerplate') on its use and the statement that it cannot form the basis of an investment decision.

61. In correspondence HMRC had questioned Mr Teste's independence as an expert witness, in particular given TMG's previous involvement with Chartersea's acquisition of WML. TMG had apparently charged no fees for producing the 2010 Report. Afortis Ltd had submitted the 2010 Report on the basis that there was no

letter of instruction but that Mr Teste, as the Report's author, had confirmed that his opinion on valuation as expressed in the Report had not changed. In cross-examination by Mr Margolin Mr Teste was unclear who his client was (whether Mr Dallimore or Mr Salisbury or another) and it appeared that he had not yet been paid any fee for the Report or for the time spent in its production.

62. Mr Teste explained that he had been happy to produce the 2010 Report at the time based on the work that he had done in relation to raising debt finance for Chartersea. He had already done a great deal of work on the WML acquisition and producing the 2010 Report had not been lengthy or complex. He already had all the necessary knowledge and the 2010 Report was based on that knowledge. Nevertheless, the 2010 Report was a separate exercise and was certainly not part of arranging the debt finance. He said that the request was not time consuming, onerous or surprising and he had agreed, without insisting on a fee at the outset, because he was hoping to do more work with Mr Salisbury. He had not envisaged in 2010 that he would have to appear to give evidence in the Tribunal in 2013.

63. Mr Teste said that he expected to be paid at the outcome of the Tribunal proceedings but he could not say who would be doing so. He could not recall the terms of his engagement but his clear understanding was that he would be paid in due course. He said that, based on his discussions with Messrs Dallimore and Salisbury, his understanding was that the fee for the 2010 Report would be £10,000 and that his other fees would be based on time spent in relation to the appeal proceedings. Mr Teste observed that he would not have been there if he was not going to get paid but he agreed that leaving payment until the end was not one of his best business decisions.

64. He had made the standard expert's declaration in which he had confirmed that he had not entered into any arrangement where the amount or payment of his fees was in any way dependent on the outcome of the case. Mr Margolin suggested that it was surprising and irregular for payment to be left until the end and that this called into question Mr Teste's independence. Mr Teste said that this was the first occasion on which he had appeared as an expert witness in a tribunal hearing. In his work as a corporate financier, invoices were rarely raised during the course of a transaction. Instead they were raised on conclusion but regardless of outcome. Mr Teste explained that he was keeping a record of his time and it would only be at the end that he would know how long he had spent. Mr Margolin asked him whether paragraph 8 of his declaration ("*I confirm that I have not at any time entered into any arrangement where the amount or payment of my fees is in any way dependent on the outcome of the case.*") was true and Mr Teste said that it was. He was confident that he was not being paid by reference to the outcome of the appeal. He said that he would split the eventual fee with TMG.

65. Mr Teste's valuation in the 2010 Report was based on the audited results of WDL for the years ended 31 March 2004 to 2007, the management accounts for the six months to 30 September 2007, the budget for the year ended 31 March 2008 and a marketplace commentary. The 2010 Report outlined WDL's business and its market place. It concluded that *the* appropriate valuation technique for the entire share capital was the "Price/Earnings" (P/E) technique, i.e. the application of an appropriate multiple to the sustainable earnings of the company, to produce an "Enterprise

Value", which is subject to adjustment in various ways. In this respect Mr Teste did not disagree that there were other valuation techniques but he considered that the P/E technique was the appropriate technique for Chartersea and that any other approach would be wrong.

66. Mr Teste concluded in the 2010 Report that an appropriate range of P/E multiples based upon research and personal experience of the type and size of business, given the market conditions in March 2008, might be 8 to 13 to illustrate Chartersea's Enterprise Value. However, having regard to a number of companies that operated directly in or in associated business sectors, the range of P/E multiples was broadly 10 to 15, with an average P/E multiple of 12.9. The 2010 Report considered that some modest discount would be appropriate at the time of flotation and therefore used the range of 9 to 14 to illustrate the considered fair market value (*sic*). The valuation was then worked on three bases: (a) equal weighting to the three financial years ended 31 March 2007 and adjusted budget to 31 March 2008; (b) equal weighting to the year 31 March 2007 and adjusted budget to 31 March 2008; and (c) based exclusively on the adjusted budget to 31 March 2008. **An average of these three bases produced a "Business Value" (*sic*) of £8.5 to £9 million for the entire Chartersea share capital with no devaluation for a minority share.** We observe (although it is not stated in these terms in the 2010 Report) that this is equivalent to a range of 88p to 93p per Chartersea share.

67. Mr Teste produced a six page note in which he criticised various aspects of Mr Ruse's report. As illustrations of this, he called into question Mr Ruse's practical experience of advising on corporate transactions (as compared with Mr Teste's experience in that area); he pointed out certain factual inaccuracies in Mr Ruse's description of the transactions; he questioned Mr Ruse's statement that there had been no arm's length sales of Chartersea shares and criticised his use of information not available on the open market, his decision to ignore the CISX listed price and the inherent value of listing, the relevance of the lack of trading of CISX listed securities and his refusal to recognise the possibility that WML had been sold at a special price.

68. Commenting on the valuation techniques adopted in Mr Ruse's report, Mr Teste said that Mr Ruse's first valuation technique was completely inappropriate. The amount invested in a company bore no relation to the market value of that company's shares. Market value was the value that the market would put on that company and the amount subscribed was no indication of the market value of the shares.

69. As regards Mr Ruse's second valuation technique, he agreed that if company A bought company B and company B were company A's only asset, then he would expect the value of company A to reflect the value of company B. However, Mr Teste said that the price paid for WML was not an open market value price. It was the price the parties had agreed to. Mr Teste considered that Chartersea had got a good deal when it acquired WML. He accepted, however, that if the WML purchase price had been an open market value, then this technique could be used. In relation to Mr Ruse's reliance on the involvement of a third party lender as indicating that Chartersea's acquisition of WML was at a proper price, Mr Teste pointed out that price was irrelevant to the lender. The sole questions for the lender are whether the debt structure is appropriate and whether the debt will be repaid.

70. As regards Mr Ruse's third valuation technique, Mr Teste said that he was familiar with DCF from academic articles but he had never seen it used in practice. He considered that it was very theoretical and subjective. There were a number of variables open to interpretation. In his view, the level of subjectivity was obvious; there were so many variables that it was impossible to use accurately. In contrast, the price to earnings method was accepted practice. It ought to have only one variable (the PER) because the earnings should be a question of fact, subject to a choice about the number of years to include. DCF had far more variables and an undesirable level of subjective input. Typically, he said, DCF would be used in looking at capital projects, where it was possible to control for variables. However, in his view, it should not be applied to open market valuations because there was no control over interest rates. Mr Teste's view was that DCF was "hyper-subjective" and he fully agreed with the points made in Section 13-08 of *Eastaway* on the disadvantages of DCF.

71. Referring to Mr Ruse's criticisms of Mr Teste's choice of comparable transactions and PER multiples (see paragraph 66 above), Mr Teste noted that a difference between his figure of sustainable earnings and those used in Mr Ruse's "Quick" PER valuation (see paragraphs 54 and 58 above) was that he (Mr Teste) had identified "add backs" which increased the profit figures, these being two non-recurring items—

> (1) A management charge – the accounts explained that this was a transfer up to the parent company and once Gavin Johnson had left the business it would not recur.
>
> (2) Expenditure personal to Gavin Johnson based on a notional charge.

Mr Teste did not agree with Mr Margolin's suggestion that an adjustment in the other direction of £75,000 *p.a.* should be made to reflect the likely cost of "strategic and ongoing business advice" going forward (which would more or less exactly negate the adjustment in respect of the management charge levied by WML).

72. Mr Teste had looked at four years' results whereas Mr Ruse had taken one, a low year (2008) in isolation. Mr Teste said that a buyer would not base his value on the last year of profits as one year in isolation was not representative. Mr Margolin suggested that performance over three years was a better indicator than performance over four years and that the best indication was the most recent year's results. Mr Teste said that the longer the period, the better. Fundamentally one was just trying to find sustainable earnings and that is a matter of opinion. Three to five years before the valuation date would be the range and anything earlier than five years would not be regarded as representative. Three years might be appropriate, but one year was not going back far enough. Responding to Mr Margolin's suggestion that greater weighting should be applied to recent years, Mr Teste said that the weighting reflected an interpretation of the risk and that "you would only emphasise 2008 earnings if you expected it to continue".

73. Mr Teste said that he considered WDL to be at the top end of the range. It was an excellent company. He had not based his valuation directly on his sample of companies in WDL's business sector. They were not directly comparable or representative but there was no directly comparable company and they were offered as a guide. WDL's profit margins were better; it was a smaller company and offered

the possibility of growth. He explained that ultimately the PER is an opinion but his choice of the range of PERs and the PER applied was based on—

(1) his experience and the deals with which he had been involved, of which there had been over 150 corporate finance deals (mainly involving unlisted, private acquisitions);

(2) his consideration of the company;

(3) his consideration of the sector in which it was operating.

Asked whether he had taken into account Chartersea's debt, Mr Teste said that the PER takes this into account. One would adjust for an abnormal amount of debt but not for a normal level of debt. His multiple recognised the level of gearing in Chartersea.

