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Case Number: TC 08908

FIRST-TIER TRIBUNAL
TAX CHAMBER

Taylor House, Rosebery Avenue, London

Appeal references: TC/2014/05157,05158, 06183, 06186, 06187, 06188, 06190 & 06191

Corporation tax – relief for amortisation of goodwill – Schedule 29 Finance Act 2002 & Part 8 Corporation Tax Act 2009 – purchase of care home businesses including properties – amounts of goodwill to be recognised and capitalised on acquisition, available for subsequent amortisation with corresponding corporation tax debits – UK GAAP – Financial Reporting Standards 6 & 7 – RICS "Red Book" valuation principles – goodwill amounts dependent on property valuations – whether properties should be fair valued under UK GAAP using market value or depreciated replacement cost
Stamp Duty Land Tax – just and reasonable apportionment of price paid for properties and for goodwill – paragraph 4, Schedule 4 Finance Act 2003

Heard on: 25-28 April and 4-5 May 2022
Judgment date: 11 August 2023

Before

TRIBUNAL JUDGE KEVIN POOLE
RICHARD LAW FCA CTA
IAN PERRY FRICS

Between

NELLSAR LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Simon Farrell KC and Patrick Cannon, instructed by Charles Russell Speechlys LLP

For the Respondents: Michael Jones KC and Harry Winter, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. These long-running appeals concern two aspects of the tax treatment of acquisitions of a number of residential care and nursing homes as going concerns between April 2004 and May 2007. Most significantly, they concern the amounts to be recognised, capitalised and subsequently amortised for corporation tax purposes in respect of goodwill said to have been acquired as part of the transactions. In two cases, they also concern the apportionment of the purchase price for stamp duty land tax ("SDLT") purposes between property and other assets (most materially, in the Appellant's submission, goodwill).

2. It might be thought that the principles to be applied in such cases would have been decided long ago, the relevant legislation having been enacted in 2002 and 2003. However, the matters involved are complex, involving the interaction of UK generally accepted accounting practice ("GAAP") and principles of property valuation as well as tax legislation. We understand that there are numerous similar appeals awaiting the outcome of these proceedings.

THE EVIDENCE

Introduction

3. We received, in electronic file format, documentary evidence running to 1,413 pages, witness statements and expert evidence running to 1,561 pages and authorities and reference material running to 1,824 pages.

Evidence of fact

4. We received uncontroversial written witness statements from Arinesarajah Ragumoorthy (the managing director and 50% owner of the Appellant, referred to in this decision as "Nellsar") and Mark Payne of Thickbroom Coventry, accountants to Nellsar. Mr Ragumoorthy described the processes he had gone through in negotiating the purchase of the homes in question. Mr Payne had advised Nellsar on the allocation of the total purchase prices paid for its acquisitions and in drawing up its accounts, and his witness statement described the processes he had gone through in doing so. It was agreed that insofar as his witness statement expressed opinions about the correct application of GAAP, we should disregard those opinions. No oral testimony was required from either witness.

Expert evidence

5. On the joint application of the parties, the Tribunal had directed that each party would have leave to adduce expert evidence on the following three areas:

(1) "On the generally accepted accounting practice relevant to the identification of the fair value of tangible and intangible assets on the acquisition of a care homes business, including the basis of measurement required by such practice";

(2) "On the meaning and proper interpretation of the RICS Valuation Standards, in particular those applicable to the valuation of non-specialised or trade-related properties as far as relevant for the purposes of taxation and for the application of generally accepted accounting practice, including the distinction between valuation, allocation and apportionment"; and

(3) "As to the value of the assets acquired by the Appellant which are the subject of the appeals listed above, such valuation to be informed by the positions taken by the experts in respect of areas referred to in [(1)] and [(2)] above".

6. Included in the documents before us were experts' reports from:

(1) Paul Merris BSc ACA instructed by Nellsar, in relation to issue 5(1) above;

(2) Sukhbinder Singh Lotay BA (Hons), FCA, FCCA instructed by HMRC, in relation to issue 5(1) above;

(3) Iain Michael Lock BA MRICS instructed by Nellsar, in relation to issues 5(2) and 5(3) above; and

(4) Joanne Thorneagle MRICS instructed by HMRC, in relation to issues 5(2) and5(3) above.

7. We also heard oral evidence from Mr Merris, Mr Lotay, Mr Lock and Ms Thorneagle.

8. Also included in our bundles were copies of experts' reports from various other experts who had been instructed by one party or the other on the issues referred to above at various earlier stages of the proceedings. We were not taken to those reports during the hearing and did not rely on them in reaching our decision.

SCOPE OF THE TRIBUNAL'S JURISDICTION

9. Whilst the questions before this Tribunal are, in relation to the corporation tax issues at least, focused around the value of goodwill rather than of land, it is agreed that the goodwill value depends almost entirely on the value of the land (and buildings) in each case – to the extent the purchase price is not attributable to the land and other tangible assets, any balance is attributable to goodwill. Whilst the SDLT issues are slightly different – being concerned with an apportionment of the total consideration, rather than a specific valuation of the goodwill element, the value of the land and buildings may be a material element in carrying out such apportionment.