74. The 2010 Report referred to a variety of deals as evidence of a substantial level of mergers and acquisitions activity over the five years preceding the flotation. Mr Teste explained that he was not offering these deals as evidence to support his Chartersea multiple. He had not analysed the transactions in detail although he was familiar with the two oldest transactions. He accepted that some of them were too large to be comparable. The other companies to which he had referred in the 2010 Report were not directly comparable but he explained that that was not the point of him including them. He explained that larger companies buy smaller companies and in doing so, they buy "up to" their own PER multiple. His point was that one of the companies in the table might buy Chartersea, and if they did so, they would apply their multiple. The examples evidenced such M&A activity. Mr Teste also made the point that WDL's ratios were better than the ratios of these companies. Pro rata, WDL was a better performer and, therefore, all things being equal, it would have a higher PER. His multiple was an opinion based on research but he took comfort in the fact that the multiple he reached was not unusual. A colleague in TMG had undertaken the research.

75. Responding to Mr Margolin's questions about some of his criticisms of Mr Ruse's report, Mr Teste admitted that trading quoted shares was not his area of expertise. His comments on this aspect of the matter had been made in response to Mr Ruse's comments. He had made enquiries of Mr Dallimore as to whether there had been any trades and had been told that there had been. Mr Teste accepted that if the two trades on 4 April 2008 were not at arm's length, they would not be relevant to the valuation. He was familiar with the idea of a minority discount and agreed that minority status could affect the value significantly. However, he said that as Chartersea was a quoted company, there should be no discount. His assumption in saying this was that there was no restriction on trading the shares, which could lead to a discount. He agreed that his expertise was not in quoted companies or the CISX secondary market, although he was familiar with the idea of paying a premium for control. His understanding was that listing did add value to a company but he was not in a position to say how much value was added. He considered that it would be inappropriate to ignore it completely.

The Vista comparator

76. In his third (second supplemental) report Mr Ruse indicated that his attention had been drawn since his first two reports to the announcement on 27 March 2008 that the 4 March 2008 cash offer by Acorn Corporate Finance Limited ("Acorn") for the AIM listed Vista had been declared unconditional. He had previously been unaware of this transaction. In Mr Ruse's view the degree of similarity between Vista and WDL was "remarkable"; in particular—

> (1) Vista, through its subsidiary Vista Panels Limited, manufactured uPVC doors, panels and GRP doors. WDL manufactured uPVC windows, doors, sealed glazed units, conservatories, etc.
>
> (2) Vista's accounts for the year ended 31 December 2007 were dated 15 May 2008, so that in estimating an entirety value in April 2008 the 2007 numbers could be taken to be ascertained more or less as signed off. Those accounts showed that it had achieved turnover of £7.7 million and an operating profit of £918,000. The financial statements of WDL for the year ended 31 March 2007 disclosed a turnover of £4.19 million and an operating profit of £942,236. Mr Ruse noted that Vista's turnover was higher than that of WDL but its net margin was lower. He accepted that as well as having a broader product range WDL appeared to be at the better quality end and this may explain its superior margin.
>
> (3) Vista and WDL were both based in Merseyside.
>
> (4) Gavin Johnson was (until 27 March 2008) chairman of Vista. He and his wife owned the entire share capital of WML.
>
> (5) Mr Salisbury was (until 27 March 2008) a director of Vista. He was also a director of Chartersea.
>
> (6) The Co-operative Bank had funded the purchase of Vista (as also WML) and Lee Teste had advised on the purchase of Vista (as also WML).

77. Acorn's offer was 19.5p per share which valued Vista at approximately £3 million and represented a premium of 25.8 per cent to the AIM closing price of 15.5p per share on 3 March 2008. The PER implied in the deal was therefore 5.63. Mr Ruse noted that the Vista and WDL businesses operated in the same sector and were quite alike, so that Vista was a sound comparator for the purpose of valuing WDL. Vista's turnover was around 80 per cent higher than that of WDL and its net margin was around 10 per cent as compared to WDL's 20 per cent. Based on a pre-tax operating profit for the year ended 31 March 2008 of £723,000 (post-tax £550,000), the PER implied for WDL was 7.82. The PER for Vista was 28 per cent lower than WDL's, which Mr Ruse thought was sufficient to allow for any difference in rating between the two businesses. Mr Ruse emphasised that these figures were 'entirety values' and that his 30p per Chartersea share made no allowance for minority status; the reciprocal of Vista's premium of 25.8 per cent is a discount from entirety value of 20.5 per cent, which by illustration reduces 30p to 23.85p per share. In his view Vista provided clear support for Mr Ruse's valuations and illustrated that Mr Teste's range of multiples was plainly excessive.

78. Mr Teste did not dispute Mr Ruse's analysis of the Vista figures but disagreed that it would have been more helpful to include Vista among the comparable transactions referred to in the 2010 Report. He had not left it out because it did not fit his valuation. He said that it was not a comparable company: it operated in a different market and was a customer not a competitor. He accepted that the marketplace commentary included in the 2010 Report covered the manufacture of both doors and windows but he explained that Vista and WML involved very different dynamics in that market. He explained that, prior to 2004, Vista had supplied B&Q but when it had lost B&Q as a customer it became virtually insolvent. In 2005 it had tried to reinvent itself, with some success, by taking the short-term view of investing heavily in the 'Decent Homes' initiative. Although the marketplace commentary in the 2010 report stated that key drivers for growth would include spending from the Government's 'Decent Homes' initiative these comments were about the sector in general and not WDL specifically. WDL had very little exposure to that initiative.

79. Mr Teste agreed that Mr Ruse had noted some similarities but he said that those particular similarities (for example, common directors) were irrelevant to valuation. Mr Teste also said that Vista illustrated the point that in calculating PER one year's figures can be distortive in isolation. It was known that Vista only had a few years left of the Decent Homes initiative, so that if the question was whether its 2007 earnings should be taken as representative, his answer would be "no".

80. Overall, Mr Teste said that there were significant differences between WDL and Vista—

(1) Vista's performance was not considered sustainable;

(2) Vista and WDL made and sold different products, in particular Vista was not in the window fabrication business;

(3) Vista was subject to more commercial risk;

(4) Vista was subject to warranty claims, giving rise to uncertainty;

(5) Vista was reliant on one person (the managing director) who did not have a large shareholding and was thus perceived to be riskier;

(6) Vista had a short profit track record; and

(7) Although Vista and WDL produced products that went to the same end user, they had very different customer bases. Vista had a lot of customer concentration, whereas WDL had a broader base.

81. Mr Teste accepted that Vista and WDL operated in closely associated market sectors. He also accepted that the fact that Vista did not manufacture windows was not, when taken in isolation, a sufficient reason to omit it and that Vista was not irrelevant. He did not accept, however, that his PER was called into question by Vista. He said that one would have to discount Vista on the basis that it was a troubled company with an inconsistent track record. He noted that even Mr Ruse accepted that WDL was the materially better company. Once the Decent Homes initiative was over, Vista would have to reinvent itself again.

82. Gavin Johnson was also asked about Vista and agreed that the accounts showed that sales went both ways between WDL and Vista, but he said that they were two

different businesses. Vista made door panels and had been one of WDL's suppliers. They were in the same sector, but they were not rivals. He did not agree that there was a remarkable degree of similarity between Vista and WDL; they were two different types of business: WDL was better run; WDL made a lot more money; Vista relied on social housing; WDL was a cash business, whereas Vista had a lot of debtors; and Vista had issues with a new product, composite doors. Mr Johnson said that the future of Vista did not look good when he sold his shares. He accepted that Vista and WDL made similar but not identical things and that the issues with the composite doors were teething problems and that they were of commensurate quality.

83. Mr Salisbury did not agree that there was a remarkable similarity between Vista and WDL. Vista was a high volume low margin business; it relied on social housing and in particular the Decent Homes Initiative, as material provided to the Tribunal showed, had an end date. Effectively all Vista contracts covered by this would come to an end in 2010. Mr Salisbury said that Keith Sadler was getting worried that 2010 was approaching with no plan for Vista. Vista had started to receive warranty claims on GPR doors. While this only amounted to about £100,000 by the time Mr Salisbury sold his Vista shares he thought that the figure could only go higher. Vista's product was composite doors, which as a product was being commoditised by everyone importing it very cheaply from abroad.

The Legislation

84. At the relevant time, Chapter 3 of Part 8 of ITA provided as follows—

> **431 Relief for gifts of shares, securities and real property to charities etc**
>
> (1) An individual who disposes of the whole of the beneficial interest in a qualifying investment … to a charity is entitled to relief if—
>
> (a) the disposal is otherwise than by way of a bargain made at arm's length, and
>
> (b) the individual makes a claim.
>
> (2) The relief is given by deducting the relievable amount in calculating the individual's net income for the tax year in which the disposal is made…
>
> …
>
> **432 Meaning of "qualifying investment"**
>
> (1) In this Chapter "qualifying investment" means—
>
> (a) shares or securities which are listed on a recognised stock exchange or dealt in on any designated market in the United Kingdom,
>
> …

434 The relievable amount

(1) If the disposal is a gift, the relievable amount is given by the formula—

$$V + IC - B$$

where—

V is the value of the net benefit to the charity at, or immediately after, the time when the disposal is made, whichever is less,

IC is the amount of the incidental costs of making the disposal to the individual making it, and

B is the total value of any benefits received in consequence of making the disposal by the individual making the disposal or a person connected with the individual.

437 Value of net benefit to charity

(1) For the purposes of this Chapter the value of the net benefit to a charity is—

(a) the market value of the qualifying investment, or

(b) if the charity is, or becomes, subject to a disposal-related obligation, the market value of the qualifying investment reduced by the total amount of the disposal-related liabilities of the charity.

…

438 Market value of qualifying investments

(1) The market value of a qualifying investment for the purposes of this Chapter is determined in accordance with sections 272 to 274 of TCGA 1992 (subject to Part 1 of Schedule 11 to that Act).

…

85. "Recognised stock exchange" was defined at the relevant time in section 1005 ITA, as follows—

1005 Meaning of "recognised stock exchange" etc

(1) In the Income Tax Acts "recognised stock exchange" means—

(a) any market of a recognised investment exchange which is for the time being designated as a recognised stock exchange for the purposes of this section by an order made by the Commissioners for Her Majesty's Revenue and Customs, and

(b) any market outside the United Kingdom which is for the time being so designated.

…

(3) References in the Income Tax Acts to securities which are listed on a recognised stock exchange are to securities—

(a) which are admitted to trading on that exchange, and

(b) which are included in the official UK list or are officially listed in a qualifying country outside the United Kingdom in accordance with provisions corresponding to those generally applicable in EEA states.

(4) For this purpose “qualifying country outside the United Kingdom” means any country outside the United Kingdom in which there is a recognised stock exchange.

…

(6) In this section—

…

“securities” includes shares and stock.

86. CISX was designated as a “recognised stock exchange” on 10 December 2002. HMRC therefore accepted that Mr Green’s shares in Chartersea were a “qualifying investment” within the meaning of section 432(1)(a) ITA. They also accepted that Mr Green disposed of the whole of his beneficial interest in the Gifted Shares, that his disposal of the Shares was indeed by way of gift and that each transferee was a charity.

87. HMRC also accepted that the “relievable amount” for the purposes of section 431(2) ITA is given by the formula in section 434(1) and comprises “the value of the net benefit to the charity” (s.437 ITA). This was the “market value” of the Shares, which is to be determined in accordance with sections 272 to 274 of the Taxation of Chargeable Gains Act 1992 (“TCGA”), which provide as follows—

272 Valuation: general

(1) 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.

(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.

(3) Subject to subsection (4) below, the market value of shares or securities quoted in The Stock Exchange Daily Official List shall, except where in consequence of special circumstances prices quoted in that List are by themselves not a proper measure of market value, be as follows—

(a) the lower of the 2 prices shown in the quotations for the shares or securities in The Stock Exchange Daily Official List on the relevant date plus one-quarter of the difference between those 2 figures, or

(b) halfway between the highest and lowest prices at which bargains, other than bargains done at special prices, were recorded in the shares or securities for the relevant date,

choosing the amount under paragraph (a), if less than that under paragraph (b), or if no such bargains were recorded for the relevant date, and choosing the amount under paragraph (b) if less than that under paragraph (a).

(4) Subsection (3) shall not apply to shares or securities for which The Stock Exchange provides a more active market elsewhere than on the London trading floor; and, if the London trading floor is closed on the relevant date, the market value shall be ascertained by reference to the latest previous date or earliest subsequent date on which it is open, whichever affords the lower market value.

…

273 Unquoted shares and securities

(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.

(2) The assets to which this section applies are shares and securities which are not listed 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.

(3) 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.

88. HMRC accepted that section 273 is not applicable and that the relevant valuation rule is found in section 272 TCGA. HMRC’s contention, however, was that although

the Gifted Shares were quoted on a Recognised Stock Exchange at £1 at the time of the gift, the rule in section 272(3) did not apply because the shares in Chartersea were not "shares or securities quoted in The Stock Exchange Daily Official List". Accordingly, HMRC contended that what must be determined in order to arrive at "the market value of the qualifying investment" is simply "the price which those assets might reasonably [have been] expected to fetch on a sale in the open market" as at 4 April 2008 (s.272(1) TCGA).

The Appellant's submissions

89. Mr Way on behalf of Mr Green agreed with HMRC that the only question for our determination was, "what price [the Gifted Shares] might reasonably [have been] expected to fetch on a sale in the open market" as directed by section 272(1) TCGA. The answer, he submitted, was that Mr Teste's valuation and methodology in the 2010 Report were correct. His approach, in identifying Chartersea's sustainable earnings and an appropriate multiple to be applied to those earnings, was to be preferred to any of the three valuation methods adopted by Mr Ruse.

90. The relevant case law clearly established the principles that had to be applied:

> (1) The hypothetical vendor and purchaser should be assumed to do whatever reasonable people buying and selling the property in question would be likely to have done in real life (*IRC v Gray* [1994] STC 360 per Hoffmann LJ at 372);
>
> (2) The purchaser is a willing purchaser who behaves reasonably and makes proper enquiries about the property (*ibid*) and is cautiously optimistic about the company's future prospects (*Marks v Sherred* [2004] STC 362 at §26);
>
> (3) The only information available to the hypothetical purchaser is what is available to the open market (*re Lynall deceased: Lynall & another v CIR* [1972] AC 680; 47 TC 375);
>
> (4) The vendor is a reasonable vendor, who goes about the sale as a prudent man of business, negotiating seriously without giving the impression of being over-anxious or unduly reluctant (*Gray*, as above);
>
> (5) It may be appropriate to apply a discount to the proportion of the overall value of the company that a share represents, when it is part of a minority holding;
>
> (6) The usual reason for applying a minority discount is that the shareholding in question is in a private company and therefore less marketable than quoted shares and usually subject to restrictions on transfer in the articles of association (see, for example, *S Patrick Erdal v. HMRC* [2011] UKFTT 87 (TC) at §59). Chartersea's shares were quoted, so this rationale did not apply. Neither expert applied any discount based on the size of holding of the Gifted Shares.
>
> (7) While a sale between parties acting at arm's length may provide evidence of the market value, it is a logical fallacy to assume that an arm's length price must equal the market value.

91. In the present case the correct approach was to identify the sustainable earnings of Chartersea and then apply an appropriate multiple to arrive at the correct valuation (the "capitalisation of earnings" method). He said that this was consistent with the majority of cases on valuing trading companies (citing as examples *Caton v. Couch* [1995] STC (SCD) 34; *Erdal v. HMRC* [2011] UKFTT 87 (TC); *Solomon Marks v. HMRC* [2011] UKFTT 221 (TC)). It was the approach that Mr Ruse had advocated in a number of published articles and had adopted in *Marks v Sherred*. It required a detailed factual enquiry into both the company and the market place in which it operated.

92. This is what Mr Teste had done in the 2010 Report—

> (1) He had analysed the marketplace in which WDL operated, looking at the number of competitors, the barriers to entry and potential economies of scale;
>
> (2) He had analysed WDL's position within that market, noting that its growth had been restricted apparently due to the owner's preference rather than market demand;
>
> (3) He had had regard to the important considerations to be taken into account when deciding upon an earnings multiple; and
>
> (4) He had identified companies that operated in the same or associated business sectors with WDL, comparing attributes such as size, stock days and margins to arrive at a range in which the correct multiple ought to lie.

93. Mr Way submitted that Mr Teste has gone through all the steps that would be expected of a valuation expert in identifying a level of sustainable earnings and then working out a multiple based upon a comparison with similar companies. We ought therefore to accept his valuation as fair and accurate and thus the correct valuation for the purposes of s.272 TCGA.

94. He noted that Mr Ruse had produced three valuations. The first two were essentially the same and took no account of any increase in value derived from the flotation and involved no investigation into how the price paid for WDL had been negotiated. It assumed that the purchase price was an open market price with no special circumstances attaching to it. The evidence, however, demonstrated that the sale price for WML had been a special price, in effect a sale at an undervalue, and the market value of the Chartersea shares could not be limited by reference to that special price. Mr Way said that the key fact for our determination was whether or not Mr Gavin Johnson had accepted a lower price for the reasons that he had explained.

95. Mr Ruse's third valuation method was to adopt a discounted cashflow method. Mr Teste's evidence, however, was that this was without precedent, it was theoretical and subjective and had many variables open to interpretation. In any event it involved Mr Ruse using information that would not have been available to an open market purchaser and this calculation was therefore inadmissible.

96. Although Mr Ruse had produced a "Quick PER valuation for WDL", the question was which of the PER calculations produced by the experts should be preferred. Mr Way submitted that Mr Teste's more extensive experience suggested that his should

be preferred. A PER calculation involved two elements: sustainable earnings and the PER ratio. As regards the former, Mr Ruse had only taken the most recent year, 2008. In contrast Mr Teste had taken the last four years of results and had calculated an average. His evidence had been that the typical range was three to five years and that a buyer would not base his valuation on the last year of profits in isolation in case it was not representative. Mr Ruse had also made no add backs to take account of any non-recurring items of expenditure that did not affect profitability. Mr Teste in contrast had added back a management charge to the parent company that did not reduce profitability and expenditure that was personal to Gavin Johnson, which would not continue after the sale.

97. The experts were agreed that the PER was a matter of opinion. However, Mr Way submitted that Mr Teste's choice should be preferred: he had greater deal experience, including in the window fabrication sector, and he had considered the company and the sector in which it was operating. Mr Ruse had little information on that sector. The experts were agreed that WDL was a very good company with very good margins. They disagreed as to whether Vista was an appropriate comparator for the PER calculation. Mr Teste, however, had been involved in the sale of Vista and therefore had a much better knowledge of the company and the various factors that showed that Vista and WDL were not comparable. His evidence in this respect had been supported by Gavin Johnson and Keith Salisbury, both of whom had been directors of Vista and were therefore in a position to comment.

98. Mr Way noted that Mr Teste's evidence was that he thought that there should be no discount for the minority status of a quoted company. Mr Ruse had expressly stated that his valuation did not take into account any minority shareholding discount, and, therefore, offered no specific evidence on any particular level of discount that he thought should be applied to Chartersea. The parallel that Mr Ruse had drawn by reference to the bid price for Vista was "by illustration" only. Mr Way accordingly submitted that there was no basis on which we could apply a minority discount and invited us not to do so.