10. It is quite clear, pursuant to regulation 12(a)(iii) of the First-tier Tribunal and Upper Tribunal (Chambers) Order 2010 that "all functions related to… the determination of questions of the value of land or an interest in land arising in tax proceedings" are allocated to the Lands Chamber of the Upper Tribunal, accordingly the parties are agreed that the role of this Tribunal in relation to such matters is limited to adjudicating on the meaning and effect, in the context of the facts of these appeals, of the statutory framework within which a determination of any such value must be carried out. We concur.

11. Whilst we were supplied with expert evidence under heading 5(3) above, therefore, it was common ground that the purpose of doing so was only in order to ensure that our consideration of the issues actually before us was informed by the practical outcomes of the different approaches, as seen by both experts, and not with a view to us reaching any decisions on matters which are properly the preserve of the Lands Chamber of the Upper Tribunal. In fact, the parties anticipated that once a decision had been reached on the issues before this Tribunal, they would have no difficulty in agreeing final values.

THE FACTS

12. We make the following findings of fact.

The transactions involved in the appeals

13. Nellsar has at all material times carried on business as an operator of residential care homes and nursing homes. The current proceedings arise out of its acquisition of five such homes in 2004 to 2007.

14. There was a draft summary of agreed facts included in our bundle. Whilst it does not appear to have been formally agreed between the parties, its content appears uncontroversial and it identifies the properties concerned and sets out the relevant terms of the acquisition in each case. This summary includes the following:

Other material

Introduction

88. As can readily be seen, both Schedule 29 and CTA09 (at paragraph 5(1) and s 716(4) respectively) ultimately require an examination of what is "generally accepted accounting practice" ("GAAP" or, specific to the UK, "UK GAAP") in preparing accounts. There is no formal definition of this phrase, either there or in the companies legislation. It is generally taken as encompassing the statutory requirements in relation to accounts (as contained in the companies legislation from time to time), the chief of which is the requirement for accounts to give a "true and fair view"; but more specifically it encompasses the accounting principles contained in the accounting standards issued or adopted from time to time by the Financial Reporting Council ("FRC") pursuant to section 464 Companies Act 2006 ("CA06"). Finally, the parties agreed that material published by leading firms of accountants in their technical manuals can also provide good evidence of what is GAAP.

89. In relation to the accounts reflecting the various acquisitions the subject of these appeals, the regulatory structure was slightly different – the Accounting Standards Board ("ASB") rather than the FRC was responsible for issuing the relevant material, and the material took the form of separate "Financial Reporting Standards" covering discrete topics. The ASB was overtaken by the FRC on 2 July 2012, and the old Financial Reporting Standards were replaced (mostly for reporting periods starting on or after 1 January 2015) by new Financial Reporting Standards. Those new standards were not considered in the course of this hearing, as the Appellant's accounts covering the acquisitions all predated the changes.

90. For present purposes, therefore, we were mainly concerned with the Financial Reporting Standards in force over the period prior to 2008, in particular FRS 6 "Acquisitions and Mergers", FRS 7 "Fair Values in Acquisition Accounting", FRS 10 "Goodwill and Intangible Assets" and FRS 15 "Tangible Fixed Assets".

Companies legislation and FRSs

91. The statutory foundation of GAAP for present purposes is paragraph 9(2), Schedule 4A, Companies Act 1985 ("CA85"), which set out "the acquisition method of accounting" as requiring that:

> The identifiable assets and liabilities of the undertaking acquired shall be included in the consolidated balance sheet at their fair values at the date of acquisition. In this paragraph the *"identifiable"* assets or liabilities of the undertaking acquired means the assets or liabilities which are capable of being disposed of or discharged separately, without disposing of a business of the undertaking.

92. FRSs 6 and 7 build on this statutory foundation. It is important to remember that the scheme of acquisition accounting set out in CA85 was addressed specifically at how acquisitions were to be accounted for by groups of companies, most particularly in the consolidated balance sheet. The extension of the scheme to acquisitions of unincorporated businesses by singleton companies was effectively introduced by FRS 6.

93. The starting point is FRS 6 "Acquisitions and Mergers". It is common ground that all the acquisitions in this appeal were subject to "acquisition accounting" under this FRS. As is stated in paragraph 4 of FRS 6 ("Scope"):

> Financial Reporting Standard 6 applies to all financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period. Although the FRS is framed in terms of an entity becoming a subsidiary undertaking of a parent company that prepares consolidated financial statements, it also applies where

c …

d Fair values should be based on the value at which an asset or liability could be exchanged in an arm's length transaction…

e Unless they can be measured at market value, the fair values of non-monetary assets will normally be based on replacement cost, but should not exceed their recoverable amount as at the date of acquisition. The recoverable amount reflects the condition of the assets on acquisition but not any impairments resulting from subsequent events. The FRS specifies the methods for determining fair values of individual categories of assets and liabilities.

…

100. FRS 7, in paragraph 1, defines its "Objective" as being to ensure that "when a business entity is acquired by another, all the assets and liabilities that existed in the acquired entity at the date of acquisition are recorded at fair values reflecting their condition at that date…".

101. In paragraph 2 of FRS 7, the following relevant definitions are set out:

Fair value:-

The amount at which an asset or liability could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale.

Identifiable assets and liabilities:-

The assets and liabilities of the acquired entity that are capable of being disposed of or settled separately, without disposing of a business of the entity[3].

Recoverable amount:-

The greater of the net realisable value of an asset and, where appropriate, the value in use.