The Respondent's submissions

99. Mr Margolin said that Mr Green would have decided to make gifts to charity some time before the transactions in question and that the gifts were part of a scheme devised and/or promoted by Champion Consulting Ltd and Afortis Ltd to exploit section 431 ITA and enable taxpayers to generate artificial tax losses. It was clear that, in reality, the transaction was structured in the way it was with this in mind. Mr Margolin noted that on 29 September 2004, Mr Dallimore had notified under section 308 Finance Act 2004 a very similar scheme involving the listing of shares on AIM rather than on CISX.

100. Although it was common ground that what the Tribunal was being asked to determine is what "price [the shares] might reasonably [have been] expected to fetch on a sale in the open market" on 4 April 2008, and that ultimately this was a valuation issue, the fact that Mr Green's acquisition of the shares, his gift of the shares to charity and, so it would seem, the trades in the shares on 4 April 2008 all formed part of a tax avoidance scheme was, in Mr Margolin's submission, an important part of the context – particularly insofar as concerns the weight, if any, to

be given to the so-called "independent trades", supposedly at arm's length, at a price of £1.00 per share. Those two trades had taken place within one minute of each other and it was reasonable to conclude (as Mr Ruse had done in his preliminary report for HMRC) that they were either pre-ordained or orchestrated in an attempt to confer an appearance of legitimacy on the price of £1 per share.

101. Mr Margolin noted that it appeared to be common ground that the acquisition by Chartersea of WML was structured in the way that it was in order to achieve fiscal advantages for certain investors, and that Mr Green participated in this "investment opportunity" with that consideration in mind.

102. In his report, Mr Ruse had approached the valuation of the shares in three ways—

> (1) The first was based on a "simple but cogent argument" that the market value of the shares is represented by the price that was paid for the shares by those members other than Mr Dallimore, Mr Salisbury and Brian Johnson. Those other members paid 1p for each of nearly 5 million private placing shares (on 10 March 2008) and £1 each for nearly 1.65 million rights issue shares (on 12 March 2008), giving an average price per share of 25.6p.
>
> (2) The second identified the value of Chartersea as consisting in the value of the underlying business of WDL, which Chartersea acquired when it acquired WML in an arm's length transaction that was dependent upon obtaining third party finance, in respect of which due diligence was undertaken by Chartersea and investigations were also undertaken by the lender, and which resulted in an offer being made which Gavin Johnson clearly regarded as satisfactory. This approach gave a value of 26.9p per share.
>
> (3) The third involves a DCF (discounted cash flow) calculation (in respect of which Mr Ruse had applied a residual PER of 6), which produced a value of 27.1p per share.

103. Mr Ruse accepted that his first method did not provide an absolute answer. He was also at pains to point out that no valuation was definitive and that was why he undertook three methods with strikingly similar results. Mr Teste had considered that in the present case "*the* appropriate valuation technique" was the "Price/Earnings" method. He had accepted, however, that there were other approaches to valuation that might legitimately be adopted in appropriate circumstances. Mr Ruse had never denied that the "capitalization of earnings" approach to share valuation was "in essence acceptable", and one which is widely adopted. However, he considered that Mr Teste's multiplier was excessive. Mr Margolin referred to Mr Ruse's other criticisms of Mr Teste's 2010 report. He submitted that it was clear that the PER approach was by no means the only legitimate way of valuing a company's shares.

104. Mr Teste criticised DCF as a "hypersensitive methodology", but had not specifically commented on individual elements of Mr Ruse's calculation. Mr Ruse had not denied that a DCF calculation involved a fair degree of personal judgement and that the result was indicative and not conclusive. Mr Ruse's view was that a PER

approach was "only a proxy for a DCF calculation". Mr Teste accepted that deciding upon an appropriate multiplier for his valuation also necessarily involved a high degree of subjectivity and personal experience. Ultimately, the range of multipliers which he and Mr Ruse put forward respectively was arrived at (subject, in Mr Ruse's case, to information derived from the Vista transaction) as a matter of judgment and general experience rather than by reference to specific comparables.

105. As regards the information to which it was appropriate to have regard, Mr Ruse's evidence was that any prudent purchaser contemplating a purchase of a substantial number of shares in Chartersea would require additional information about the company, over and above the listing on CISX, and would request such information from the company. It is submitted that such additional information would not necessarily extend to confidential information of the kind which it was held in *re Lynall deceased* would not have been provided to a prospective purchaser and ought not, therefore, to be taken into account for the purpose of valuation (see, in particular, [1970] AC 680 per Lord Morris of Borth-y-Gest at 697-700). A prudent purchaser would have sought information that fell on the right side of the *Lynall* line. What market would there be for these shares without more information?

106. That apart, the projections of revenue and earnings to which Mr Ruse had had regard were prepared having regard to the past results of the Company, including the actual results for the period 1 April 2005 to 31 December 2007 (as well as the future plans for the business). A prospective purchaser would have been able to produce his own projections by reference to the same material relating to past performance, and there is no reason to suppose that he would have arrived at projections which differed in substance from those produced by the directors of WDL and TMG Corporate Finance.

107. The six transactions referred to in Mr Teste's report under the heading "Background to the Valuation and the Company" were no more than illustrations of transactions that were indicative of activity in WDL's marketplace, none of which was truly representative or comparable. These transactions did not appear to have had any direct bearing on Mr Teste's production of a PER range of 8 to 13 **(**or 9 to 14). Mr Ruse had analysed one of those transactions as disclosing a PER of 6 based on the company's 2002 results and a PER lower than 6 based on the 2003 results and another as disclosing a PER of 7.4 based on the company's results for 2002/03. Mr Teste had not disagreed with Mr Ruse's analysis.

108. It was difficult to understand why Mr Teste had not mentioned the Vista transaction, on which he himself had advised, when he produced his report in June 2010, given the dearth of transactions in the relevant market sector. Gavin Johnson agreed that WDL and Vista had been operating in closely aligned market sectors and manufactured similar though not identical products. Mr Teste gave a number of reasons why Vista was not comparable with WDL. It was apparent from Mr Teste's own "Marketplace Commentary", however, that the market sector in which both Vista and WDL were operating was expected to grow, the key drivers for growth being "new housebuilding in both the private and public sectors along with spending from the Government's 'Decent Homes' initiative". His report indicated that growth was accelerating "as a result of the rise in government funds for public housing refurbishment and improvement" and that "the door and door frames market" in

which Vista operated was "forecast to show 26% growth [and] to be worth £1.1 billion in 2012". In addition, notwithstanding what Mr Teste had to say about WDL being an excellent company and superior to Vista in various respects, its results were as Mr Ruse pointed out somewhat "flat", and "in terms of profitability it wasn't going anywhere fast".

109. The Gifted Shares comprised just 2.46% of Chartersea's issued share capital. They were listed on CISX, which Mr Ruse had noted (and Mr Salisbury had agreed) "lists a limited number of equities in which there is very little trading" and was "at best, a secondary market for UK equities". Mr Dallimore had accepted that there were more obvious markets so far as liquidity and raising capital were concerned. Mr Salisbury accepted that CISX was probably less well-known than other exchanges and that if, in due course, Chartersea were to seek to raise funding for a further acquisition, it might have wanted to list on another stock exchange.

110. Mr Teste stated in his report: "We have valued the entire shareholding in this illustration and have therefore assumed that there would be no devaluation for any minority share/stake". It would appear that he recognised that a discount might potentially be appropriate "given any restrictions on various classes of shares or for a minority stakeholding", although he said that he did not consider that a minority discount would be applicable in the case of a quoted company. He appeared to accept, however, that a control premium might have to be paid for a controlling interest (*a fortiori* for the entire shareholding in a company). Mr Margolin submitted that the corollary of this is that a discount may be applicable for a minority shareholding.

111. Although Mr Teste had stated in his supplemental report that, "The price paid by [Chartersea] for WML ignores the inherent value of the market listing i.e. access to further capital, increased exposure to the market, PR etc.", he accepted in cross-examination that he was not an expert in quoted shares or CISX and that he was not in a position to quantify what "the inherent value of the market listing" (if any) might have been. In this context, Mr Margolin said that the note in the accounts of the National Eczema Society to the effect that no value had been ascribed to the shares gifted to it by Mr Green was not without significance.

112. The circumstances in which Mr Sadler and Mr and Mrs Tilley came to purchase a small number of shares in Chartersea on the morning of 4 April 2008 remained rather unclear. It would appear from what Mr Salisbury said that it was from him that Mr Sadler would have come to know about Chartersea's acquisition of WML and its listing on CISX, although he did not know Mr Tilley and did not know how Mr Tilley would have come to know about these matters. (Nor, Mr Dallimore said, did he know how Mr Tilley would have known.) Mr Salisbury's evidence was that there could have been discussions between himself and Mr Sadler regarding share price, but that he could not remember. At all events, the trades on 4 April 2008 (the only trades which have ever taken place in Chartersea's shares) could not safely, on a balance of probabilities, be taken to have been arm's length transactions.

113. Mr Margolin said that a number of reasons had been put forward to support the claim that Mr and Mrs Gavin Johnson were prepared to sell their WLM shares at a substantial discount. As to these reasons:

(1) Mr Brian Johnson had only acquired a 10.36% stake in Chartersea. The transaction was not, as Gavin Johnson had described it in his witness statement, a sale to his brother. Nor did it seem that Brian Johnson's continued employment (or that of the other members of the Johnson family) was in any way guaranteed.

(2) It would appear that the impact of the abolition of taper relief would have been far less dramatic than Gavin Johnson thought he had been advised at the time. Beyond that, it would seem that he and his wife would have been entitled to entrepreneur's relief which would have further mitigated the effect of the abolition of taper relief. The suggestion that he would need gross proceeds of £6 million to replicate the post-tax outcome with taper relief was implausible. It was unlikely that he would have accepted such a low value.

(3) Given that Mr Gavin Johnson had taken very much a back-seat role for a number of years, it was unlikely that news of his intended sale of the business (particularly in circumstances where his brother was to remain at the helm) would have led to the "problems" that he said concerned him.

114. Mr Margolin also drew attention to some other 'surprising' things that Mr Johnson had said in giving evidence. For example, he did not take any advice on the value of the business in 2003 and could not recall clearly whether he had taken any advice on the value of the business in 2008. Whilst his financial position might well have improved over the intervening period, Mr Margolin suggested that it was frankly implausible that he would have been as unconcerned as he sought to suggest with regard to the difference between £8 million and £4.3 million. And although Mr Salisbury claimed that he had managed to "negotiate a substantial discount to the real value of the Warwick business", so that the price paid was not reflective of market value, the fact was that when he tried to negotiate the price down from £8 million to £4 million (and indeed below that) Mr Gavin Johnson "pushed back hard": this, Mr Margolin submitted, was entirely consistent with the notion that Gavin Johnson was behaving, as one would expect, in an entirely conventional, commercial way rather than giving away at a substantial discount the business he had worked hard to develop.

The Appellant's submissions in reply

115. Mr Way replied on behalf of Mr Green. In doing so he dealt at length with HMRC's contention that the arrangements were designed to create artificial tax losses and were motivated by tax avoidance. He also addressed again various aspects of Mr Ruse's valuations on which Mr Margolin had relied, concluding that not one of his valuation methods could be accepted by the Tribunal: they either relied upon information that would not have been available to an open market purchaser or were based on the assumption that the sale of WML to Chartersea was at arm's length, which the evidence indicated was not the case. He noted that Mr Ruse had failed to provide any comparator (other than Vista – which was not an appropriate comparator) to support his suggested PER multiple of 6. Mr Teste, on the other hand, had adopted the appropriate valuation methodology and had put forward appropriate multiples supported by a variety of comparators.

Discussion

Introduction

116. We have set out the evidence and the parties' submissions in some detail to facilitate the statement of our decision and our reasons for it. Broadly speaking, the statutory question that we must answer is straightforward and agreed: what price might the Gifted Shares reasonably have been expected to fetch on a sale in the open market on 4 April 2008? The question is straightforward; the answer is not.

117. Mr Way summarised the principles that we must apply and Mr Margolin did not dissent from that summary (see paragraph 90 above). Our attention was drawn to a variety of dicta in the authorities, some of which are referred to in paragraph 90 above but also *Lynall v IRC* [1972] AC 680 per Lord Morris at 697A-D and 699D-700B and Lord Dilhorne at 701F-702B; *Administrators of the Estate of Caton v Couch* [1995] STC (SCD) 34 at 51d-54g; and *Bullivant Holdings Ltd v IRC* [1998] 905. We do not believe that extensive citation from the authorities is needed. We include citation as we think appropriate in dealing with the various issues that arise for our consideration.

The tax avoidance motive

118. We start with some preliminary issues. First, we think that the issue of tax avoidance is irrelevant to the question we must answer. If the market value of the Gifted Shares on 4 April 2008 was £237,000 as Mr Green claims, it is of no consequence whether or not the arrangement was devised and Mr Green entered into it with the tax advantage exclusively or mainly in mind. It is difficult to understand what relevance (even as general background) an avoidance motive has to the question that we must answer. It is unnecessary, therefore, for us to address the various submissions that were made by Mr Margolin and Mr Way regarding the 2004 disclosure under section 308 Finance Act 2004. In disposing of this point we would also note that Mr Margolin for HMRC effectively conceded that tax avoidance could not have been the sole motivation behind the transactions in this case.

The two 4 April trades

119. The 'tax avoidance' background was mainly relied upon by Mr Margolin in relation to the two trades on 4 April 2008 (see paragraph 101 above). Mr Ruse, in his preliminary report to HMRC, considered that they were part of the "window dressing" for claiming tax relief rather than providing evidence of market value and in that report he went so far as to characterise the whole listing on CISX as "a means to facilitate a rigged share capitalisation". These were not conclusions on which in our view he had the necessary evidence from which to draw such conclusions (even assuming that it was part of his function and expertise as a valuation expert assisting this Tribunal to do so). We comment below on how in our view his preliminary report to HMRC affects the view we should take of his evidence (see paragraph 156 below). Stephen Johnson expressed similar views based on his investigations into the two trades. His evidence, however, was to report on what his investigations had produced. His view of that evidence does not bind us.

120. Mr Ruse excised the material we have referred to from his first (main) report for this Tribunal. That report states instead that the trades were "unrepresentative of market value". It also records that as far as Mr Ruse can see there have been no arm's length sales of Chartersea shares at any time and that the CISX bid/ask range was not supported by any open market transaction. The language changed but his conclusion regarding the 4 April trades did not. He offered no detailed reasons for his conclusion (only stating there was no evidence that they were true open market transactions) and he did not comment on what (if any) effect it would have on his valuation if his conclusion were shown to be wrong.

121. We are unable to draw the same conclusion as Mr Ruse regarding the 4 April trades. The fact is that they were market transactions and, using the language of his preliminary report, there is no evidence that Chartersea's listing on the CISX was in any sense a "rigged share capitalisation". No doubt, a reason (possibly the reason) for the listing was to facilitate the claim that Mr Green and others were proposing to make for tax relief. That does not in our view, however, amount to a "rigged" share capitalisation. The listing was real and (as we outline below) had a real effect on the nature of the asset to be valued beyond the tax relief being sought.

122. The House of Lords in *Lynall v IRC* [1972] AC 680 reaffirmed its decision in *IRC v Crossman* [1937] AC 26 that a sale in the open market had to be assumed even in the case of a private company that imposed restrictions on transfer. The principle that their Lordships unanimously adopted in *Lynall* reflected what Lord Fleming had said in *Salveson's Trustees v IRC* (1930) SLT 387—

> "…any restrictions which prevent the shares being sold in an open market must be disregarded …but on the other hand the terms of [the Act] do not require or authorise the commissioners to disregard such restrictions in considering the nature and value of the subject which the hypothetical buyer acquires at the assumed sale. Though he is deemed to buy in an open and unrestricted market, he buys a share which, after it is transferred to him, is subject to all the conditions in the articles of association, including the restrictions on the right of transfer, and this circumstance may affect the price which he would be willing to offer."

123. In the present case the listing on the CISX ensured that any purchaser of the Gifted Shares on 4 April 2008 would have acquired an asset that was subject to no restrictions on further sale on the CISX. The nature of the Chartersea shares cannot therefore be divorced from the market on which they were freely transferable. In this respect we had little information about the CISX. Mr Ruse noted that CISX listed a limited number of equities in which there was very little trading and that it was, at best, a secondary market for UK equities. Mr Salisbury agreed with Mr Ruse's description. Mr Dallimore reported a meeting that he and Mr Salisbury had had in May 2008 with the Chief Executive Officer of the CISX in which she had made it very clear that her intention was to develop CISX as an active trading market for shares and a market to which companies could come to raise equity funding. The implication of that evidence is that in February 2008 the CISX had neither of those characteristics or did not have either characteristic to a significant degree (as Mr Salisbury's and Mr Ruse's evidence suggests).

124. The basis of the 4 April trades and their pricing are opaque without evidence from the sellers and purchasers concerned. All that we do know from the evidence we heard, apart from the bald details of what was bought and sold and at what price, is that the purchasers were associated in some way, directly or indirectly, with the parties who were concerned in putting the whole transaction together. The timing of the trades suggests that the purchasers were 'waiting in the wings' ready to purchase as soon as the shares were first listed. At the same time Messrs Maloney and Quinn were on hand and ready to sell a small parcel of shares immediately on first listing. The probability is that the trades had been agreed in advance and we therefore reject (on the evidence we heard) Mr Dallimore's epithets of "independent" and "unconnected", at least in their non-technical commonsense meaning (see paragraph 31 above).

125. That does not, however, automatically characterise the trades as "window dressing" or necessarily suggest a "rigged market". Furthermore none of that detail would be known to or ascertainable by other potential purchasers in the market. Nevertheless, we have concluded that the two trades do not represent significant evidence of open market value and we have therefore attached very little weight to the two trades in reaching our decision. A potential purchaser of the Gifted Shares on 4 April 2008 could have noted the fact of the two trades, as we have done, but in our view a potential purchaser would have attributed very little weight to the trades in assessing the price they should pay for the Gifted Shares. The trades involved a tiny parcel of Chartersea shares (and therefore a correspondingly tiny investment in the company) and the timing of the trades (given the nature of the market in CISX listed shares and the untested quality of the shares involved) would in our view indicate that a prudent purchaser would have looked beyond these two trades and made further enquiries. In other words, a purchaser of the Gifted Shares would have looked to other available information for confirmation or corroboration of the price that they should pay before investing in the shares.

126. Mr Ruse ignored the two trades in arriving at his valuation, concluding that "there have been no arm's length sales of shares at any time" presumably for the reasons that he had articulated in his preliminary report for HMRC but, as we have already noted, we do not believe that he had the necessary evidence to reach that conclusion. More significantly, Mr Teste did not rely upon the two trades in the 2010 Report. In his supplemental evidence Mr Teste criticised Mr Ruse's conclusion on the two trades and in the course of doing so he provided details of the trades which we think he can only have derived from Mr Dallimore or Mr Salisbury or others acting on Mr Green's behalf, rather than from his own researches. For the reasons that we have already recorded, we regard the basis of Mr Teste's instructions as unsatisfactory and in our view much of Mr Teste's supplemental evidence in this regard has the flavour of submission rather than expert evidence. We therefore approach it with caution (see paragraphs 158-161below).