Value in use:-

The present value of the future cash flows obtainable as a result of an asset's continued use, including those resulting from the ultimate disposal of the asset.

102. The following relevant passages appear in the "Statement of Standard Accounting Practice" section (paragraphs 4-31) of FRS 7:

Determining the fair values of identifiable assets and liabilities acquired

Principles of recognition and measurement on an acquisition

5 The identifiable assets and liabilities to be recognised should be those of the acquired entity that existed at the date of the acquisition.

6 The recognised assets and liabilities should be measured at fair values that reflect the conditions at the date of the acquisition.

Application of the principles

7 …

8 The application of these principles to specific classes of asset and liability is detailed in paragraphs 9-22 below. Subject to those paragraphs, fair values

[3] It can readily be seen that the wording of this definition tracks closely, but does not exactly follow, the definition contained in paragraph 9(2), Schedule 4A Companies Act 1985 (see [91] above). No change in meaning appears to be intended as a result of the slightly different words used, and neither party argued that the slight differences had any relevance for present purposes.

> gross replacement cost reduced by depreciation to take account of the age and condition of the asset…

105. For completeness, it is important to mention FRS10, entitled "Goodwill and Intangible Assets". This FRS requires that "purchased goodwill" (such as we are here concerned with) should be capitalised as an asset and then amortised through the profit and loss account on an appropriate basis. HMRC do not raise any issue about how the requirements of FRS10 have been carried through into Nellsar's accounts, except with regard to the amount of goodwill initially recognised on each acquisition. We do not therefore need to mention it further.

106. FRS15 (entitled "Tangible Fixed Assets") is concerned with what might be called "normal" acquisitions of tangible fixed assets (i.e. on an individual or piecemeal basis and not as part of a business acquisition) and the subsequent treatment of those assets in a company's accounts, particularly with respect to revaluations, depreciation and disclosure. As is stated in paragraphs a and b of its lengthy introductory "Summary":

> a. Financial Reporting Standard 15 'Tangible Fixed Assets' sets out the principles of accounting for the initial measurement, valuation and depreciation of tangible fixed assets, with the exception of investment properties…
>
> b. The FRS codifies much of existing accounting practice. Its objective is to ensure that tangible fixed assets are accounted for on a consistent basis and, where a policy of revaluation is adopted, that revaluations are kept up-to-date.

107. The stated "Objective" of FRS15 has four limbs:

> The objective of this FRS is to ensure that:
>
> (a) consistent principles are applied to the initial measurement of tangible fixed assets.
>
> (b) where an entity chooses to revalue tangible fixed assets the valuation is performed on a consistent basis and kept up-to-date and gains and losses on revaluation are recognised on a consistent basis.
>
> (c) depreciation of tangible fixed assets is calculated in a consistent manner and recognised as the economic benefits are consumed over the assets' useful economic lives.
>
> (d) sufficient information is disclosed in the financial statements to enable users to understand the impact of the entity's accounting policies regarding initial measurement, valuation and depreciation of tangible fixed assets on the financial position and performance of the entity.

108. For the purposes of FRS15, definitions from the RICS Appraisal and Valuation Manual of the following terms are specifically adopted: specialised properties, non-specialised properties, open market value, depreciated replacement cost (of property) and existing use value. Copies of those definitions are included at Appendix [3] to this decision. In addition, the following definitions are set out:

> *Current value:-*
>
> The current value of a tangible fixed asset to the business is the lower of replacement cost and recoverable amount.
>
> *Recoverable amount:-*
>
> The higher of net realisable value[5] and value in use.*

[5] No definition of the phrase "net realisable value" is given or referred to.

> * Refer to FRS11 'Impairment of Fixed Assets and Goodwill' for a definition of value in use and details about its calculation.

109. The primary requirement of FRS15, in the first section headed "Initial measurement", is that "[a] tangible fixed asset should initially be measured at its cost" (paragraph 6, a statement of standard accounting practice), reflecting the first limb of the objective set out at [107] above. There follows a great deal of detail on how that initial "cost" should be measured (none of it by reference to any valuation of the asset itself). Once the cost has been established, it should be compared with the "recoverable amount", and if the cost exceeds the recoverable amount, the asset should be written down to the latter amount.

110. FRS15 then goes on to a section entitled "Valuation", addressing the second of the four objectives set out at [107] above (requirements when revaluations are carried out). Under this heading, the following paragraphs appear as part of the "statement of standard accounting practice":

> 42 Tangible fixed assets should be revalued only where the entity adopts a policy of revaluation. Where such a policy is adopted then it should be applied to individual classes of tangible fixed assets… but need not be applied to all classes of tangible fixed assets held by the entity.
>
> *Frequency*
>
> 43 Where a tangible fixed asset is subject to a policy of revaluation* its carrying amount should be its current value as at the balance sheet date.
>
> * The term 'revaluation' does not encompass either the write-down of the carrying amount of a tangible fixed asset held at historical cost for an impairment in accordance with FRS11, or determination of the cost of an asset acquired as a result of a business combination stated at its fair value at the date of acquisition, in accordance with FRS7 'Fair Values in Acquisition Accounting', or, for charities, the initial measurement at current value of a donated tangible fixed asset in accordance with paragraph 17.

111. There then follow a number of paragraphs of commentary, dealing with the process and frequency of valuations in such cases. This is followed by a further paragraph, identified as part of the statement of standard accounting practice, as follows:

> *Valuation basis*
>
> 53 The following valuation bases should be used for revalued properties that are not impaired:
>
> (a) non-specialised properties should be valued on the basis of existing use value (EUV[6]), with the addition of notional directly attributable acquisition costs where material. Where open market value (OMV) is materially different from EUV, the OMV and the reasons for the difference should be disclosed in the notes to the accounts.
>
> (b) specialised properties should be valued on the basis of depreciated replacement cost.
>
> (c) properties surplus to an entity's requirement should be valued on the basis of OMV, with expected directly attributable selling costs deducted where material.

[6] The RICS definition of Existing Use Value, incorporated into FRS15, is effectively the same as Open Market Value, but with an additional main assumption that "the property can be used for the foreseeable future only for the existing use".

112. Three paragraphs later, the following Explanation paragraph appears:

> 56 Certain types of non-specialised properties are bought and sold, and therefore valued, as businesses. The EUV of a property valued as an operational entity is determined by having regard to trading potential, but excludes personal goodwill that has been created in the business by the present owner or management and is not expected to remain with the business in the event of the property being sold.

113. Under the heading "Depreciation" (addressing the third of the objectives set out at [107] above) at paragraph 83 (dealing with the particular case of assets comprised of multiple major components with substantially different economic lives, where each component should be separately accounted for and depreciated), the following Explanation appears:

> 84 Land and buildings are separable components and are dealt with separately for accounting purposes, even when they are acquired together. With certain exceptions, such as sites used for extractive purposes or landfill, land has an unlimited economic life and therefore is not depreciated. Buildings have a limited life and therefore are depreciated. An increase in the existing use value of the land on which a building stands does not affect the determination of the useful economic life or residual value of the building. Another example of separable components that may have substantially different useful economic lives is the structure of a building and items within the structure such as general fittings.
>
> 85 It would not be appropriate, however, to treat the trading potential associated with a property that is valued as an operational entity, such as a public house or hotel, as a separate component, where the value and life of any such trading potential is inherently inseparable from that of the property.

114. The PriceWaterhouseCoopers Manual of Accounting (2010 edition), in its chapter entitled "Acquisition Accounting", included a section on "Fair valuing fixed assets". In that section, the following paragraphs appeared:

> 25.265 Existing use value is the basis normally used for valuing properties that are occupied in the company's business and that have not been declared surplus. It is based on market value, but the valuation reflects an important assumption that the property can be used for the foreseeable future only for the existing use. It is intended to represent the cost of replacing the remaining service potential of a property.
>
> 25.266 Neither market value nor existing use value include any value attributable to the goodwill generated by the business that occupies the property with the following exception. A variation of existing use value is 'existing use as a fully operational business unit'. This basis applies to properties that invariably change hands in the open market at prices based directly on trading potential for a strictly limited use. Examples of such properties include hotels, private hospitals and nursing homes, public houses, cinemas, theatres, bingo clubs, gaming clubs, petrol filling stations, licensed betting offices and specialised leisure and sporting facilities. The valuation includes the value of the trading potential which runs with the property, but should not include any goodwill which has been created by the owner and which would not remain with the property should it be sold.
>
> 25.267 In acquisition accounting, properties that would normally be valued under the alternative accounting rules on an existing use value basis in the acquired company's financial statements (that is, those occupied for the purpose of its business) would also usually be valued on this basis in the fair value exercise. That is because FRS7 requires fair values to reflect the

covered properties far more "specialised" than care/nursing homes. As the parties clearly agreed, GN1 was intended from the outset to cover a far wider range of what later became defined as "trade related properties" (including nursing/care homes – as was made explicit in the 2007 version).

131. In accordance with paragraph 1.2 of its introduction (see [128] above), the purpose of GN1 was to draw attention to "the additional criteria that need to be considered by the valuer" when valuing the properties to which it related, and it was not concerned with the actual "methodology" or "method of valuation" in each case.

132. We were also provided with a further RICS document, apparently dating from 2011, entitled "GN2 Valuation of individual trade related properties", whose stated purpose was to set out the principles of the "income approach" method of valuation, but without going into the detailed approach that might be relevant to any particular sort of trade related property. The purpose of this Guidance Note therefore appears to be to provide more detail of the methodology to be adopted in approaching the valuation of such properties.

133. Dealing first with GN1 in its various iterations, the first issue addressed was "identifying the operational entity". This was concerned with ensuring that only the appropriate assets were included in any valuation (so excluding consumables, stock in trade, leased assets, etc).

134. The core of GN1 was then concerned with distinguishing between trading and non-trading properties for valuation purposes. The "correct" valuation basis for a trading property was given as "market value as a fully-equipped operational entity, having regard to trading potential", whereas for a non-trading property the "correct" basis was given as "market value of the empty property having regard to trading potential". By way of commentary on the latter basis, the versions up to 2006 said this:

> The closure of a business, and the removal of some, or all, of the trade equipment, may have a significant effect on the value of the property. It will, therefore, often be appropriate to express the value on the basis of one or more Special Assumptions, as well as on a basis reflecting the status quo. This is often a requirement when advising a lender as to the value of trade-related property for loan security purposes.

135. In the 2007 and 2008 versions of GN1, the text was significantly revised, but wording to the same effect was included, with the addition of the following:

> It does not follow that the difference between this *special assumption* and the value reflecting the status quo represents the value of *transferable goodwill*, and valuers should not indicate any such apportionment. For example, the differences could reflect the cost and time involved in removing the fixtures and purchasing new equipment.