127. On the issue of the two trades Mr Teste expressed the view that the fact that the transactions took place within the bid/offer spread on the CISX should act as third party evidence of the market value given that the Chartersea shares were listed. He went on to compare the small amount of equities traded on the CISX with the similar situation of equities traded on AIM and referred to certain conventional accepted

practices of CISX and AIM listings. However, he had agreed in cross-examination that the listing of shares was not within his area of expertise and we conclude that in this part of his supplemental evidence he was merely articulating what he had been told by others on behalf of Mr Green. None of this, in our view, suggests that we should attach greater weight to the two trades than we have previously indicated.

The available information

128. A prudent purchaser of the Gifted Shares would, in our view, have resorted to the information that was available about Chartersea through the listing of its shares on the CISX. In *Lynall*, the House of Lords had to consider whether *confidential* information could be taken to be known to a potential purchaser of shares in a private company. The House of Lords concluded that such information (in particular that relating to the possible listing of the shares in question) could not be assumed to be generally available to potential purchasers in the open market and would not be disclosed by the company on enquiry. As a result the House of Lords endorsed a lower value for the shares in question than the value they would have commanded had the confidential information been known. The decision in *Lynall* was followed by the enactment of section 51 Finance Act 1973 (see *Caton's Administrators v Couch* [1995] STC (SCD) 34 at 47-51). This is now section 273(3) TCGA, which does not apply in this case (see paragraph 87 above).

129. In his report Mr Ruse concluded that the relevant open market information was limited to documents filed at Companies House for Chartersea, WML and WDL, the private placing memorandum issued on 4 February 2008 and such information as was at the valuation date accessible on the CISX website. In the present case, however, we think that the listing on the CISX would have ensured that more information relating to Chartersea and its subsidiaries, WML and WDL, would have been available to any prudent and careful potential purchaser of the Gifted Shares. In particular, the draft Listing Application with which we were supplied indicates that the following information was available for inspection until 30 April 2008:

(1) The memorandum and articles of association of Chartersea;

(2) All reports, letters and other documents, balance sheets and valuations, any part of which is extracted or referred to in the Listing Document;

(3) The material contracts referred to in section G of the Listing Application;

(4) The Placing Memorandum, incorporating the Accountant's report on the Issuer from 6 November 2007 to 1 February 2008;

(5) The Accounts;

(6) Any contracts in which the Directors have material interests, in relation to the business.

The material contracts under (3) included the share purchase agreement between Mr and Mrs Gavin Johnson and Chartersea, the Co-operative Bank financing documents and the Unsecured Loan Notes 2012, all of 18 March 2008

130. We assume no alteration to this list in any final Listing Application that was produced. Mr Salisbury confirmed that the listing information would have been available to any purchaser in the market (see paragraph 36 above). In any event, even if the information listed above were not generally available we do not think that it would in the circumstances have been regarded as confidential and we therefore assume that it would have been supplied to any potential purchaser who requested it. The information would have disclosed to such a purchaser the nature of the company involved (in particular WDL), its recent financial performance and the terms of Chartersea's acquisition of WML shortly before the listing. It appears that the due diligence report prepared for Chartersea's acquisition of WML and the materials prepared for The Co-operative Bank were not among these generally available documents. In particular, from our reading of the draft Listing Application they do not appear to be encompassed within item (2) and we were not told whether item (2) in fact included those materials.

131. The other information that would have been generally available to any prospective purchaser of the Gifted Shares who made appropriate enquiries is the information relating to Acorn's cash offer for the AIM-listed Vista (see paragraph 76 above). We deal with this in due course.

Mr Gavin Johnson's evidence

132. The available information relating to WML and WDL would not have revealed the reasons that Mr Gavin Johnson gave in evidence for selling WML at the price at which he did. As we heard that evidence we shall comment upon it in due course (see paragraph 135 below) but in our view it is not information that can be taken to have been publicly available or generally known so as to influence the open market value of the Chartersea shares. Lord Pearson makes the point in *Lynall* ([1972] AC at page 706):

> "It is, however, suggested that [the confidential information] would have been available in two ways. First, it is said that the likely purchasers might have included a director of the company, and he would have had the information ex officio. But unless others also knew it, his possession of the information would not materially affect the market price which he or any other purchaser would have to pay. The situation differs from that in *Inland Revenue Commissioners v Clay* [1914] 3 K.B. 466, 471-472, where the special fact enhancing the price of the property was assumed to be a matter of local knowledge. Secondly, it is said that the directors of the company might have been willing to impart the information confidentially to a chartered accountant or other expert acting \as agent for a purchaser, though the information might be imparted on the terms that it would not be passed on to the purchaser himself. But in such a case the transaction would be in the nature of a private placing and not a sale in the open market such as has to be envisaged under section 7(5)."

133. Mr Gavin Johnson may have made no secret of his reasons for selling WML at the price that he did, so that his reasons might have been "a matter of local knowledge". Nevertheless, we were given no reason to believe that such "local knowledge" would be relevant to dealings in the Chartersea shares on the CISX. The directors' 'insider' knowledge in *Lynall's* case, to which Lord Pearson refers, might

possibly be equated with the 'insider knowledge' that directors might have had in the present case, which might perhaps be said to have underpinned Mr Sadler's and Mr and Mrs Tilley's decisions to acquire a small number of Chartersea shares for £1 per share on 4 April 2008. As we have noted, however, we do not know what (if anything) lay behind their purchases. However, even if a potential purchaser of the Gifted Shares on 4 April 2008 had observed the fact of those market acquisitions, we do not think that that fact should lead us to conclude that Mr Gavin Johnson's reasons for selling WML at the price that he did should be treated as part of the information generally available to potential purchasers in the open market. If a potential purchaser had asked, no doubt Mr Dallimore and Mr Salisbury (as the two directors of Chartersea at the time) might have told the purchaser that the price that Chartersea had paid Mr and Mrs Johnson to acquire WML was an extremely favourable one. That would not, however, equate to hearing Mr Gavin Johnson's reasons for agreeing the price that he did.

134. We have therefore assumed that a prospective purchaser of the Gifted Shares would be buying them knowing that Mr and Mrs Gavin Johnson had sold the entire issued share capital of WML for £4,112,267.90 (plus certain outstanding debts) shortly before the listing but without knowing the reasons that Mr Gavin Johnson gave for selling at that price.

135. Nevertheless, having heard his evidence, it is appropriate that we should express our view of it having regard to Mr Way's submission that it was a key fact for our determination (see paragraph 94 above) and so that, in the event of a further appeal, the Upper Tribunal has the benefit of our conclusions on Mr Gavin Johnson's evidence. We accept Gavin Johnson's evidence that he had lost interest in the business and that he was content to leave the running of the business to his brother, Brian. The Financial Due Diligence Report indicates that since around 2005 Gavin Johnson had spent several months abroad each year leaving his brother, Brian Johnson, as acting managing director. It may also be that the prospective change to the Capital Gains Tax regime was a factor on which he was advised at the time: his recollection of that point was 'sketchy'. We can also accept that the arrangement that Mr Salisbury was offering had some benefit (as compared to an outright sale to a third party) in securing his brother's position as a shareholder. Gavin Johnson might also have had a preference for a 'low-key' exit that would not excite the attention of customers and other trade contacts creating problems for the business.

136. Weighing all those matters nevertheless does not lead us to accept his evidence as to the basis upon which he agreed to sell his and his wife's shares in WML for just around £4.3 million. In particular—

(1) The vendors of WML were Mr Gavin and Mrs Amanda Johnson, and not Mr Johnson alone. Each of the vendors had a 50 per cent beneficial interest in WML. We heard no evidence from Mrs Johnson. Indeed, she scarcely featured in the evidence, apart from the fact that Mr and Mrs Johnson separated at some time before the sale in March 2008. Some might speculate in the light of that development that Gavin Johnson was more concerned to ensure that other members of his family received his consideration on the sale. Nevertheless, the sale of WML necessarily involved Mrs Johnson and we have no reason to think that she would have

been happy to sell her 50 per cent shareholding in WML at a substantial discount. Nor do we think that we should ascribe to Gavin Johnson an intention to deprive his wife of a significant part of the value of her shares by deliberately agreeing a low sale price when a better one could have been achieved. We know nothing about her financial position.

(2) The figure of £8 million sale proceeds that Mr Johnson communicated to Mr Salisbury in 2003 has the hallmark of a figure plucked out of thin air – a figure that no vendor would refuse if offered but which no purchaser would offer. Mr Johnson essentially confirmed its nature as such. If this was a figure that he ever seriously mentioned to his wife, she might have questioned why in 2008 the agreed sale price was half the figure he expected to achieve in 2003. In fact, the Financial Due Diligence Report reveals that Mr and Mrs Gavin Johnson incorporated WML in October 2003 to facilitate the purchase of the 50 per cent interest in WDL that had until at that time been owned by a Mr and Mrs Tooby. The purchase price paid at that time by Mr and Mrs Johnson through WML for the Tooby's 50 per cent interest in WDL was £1,650,000. At the same time Mr and Mrs Johnson exchanged their shares in WDL for shares in WML.