136. GN1 then went on to consider in more detail the application of the "market value" concept to trade-related properties, with some analysis of how two aspects of goodwill – the first referred to as "inherent" or "transferable" goodwill and the second as "personal" goodwill – played into the market value of such properties. The 2007 version of GN1 reflected, as one might expect, a refinement and slight evolution of the earlier versions, without material change to the underlying principles. Most of the 2007 version of GN1 is included at Appendix 4 to this decision.

137. Turning to GN2, it was not explained to us why there was no version earlier than 2011 in the documents before us, nor indeed whether an earlier version even existed. GN2 does appear to cover much of the same ground as GN1, whilst additionally going into detail on valuation methodology; it also makes reference at one point to a separate document "GN1, Valuation certainty", and since none of the versions of GN1 before us made any reference to

"valuation certainty", we infer that there had been some redrafting and re-numbering of the Guidance Notes such that GN2 now encompassed all the material previously included in GN1, which had itself been replaced by a new document which addressed entirely different issues. In short, GN2 represented an expanded version of GN1 which addressed in a single document both the relevant content from the earlier GN1 and more detail on valuation methodology.

138. The introduction to GN2 started as follows:

> **1 Introduction**
>
> 1.1 Certain properties are valued using the profits method (also known as the income approach) of valuation. This *guidance note* sets out the principles of this method of valuation. However, it does not concern itself with the detailed approach to a valuation that may vary according to the property to be valued.
>
> 1.2 This *guidance note* is of global application.
>
> 1.3 This *guidance note* relates only to the valuation of an individual property that is valued on the basis of trading potential. Valuations of businesses will be covered by separate guidance.
>
> 1.4 Certain properties are normally bought and sold on the basis of their trading potential. Examples include hotels, pubs and bars, restaurants, nightclubs, casinos, cinemas and theatres, and various other forms of leisure property. The essential characteristic of this type of property is that it has been designed or adapted for a specific use, and the resulting lack of flexibility usually means that the value of the property interest is intrinsically linked to the returns that an owner can generate from that use. The value therefore reflects the trading potential of the property. It can be contrasted with generic property that can be occupied by a range of different business types, such as standard office, industrial or retail property.

139. GN2 then went into great detail on the steps involved in a "profits method of valuation". This involved first making an assessment of the fair maintainable turnover ("FMT") that could be generated at the property by a reasonably efficient operator ("REO"). An assessment should then be made of the potential gross profit arising from the FMT, which should then be adjusted to arrive at a fair maintainable operating profit ("FMOP"). A market value could then be arrived at for the property by capitalising the FMOP "at an appropriate rate of return reflecting the risk and rewards of the property and its trading potential." In doing so, "evidence of relevant comparable market transactions should be analysed and applied".

140. Under the heading "5. Valuation approach for a fully equipped operational entity", it was stated that such a valuation "necessarily assumes that the transaction will be either the letting or the sale of the property, together with the trade inventory, licences, etc., required to continue trading." This might in turn require further assumptions to be made as to the continued availability of (for example) leased assets, licences, consents, permits etc.

141. The end result of a valuation using this approach would be reported as "Market Value as a fully equipped operational entity having regard to trading potential subject to any agreed or special assumptions…" (the same wording as paragraph 3.2 in the previous GN1, see Appendix 4).

142. Under the heading "6. Valuation approach for a non-trading property" the following text appeared:

> 6.1 The valuation process for a non-trading property is the same as outlined in section 5, but where the property is empty either through cessation of trade, or because it is a new property with no established trading history, different *assumptions* are to be made. For example, an empty property may have been

> stripped of all or much of its trade inventory, or a new property may not have the trade inventory installed, but either could still be valued having regard to its trading potential.
>
> 6.2 The cessation of an operational entity and the removal of some or all of the trade inventory are likely to have an effect on the value of the property. It would therefore be appropriate to express the value on the basis of one or more *special assumptions*, as well as on a basis reflecting the status quo. This is often a requirement when advising a lender on the value of *trade related property* for loan security purposes. For example, the differences could reflect the cost and time involved in purchasing and installing the trade inventory, obtaining new licences, appointing staff and achieving FMT.

143. The end result of a valuation using this approach would be reported as "Market Value of the empty property having regard to trading potential subject to the following special assumptions…" (the same wording as paragraph 3.5 in the previous GN1, see Appendix 4).

144. GN2 also contained definitions of "Personal goodwill (of the current operator)" and "Trading potential", as follows:

> **Personal goodwill (of the current operator)**
>
> The value of profit generated over and above market expectations that would be extinguished upon sale of the *trade related property*, together with financial factors related specifically to the current operator of the business, such as taxation, depreciation policy, borrowing costs and the capital invested in the business.
>
> **Trading potential**
>
> The future profit, in the context of a valuation of the property, that an REO would expect to be able to realise from occupation of the property. This could be above or below the recent trading history of the property. It reflects a range of factors such as the location, design and character, level of adaptation and trading history of the property within the market conditions prevailing that are inherent to the property asset.

145. Finally, we were also supplied with a further RICS document dating from January 2014 and headed "VPGA 4 Valuation of individual trade related properties". This appears to replace GN2, and apart from some small renumbering, entirely echoes the earlier document.

SDLT

146. It is common ground between the parties that the dispute revolves entirely around the issue of what was the "chargeable consideration" given for the freehold interests in the various properties. The relevant provision is paragraph 4 of Schedule 4 to the Finance Act 2003 ("FA03"), which provides as follows:

> **4 Just and reasonable apportionment**
>
> (1) For the purposes of this Part consideration attributable—
>
> (a) to two or more land transactions, or
>
> (b) in part to a land transaction and in part to another matter, or
>
> (c) in part to matters making it chargeable consideration and in part to other matters,
>
> shall be apportioned on a just and reasonable basis.
>
> (2) If the consideration is not so apportioned, this Part has effect as if it had been so apportioned.

(3) For the purposes of this paragraph any consideration given for what is in substance one bargain shall be treated as attributable to all the elements of the bargain, even though—

(a) separate consideration is, or purports to be, given for different elements of the bargain, or

(b) there are, or purport to be, separate transactions in respect of different elements of the bargain.

147. The parties are agreed that the outcome of the appeals in relation to SDLT depends on a correct "just and reasonable" apportionment between the land and the other assets, in accordance with paragraph 4, of the total consideration given in each transaction.

148. Nothing in the RICS material before us referred to any particular approach to such an apportionment. Indeed, in GN2 and VPGA4 it is specifically stated that "Apportionments for tax purposes have to be in accordance with specific legislation and are outside the scope of this guidance note.[8]"

149. In contrast, in 2013 HMRC published a Practice Note entitled "Apportioning the price paid for a business transferred as a going concern". Whilst this document was not included in our authorities bundle, it appeared as an exhibit to Ms Thorneagle's first report and was referred to by Mr Jones in his submissions without any objection from Mr Farrell.

THE ARGUMENTS IN DETAIL

Corporation tax

Interaction of paras 5 and 105 of Schedule 29

150. The parties disagreed first about the proper interaction of paragraphs 5 and 105 of Schedule 29[9]. Paragraph 5 essentially provides that if a company does not draw up its accounts in accordance with UK GAAP, the relief in Schedule 29 should be calculated as if it had done so:

5 Company not drawing up correct accounts

(1) If a company does not draw up accounts in accordance with generally accepted accounting practice ("correct accounts")—

(a) the provisions of this Schedule apply as if correct accounts had been drawn up, and

(b) the amounts referred to in this Schedule as being recognised for accounting purposes are those that would have been recognised if correct accounts had been drawn up.

151. Paragraph 105 provides that where assets are acquired together, values allocated by the company to individual assets in accordance with UK GAAP should be accepted for the purposes of the relief, but if no such values were allocated, then the expenditure on them should be decided by means of a "just and reasonable apportionment" of the overall expenditure:

105 Assets acquired or realised together

(1) Any reference in this Schedule to the acquisition or realisation of an asset includes the acquisition or realisation of that asset together with other assets.

(2) For the purposes of this Schedule assets acquired or realised as a result of one bargain are treated as acquired or realised together even though —

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[8] In VPGA 4, "guidance note" was replaced by "application".

[9] The equivalent provisions in CTA09 are ss.717 and 856. Neither side argued that the slight differences in drafting affected the outcome of this argument.

(a) separate prices are, or purport to be, agreed for separate assets, or

(b) there are, or purport to be, separate acquisitions or realisations of separate assets.

(3) Where assets are acquired together —

(a) any values allocated to particular assets by the company in accordance with generally accepted accounting practice shall be accepted for the purposes of this Schedule;

(b) if no such values are allocated by the company, so much of the expenditure as on a just and reasonable apportionment is properly attributable to each asset shall be treated for the purposes of this Schedule as referable to that asset.

152. Mr Farrell for Nellsar argued, in summary, as follows. Primarily, Nellsar's accounts had all been drawn up in accordance with GAAP and accordingly paragraph 105(3)(a) applied. The effect of paragraph 105(3)(b) however was that even if the accounts were not drawn up (and the individual assets valued) in accordance with GAAP (so that one fell outside 105(3)(a)), the correct method of valuing the assets for the purposes of the relief was by applying a "just and reasonable apportionment"; and since Nellsar had used one of the methods of valuation recognised in GAAP (depreciated replacement cost) in carrying out its apportionment, that apportionment must be accepted. In his submission, paragraph 105, being the more specific provision, overrode paragraph 5 on this point.

153. Mr Jones argued this was wrong. In his submission, if a company prepares accounts which are not GAAP-compliant, under paragraph 5 the tax treatment should be decided as if GAAP-compliant accounts had been prepared. If GAAP-compliant accounts allocated separate values to particular assets which had been acquired together, then under paragraph 105(3)(a) that allocation must be accepted. Paragraph 105(3)(b) only came into play if a company prepares GAAP-compliant accounts but those accounts do not contain allocations of value between separate assets which need to be treated differently for tax purposes under Schedule 29. It is only in such cases that paragraph 105(3)(b) steps in to require a just and reasonable apportionment.

Were the accounts GAAP-compliant?

154. This question lies at the heart of the appeal, and its exploration requires an examination of the requirements of GAAP at the time.