(3) Having decided in 2008 that he was prepared to exit the business and sell his shares in WML, we do not find Mr Johnson's evidence credible as to why he was prepared to agree a sale price that was said to be significantly lower than the price he might have achieved. If he did receive advice (as he said he probably had) as to the value of the WML shares we think it unlikely that he would have been unable to recall who gave that advice and what it was, especially if it had in fact indicated a significantly higher value than the price he eventually agreed (so that he was consciously selling at a substantial discount). At the same time, if the valuation he had received had been to that effect there would be every reason for him to produce some evidence of it. We think that the more probable explanation is that the valuation confirmed that the price he was agreeing was within the range of prices that he might expect to achieve.

(4) That conclusion would also be consistent with the position of a man who had built up a successful business over several years and who might be expected to seek to realise the maximum value for his efforts. The sale only secured for his brother, Brian Johnson, a relatively modest holding in Chartersea, equal to that acquired by Mr Dallimore and Mr Salisbury. Whatever his sentiments regarding his brother, we do not think that Gavin Johnson would have been concerned to benefit Mr Dallimore and Mr Salisbury to the same extent by selling at a price significantly lower than the price that he might have achieved. Gavin Johnson may have been advised that he risked facing a higher capital gains tax bill if he delayed the sale. We do not think, however, that this provides a full explanation.

(5) It may be that Gavin Johnson's financial position in 2008 was more secure than it had been in 2003 and that, as a result, he was not so concerned to drive as hard a bargain as he might otherwise have done. In this respect his 50 per cent share of the sale proceeds would have been just over £2 million, and not the £4 million that he suggested was sufficient to

maintain his lifestyle (see paragraph 38 above). Nevertheless, we do not think that this explains a decision to forego significant further consideration for WML if that had been achievable.

137. On the balance of probabilities and notwithstanding Mr Gavin Johnson's evidence, we therefore conclude that Mr and Mrs Johnson sold their shares in WML at a price that in fact reflected what they realistically expected to achieve at the time and without intentionally foregoing significant further consideration. In a private sale of this nature a bargain still has to be struck which, as Mr Salisbury indicated, makes the deal attractive to the purchaser. Nevertheless, we think that any purchaser of the Gifted Shares could correctly assume in reviewing the available information on 4 April 2008 that the price of just over £4.3 million that Chartersea paid to acquire WML on 18 March 2008 was a fair price for the entire share capital of WML, while still allowing scope for profit for Chartersea shareholders on the listing.

The appropriate basis for valuing the shares

138. The starting point for Mr Ruse's valuation was the average price paid by those (such as Mr Green) with whom the Chartersea shares had been placed and who then subscribed the rights issue. The average price was 25.6p per share, which he then 'verified' by reference to the price that Chartersea had paid to acquire WML, on the assumption that that price represented the arm's length value of WDL. In this respect Mr Ruse's report appears to us to represent an obvious (and easy) starting point for any potential purchaser of the Gifted Shares in making an initial assessment of the possible open market value of the Chartersea. Based on the information that in our view would have been generally available to such a purchaser, that purchaser would be able to see how much the majority of existing shareholders had paid to invest in Chartersea and the price that the previous owners of WML had agreed for Chartersea's principal asset. As Mr Teste accepted, if the WML purchase price had been an open market value (and we have indicated in paragraph 137 how we think that a prospective purchaser might view it), this technique could be used (see paragraph 69 above).

139. This would provide some counterpoint (if any is needed) to the initial CISX bid/offer price and the price paid for the two trades on 4 April 2008. The question we have to answer, however, is: how much would a prudent purchaser have paid for the Gifted Shares on 4 April 2008 if Mr Green had offered 237,000 Chartersea shares for sale on the CISX on that day rather than donating that number of shares to charity (or, alternatively, if the two charities had immediately sought to sell the Gifted Shares)? In this regard we do not believe that the price of listed shares on a recognised stock exchange – even one with very limited equity trading such as CISX – would ordinarily be determined by the considerations of the first and second valuations methods to which Mr Ruse initially refers.

140. Mr Ruse recognises this by undertaking a DCF valuation. As we shall subsequently note (see paragraph 147 below), *Eastaway* recognises that a DCF valuation may be used to arrive at the Enterprise Value or equity value of a company (which was what Mr Teste was aiming to produce in the 2010 Report). There are, however, two problems with a DCF approach: first, Mr Ruse is forced to make use of projections of revenue and earnings that he acknowledges would almost certainly not

have been available in the open market; second, it seems clear to us that this valuation technique is not one that is ordinarily used in arriving at the open market price that would be paid for shares listed on a recognised stock exchange, even one of the CISX variety.

141. Although Mr Ruse was critical of the 2010 Report and, in particular, its variable terminology (see paragraph 56 above), he conceded that the methodology it adopted was in principle acceptable and in our view it reflects the approach that purchasers of Chartersea shares on the CISX market would be likely to use. That leads us to consider the differing views expressed by Mr Ruse and Mr Teste as to the appropriate level of sustainable profits and the correct PER multiple in reaching an open market value on this basis.

The valuation of the Chartersea shares

142. Appendix B of the Listing Application includes the audited accounts of WDL for the financial years ended 31 March 2005, 2006 and 2007. Appendix C includes the audited profits and loss account of WDL for the nine months to 31 December 2007. These show the following results for each of those periods—

Period	**31.3.2005**	**31.3.2006**	**31.3.2007**	**31.12.2007**
Turnover	£4,312,195	£3,959,739	£4,193,348	£3,311,022
Gross Profit	£2,495,970	£1,594,290	£1,762,476	£1,297,250
Pre-tax Profit	£916,795	£702,013	£932,989	£564,185
Post-tax Profit	£628,585	£468,986	£651,683	£390,423

On an annualised basis the figures for the nine months to 31 December 2007 would show a turnover of £4,414,696, gross profit of £1,729,666, pre-tax profit of £752,247 and post-tax profits of £520,564.

143. The figures used by Mr Teste in the 2010 Report differ to some extent from these figures. He uses the figure of pre-tax operating profit (before interest payable and similar charges) and adopts the budgeted figure for the year ended 31 March 2008. This budgeted figure is rounded to produce a figure of operating profit of £900,000, as compared to the pre-tax profit figure based on the annualised accounts to 31 December 2007 of £752,247. Mr Teste also makes various adjustments, for example for directors' remuneration, management charges and interest. For the budgeted year to 31 March 2008 there is also an adjustment to margin, which we assume is designed to allow for the lower margin of estimated gross profit to turnover for that year. This adds a further £50,000 to operating profit, making an adjusted operating profit of £983,000 for the budgeted year ended 31 March 2008. Mr Teste's adjusted pre-tax operating profit figures by reference to which he produces his "Enterprise Value" on the various bases outlined in paragraph 66 above are £999,000 (2005), £775,000 (2006), £979,000 (2007) and £983,000 (2008). The maintainable

pre-tax profit on his three bases is therefore £934,000 (equal weighting for 4 years to 31.3.2008), £981,000 (equal weighting for 2 years to 31.12.2008) and £983,000 (year to 31.3.2008). It is by applying a pre-tax multiple of between 7.50 and 10.00 to these figures that Mr Teste produces his "Business Value" of £8.5 - £9 million.

144. Based on the audited accounts figures set out above, the average pre-tax profits are £826,011 and the post-tax profit figure is £567,454. The latter figure is slightly higher than the annualised 2008 figure of £520,000 that Mr Ruse adopted in his "Quick PER Valuation for WDL". Mr Teste made two particular adjustments in arriving at his figures: the elimination of an annual management charge between WDL and WML (approximately £79,000 *pa*) and the elimination of certain remuneration and expenses associated with Gavin Johnson. Mr Margolin suggested that the first of these would be offset by the anticipated cost of "strategic and ongoing business advice" (see paragraph 71 above). The annual management charge of £79,000 that WML made to WDL can be seen in the accounts and might be adjusted for; Gavin Johnson's remuneration and expenses are less visible and we do not think that a prospective purchaser would assume any adjustment to directors' remuneration and expenses following the sale of WML. Adjusting solely for the annual management charge produces a figure of average pre-tax profits of £905,011 and average post-tax profits of the order of £622,000.

145. These figures all relate to WDL alone. The 2010 Report provides a valuation of the entire Chartersea share capital and concludes that this valuation is achieved by applying an appropriate 'multiple' to the sustainable earnings of the company. The 2010 Report states that this results in an "Enterprise Value" for the company that is then adjusted to produce the "Business Value" (being the value to the shareholders). We have previously recorded Mr Ruse's difficulties with some of the terminology of the 2010 Report (see paragraph 56 above). Taking it at its face value, however, we note that the extract with which we were supplied from *Eastaway* (Chapter 13) defines "enterprise value" in section 13-09 as the sum of the value of equity and debt in the business. Thus—

> "it represents the value of the business, or enterprise, before deduction of the amount belonging to providers of debt finance. The equity value can be derived from the enterprise value by deducting the value of debt from the enterprise value."

146. The extract continues by pointing out that if a company is valued by reference to the P/E multiples of comparable companies, the P/E multiple is determined as a 'price of equity/profit after tax'. Thus. P/E multiples are used to determine equity values because the price relates to equity; profit after tax measures the return to equity holders after the deduction of interest expense, i.e. after charging the return to providers of debt. *Eastaway* continues—

> "By contrast, if a company is valued by reference to an EBIT, (earnings before interest and tax) or EBITDA (earnings before interest, tax, depreciation and amortisation) multiple, it is logical that this should be used to determine the enterprise value of the company. EBIT and EBITDA are measures of the earnings available to both providers of debt and equity, as they measure earnings before the deduction of interest and dividends. Thus, for consistency, a

valuation multiple that uses either EBIT or EBITDA measures should have as its numerator the enterprise value of comparative companies so that both the numerator and denominator in the multiple are based on returns available to both debt and equity providers. Using the valuation multiples, 'Enterprise Value/EBIT' or 'Enterprise Value/EBITDA' will result in a value for the enterprise rather than the equity. In order to adjust it to reach the value of equity in the company, the debt in the company being valued must be deducted."