155. The parties were able to agree on some points.

156. First, it was agreed that each nursing/care home property constitutes a tangible fixed asset which was "capable of being disposed of separately, without disposing of a business" of Nellsar. This is self-evidently true, as each building could quite easily have been bought and sold and the business closed down or transferred to another building. As such, each nursing/care home would be a separate "identifiable asset" for the purposes of FRS7. It is worth noting at this point, however, that whilst the parties agreed on this in principle, there were crucial differences between them as to the way in which they argued that the identifiable asset was to be considered for valuation purposes (see below).

157. Second, paragraph 9 of FRS7 therefore required that the fair value at which each nursing/care home should have been recognised in Nellsar's accounts was to be "based on":

(a) market value, if assets similar in type and condition are bought and sold on an open market; or

(b) depreciated replacement cost, reflecting the acquired business's normal buying process and the sources of supply and prices available to it.

The fair value should not exceed the recoverable amount of the asset.

158. The definitions of some of these terms are set out at [101] above. In particular, "recoverable amount" is defined as being the higher of "net realisable value" (for which no definition is given) and ("where appropriate") the "value in use".

159. In response to questions from the panel, both accounting experts agreed that some assessment of the "recoverable amount" of an asset would therefore clearly be required in every case when ascribing its "fair value" for FRS7 paragraph 9, which could potentially involve an assessment of both limbs of the "recoverable amount" definition – the "net realisable value" of the asset and its "value in use" – in order to ensure that the fair value which was proposed to be incorporated into the accounts did not exceed the greater of the two figures. Mr Merris's opinion was that the requirement to check the initial fair value of the asset against its recoverable amount was there in order to ensure that the carrying value on the balance sheet was not required to be immediately impaired under FRS11 (the FRS dealing with impairment of fixed assets and goodwill in company accounts, whose main stated objective was "to ensure that fixed assets and goodwill are recorded in the financial statements at no more than their recoverable value"); as long as the value under paragraph 9(a) or 9(b) of FRS7 could be shown to be less than either the net realisable value of the asset or its value in use, no further consideration of the "recoverable amount" limit was required – and in practice he argued this was in fact a very low hurdle because any assessment of the "value in use" of a nursing/care home that had been operated profitably (involving an assessment of "the present value of the future cash flows obtainable as a result of the asset's continued use…") was extremely unlikely to be less than the amount assessed as its fair value under paragraph 9(a) or (b) of FRS7, meaning that the "fair value must not exceed recoverable amount" requirement of FRS7 would be met without having to assess the "net realisable value" of the asset. Mr Lotay did not specifically disagree, but in any event neither side argued that an exploration of the "recoverable amount" in respect of any of the homes was required on the part of the Tribunal in this case; both simply focused on the question of whether "market value" or "depreciated replacement cost" was the appropriate method to apply in this case.

160. From this point, it is fair to say that the parties diverged.

161. In broad terms, Mr Farrell (supported by Mr Merris, accountancy expert) on behalf of Nellsar argued, in outline, that the "identifiable asset" under consideration in each case here is the bare nursing/care home, without any associated business (and therefore without patients, staff, consumables, permits, contracts or any of the other accoutrements of a business); that sales of such homes without an associated business, whilst occurring from time to time, are insufficiently frequent to give rise to an "open market" in such assets; and that accordingly it is not possible to arrive at a market value pursuant to paragraph 9(a) of FRS7 in respect of the homes that Nellsar bought. Paragraph 9(b) therefore requires the use of depreciated replacement cost instead, which is precisely what Nellsar did.

162. Mr Jones (supported by Mr Lotay, accountancy expert) on behalf of HMRC accepted that the "identifiable asset" under consideration is the care/nursing home in each case; but in reliance on the stated "Objective" of FRS7 (see [100] above) and paragraph 6 of FRS7 (see [101] above), they argued that the homes should have been included in the accounts at "fair values reflecting their condition" at the date of acquisition (as stated in the Objective) and at "fair values that reflect the conditions at the date of the acquisition" (as stated in paragraph 6); and whether referring to "their condition" (in the Objective) or "the conditions" (in paragraph 6), this should be taken to include the fact that in each case the home was fitted out, open and

operating as a business and should therefore be valued as such. There was a very active market in sales of operating care/nursing homes, enabling a valuer to arrive easily at a market value for these homes.

163. By way of support for this proposition, Mr Jones (again supported by Mr Lotay) went on to argue that whilst FRS7 sets out the basic rules for ascribing "fair value" to an asset, it is not entirely self-contained; in particular, it does not define the terms "market value" and "depreciated replacement cost"; to understand those terms, he submitted it was appropriate to refer to the definitions of the terms "open market value" and "depreciated replacement cost" in FRS15 ("Tangible Fixed Assets"), which contained what he argued were general principles of valuation of tangible fixed assets for accounting purposes, in spite of the fact that many of the principles there referred to were stated to apply specifically in the context of <u>revaluations</u> of existing fixed assets. Relevant extracts from FRS15 are set out at [106] to [113] above. In support of this proposition, they noted that a stated objective of FRS15 in its introductory summary was "to ensure that tangible fixed assets are accounted for on a consistent basis" (see [107] above). Accordingly, they argued, some of its provisions cast light on how the "fair value" exercise in FRS7 should be approached, even though on their face the FRS15 provisions might only be directly relevant to revaluations of existing fixed assets already held by a company.

164. In particular, they argued that the definitions of "specialised properties", "open market value" and "depreciated replacement cost" in FRS15 should be referred to when considering those terms (or "market value", the analogue of "open market value"[10]) in FRS7.