147. For completeness, given the third valuation approach adopted by Mr Ruse in his first (main) report, we should set out what follows in section 13-09 of *Eastaway*—

"Discounted cash flow, 'DCF', techniques can be used to determine the net present value of either the enterprise or the equity value of a company. Generally, DCF techniques will result in an enterprise value. This is because it is customary when performing a DCF exercise to discount cash flows before interest charges have been deducted from them, at a weighted average cost of capital for the company. Thus, forecast cash flows are being discounted before any return to debt holders at a discount rate that reflects both the cost of equity and the cost of debt in the business. The result is clearly the value of the enterprise, ie of both the debt and the equity.

It is possible to use DCF techniques to obtain a value for the underlying equity rather than the enterprise value. In order to do this, forecast cash flows must be discounted after deduction of interest and after repayment of debt. These forecast cash flows are then discounted at the cost of equity rather than at the weighted average cost of debt and the cost of equity. The result is the value of the equity in the business."

148. The 2010 Report valuation workings are, as we have noted, based on maintainable pre-tax profits and pre-tax multiples. We were also handed at the hearing post-tax figures and multiples. The relationship between the pre- and post-tax multiples (i.e. the basis of the adjustment that has been made for tax) is unclear. In WDL's case there was little debt finance, so that hardly any adjustment is needed on that account between the figure of WDL's pre-tax operating profits used in the 2010 Report (essentially, as it appears to us, EBIT) and the post-tax figures. Chartersea's acquisition of WML was, however, largely debt funded (see paragraph 10 above). Mr Teste said that his PER multiples took debt into account (see paragraph 73 above) and a note to the 2010 report indicated that:

"Term Debt has been excluded from the valuation, i.e. the valuation does not reflect a 'cash free / debt free' valuation. This approach is consistent with the valuation / p/e multiples extracted from a review of the market sector as per Appendix III."

149. Appendix III of the 2010 Report incorporated Mr Teste's 'comparators'. This included a column for Debt/Equity gearing and showed a range of percentages from 51 to 65 per cent, with an outlier of 18 per cent. As we have said, WDL had minimal external debt finance. Chartersea's gearing, by comparison, was in excess of 150 per cent. In this respect Mr Ruse's DCF calculation took account of the debt funding

involved in the Chartersea acquisition of WML (the details of which would have been information available to any prospective purchaser).

150. There are other aspects of the range of multiples referred to in the 2010 Report that seem inconsistent: for example, in describing the technique to be adopted in deriving an Enterprise Value the Report states that a broad post-tax range of 8 to 13 is appropriate; later it states that after a modest discount, the Report has used a range of 9 to 14 to illustrate the considered fair market value. The valuation workings use pre-tax multiples of 7.5 to 10. Mr Ruse commented on the shift to pre-tax multiples in the valuation workings in his second (supplemental) report. He noted that PERs are usually post-tax multiples of earnings but that pre- and post-tax multiples should deliver the same answer if the correct adjustments are made. He remained of the view that either way Mr Teste's multiples were excessive.

151. The basis of Mr Teste's choice of PER multiple is summarised in paragraphs 66 and 73 above. At paragraphs 73 and 74 we note his clarification that the comparables in the 2010 Report were only offered as a 'guide' and of his reasons for including them. Mr Ruse's criticisms of the comparables are summarised at paragraph 55 above. For a prospective purchase of the Gifted Shares on 4 April 2008, however, we think that the obvious comparator would be Acorn's cash offer for the whole issued share capital of the AIM-listed Vista.

152. Messrs G Johnson, Salisbury and Teste provided a number of reasons why the Vista transaction was an inappropriate comparator. Their reasons for differentiating Vista from WDL may have some substance but we do not think that they would be readily apparent to any prospective purchaser of the Gifted Shares. Such a purchaser would see a company in a similar line of business in respect of which a third party purchaser was prepared to make an offer of 19.5p per share, valuing Vista at approximately £3 million, representing a premium of 25.8 per cent to the AIM closing price immediately before the offer of 15.5p per share and implying a PER multiple (based on the final available year's profits) of 5.63.

153. Armed with that information, an assessment of WDL's much better net margin (discernible from the Chartersea and Vista information) and the knowledge that the previous owners of WML (one of whom also happened to be a director of Vista) had agreed to sell WML in March 2008 for £4.3 million, we think that a prospective purchaser of the Gifted Shares would be in a position to assess their open market value as CISX-listed shares.

154. On that basis a prospective purchaser could note that over a number of years WDL's earnings had consistently and significantly outperformed those of Vista. A prospective purchaser might still be thought unlikely to pay more than 30p per share, even after taking account of that factor. On the other hand, a potential purchaser having regard to Acorn's cash offer for Vista and taking an optimistic view of WDL's future prospects given the Chartersea listing might have been prepared to pay more. We think that a market price of 35p per share for the Gifted Shares is a realistic figure.

Our view of the expert evidence

155. As each party called into question the independence and objectivity of the other's expert, and therefore the reliability of their evidence, before concluding we should set out our view on this aspect of the matter, which has informed our review of that evidence.

156. We reject any suggestion that Mr Ruse lacked independence or objectivity either because he had (many years ago) been employed by the Inland Revenue in its Shares Valuation Division or because (more recently) he had been instructed regularly by the Inland Revenue and then HMRC as an expert adviser and expert witness. The only criticism that we think can be levelled at him is that he may have been too ready to take the view that the two April 4 share trades were 'rigged' and therefore should be ignored as unrepresentative of market value. The reasons he offered in his first (main) report were that there was no evidence that the transactions were true open market transactions and that Mr Dallimore's statement regarding an "orderly" market did not accord with reality. The factors to which we refer in paragraph 124 might underlie his first point. His second point might be based on the view that two trades on one day (like a swallow and Spring) do not confirm the description. He does not say. In our view, however, he would have been entitled to conclude (as we have done) that a potential purchaser of the Gifted Shares would in the circumstances have attached very little weight to those transactions and would have looked for other information as a guide to price.

157. We think that this is a slight criticism that does not undermine in any way the rest of his report on valuation, including his second (supplemental) and third (second supplemental) reports. In particular, his first two measures of value are no more than an obvious product and statement of the known facts and figures involved. His third measure, based on a DCF calculation, also appears to us to be a relatively standard approach (at least in text book terms) and we think that the main problem with it lies in what we have concluded in paragraph 140 above.

158. The basis of the 2010 Report and of Mr Teste's instructions in this matter (whatever they were and whoever gave them) strikes us as unsatisfactory. This is surprising given that the outcome of Mr Green's appeal would depend significantly on the expert valuation evidence that we received. We do not question Mr Teste's experience in valuing company shares although, as he accepted, his expertise principally lies in the realm of private companies and unlisted shares. We also do not think that his independence is undermined because he was involved in the acquisition of WML (although he would as a result have been privy to information that in our view would not have been publicly available).

159. The 2010 Report, however, was not initially produced for the benefit of this Tribunal but in order to advance Mr Green's case in correspondence with HMRC. That does not necessarily mean that its methodology is wrong, that it is unreliable or that in producing it Mr Teste was solely concerned to justify the value for which Mr Green was contending irrespective of Mr Teste's true view of the matter. As Mr Way noted, the 2010 report did not provide a value of £1 per share but came out at a slightly lower figure (see paragraph 66 above). The origins of the 2010 Report were nevertheless as they were and we would have expected Mr Teste formally to have

been instructed to prepare a separate report for the benefit of this Tribunal rather than, as he did, merely affirming the 2010 Report.

160. In particular, we think that, consistent with his obligations as an expert assisting this Tribunal, Mr Teste in a separate report should have properly addressed the Vista transaction and explained why, in his view, it did not affect his valuation of Chartersea. Mr Teste provided his explanation of this in oral evidence once the Vista transaction had been put in issue by Mr Ruse. We nevertheless think that its omission from the 2010 Report was unusual given that the 2010 Report incorporated appendices providing a marketplace commentary (including reference to the Government's 'Decent Homes' initiative) and the market values and P/E multiples in the building product sector, but without mentioning Vista. Mr Teste acknowledged that his 'comparators' were not directly comparable or representative (see paragraph 73 above), which we think undermines his reasons for not including the Vista transaction. That apart, as we previously noted (see paragraph 126 above), we approached certain aspects of Mr Teste's supplemental report with caution given his apparent sources of information and the nature of what he was saying.

161. Notwithstanding these caveats, we have accepted Mr Teste's evidence as to the appropriate valuation methodology. The principal issue that then arises (given that the necessary information on profits can be identified from the accounts) is the appropriate PER multiple. In this respect Mr Teste was open in his evidence as to his view of the appropriate multiple and the basis upon which he had put forward the 'comparisons' in the 2010 Report. Overall, however, we have concluded that Mr Teste's multiples overvalue the Gifted Shares and we prefer Mr Ruse's assessment in that respect.

Decision

162. We accordingly determine the market value of the Gifted Shares on 4 April 2008 as 35p per share. The "relievable amount" allowable under section 434 ITA is £83,125 (and not £71,250 as stated in the Closure Notice) and in accordance with section 50(7A) TMA we allow Mr Green's appeal to the extent that we amend the amount of disallowance of relief from £166,250 to £154,375.

163. 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.

MALCOLM GAMMIE
TRIBUNAL JUDGE

RELEASE DATE: 28 April 2014