165. They also argued that:

(1) it was relevant that FRS15 only permitted "depreciated replacement cost" revaluations of "specialised properties", which phrase the parties agreed does not include nursing or care homes. (The definition of the phrase imported into FRS15 from the RICS Red Book was lengthy, and is set out in full in Appendix 3 of this decision; it referred to properties which "due to their specialised nature, are rarely, if ever, sold on the open market for single occupation for a continuation of their existing use, except as part of a sale of the business in occupation" and gave, amongst other examples, oil refineries, power stations and hospitals); and

(2) paragraph 53 of FRS15 (which formed part of the core SSAP and is set out at [111] above) specifically required the use of the "existing use value" (EUV) basis for revaluation of "non-specialised properties" being used in the business (which necessarily included nursing and care homes, a fact that was acknowledged by the RICS later adding care homes as an example in its own guidance to valuers).

166. They also referred us to paragraph 56 of FRS15 (set out at [112] above), part of the commentary on paragraph 53, which built on this point, highlighting the difference between "trading potential" (which formed part of the EUV) and "personal goodwill" (which did not).

167. So far as the footnote to paragraph 43 of FRS15 was concerned (see [110] above), Mr Lotay's view was that even though this footnote appeared at first sight to exclude the determination of FRS7 cost or fair value from the scope of FRS15, this was not in fact correct.

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[10] In paragraph 8 of the commentary on RICS Practice Statement 1.1 "The bases of valuation", contained in Practice Statement 1 "Valuations for Financial Statements" (2003 version), the following text appears: "FRS15 refers to Open Market Value (OMV) rather than MV, as it was published in 1999 when OMV was still a basis supported by the RICS. As stated in the Glossary, there is no material difference between these two bases, and the correct application of either will produce the same figure. The term 'Open Market Value' should not be used in reporting, although the valuer may wish to include an explanatory note that its replacement, Market Value, produces the same figure."

Two formulations of the reasons for this were given. In the joint experts' report dated 23 September 2016, his stated reason was because on a proper interpretation, the footnote was simply clarifying that the requirement in paragraph 43 of FRS15, when a company was using the "alternative accounting rules", to keep valuations of tangible fixed assets up to date in successive accounts did not apply in the three situations mentioned in that footnote (including in relation to the determination of the cost of an asset acquired as a result of a business acquisition). In his earlier report, however, Mr Lotay had given four reasons: (a) the FRS7 process was a "valuation" exercise and not a "revaluation" exercise, (b) it was generally accepted accounting practice to fill "holes" in the guidance given in one FRS by reference to other FRSs, (c) FRS7 made specific reference at paragraph 50 to the requirement to value specialised properties at depreciated replacement cost "in the context of market values", thereby implying there was a "read across" between FRS7 and the valuation principles of FRS15, and (d) an opportunity for manipulating the accounts would be opened up by adopting DRC as the initial value of a property, then adopting a policy of revaluation the following day, requiring the property then to be revalued to EUV; this could mean that a large amount that had initially been recognised as goodwill could be retained as such on the balance sheet (and made available for tax relief) whilst also increasing the accounts value of the tangible assets, when in fact nothing had in reality changed; this was inconsistent with the requirement (stated in the Foreword to accounting standards) to "be guided by the spirit and reasoning" of accounting standards when applying them.

168. Mr Jones and Mr Lotay pointed out that the EUV basis of valuation was said, in Appendix IV to FRS15 when providing background on the development of the FRS, to be the basis "which most closely approaches" the underlying concept of asset valuation set out in the (then) draft "Statement of Principles for Financial Reporting" issued by the ASB. It also highlighted an authoritative acceptance in principle by the ASB that "trading potential" of a property was to be regarded as inherent in the value of the property, and something conceptually different from goodwill. This was reinforced by paragraph 85 of FRS7, which stated that "it would not be appropriate… to treat the trading potential associated with a property that is valued as an operational entity, such as a public house or hotel, as a separate component *[for depreciation purposes]*, where the value and life of any such trading potential is inherently inseparable from that of the property."

169. By way of support for the proposition that EUV should also be used to produce a "fair value" for the acquired properties, Mr Lotay and Mr Jones also referred us to the extract from the PriceWaterhouseCoopers Manual of Accounting set out at [114] above. This extract showed, they argued, that the use of EUV on accounting for acquisition of nursing/care homes as part of a business acquisition was generally accepted accounting practice, and highlighted that EUV included the "trading potential" which was an inherent part of the property's value, but excluded "personal goodwill" of the previous owner.

170. On this basis, Mr Jones submitted that GAAP clearly required that the properties should have been brought into Nellsar's accounts at fair values which were determined by their respective Existing Use Values. The failure to do so meant that its accounts were not "correct accounts" for the purposes of paragraph 5 of Schedule 29 and that the amounts properly to be recognised for the purposes of that schedule were therefore the amounts that would have been recognised if the accounts had been drawn up using Existing Use Values for the properties.

171. In relation to FRS15, Mr Merris's opinion was that it was of no relevance. It did not even exist until 2000, so could hardly be regarded as a proper source of reference in interpreting FRS7, which dated back to 1994. FRS7 represented a complete code for recognition of fair values in acquisition accounting, without reference to FRS15: if market value for the asset concerned could be discerned by reference to an open market in similar assets, then market

value applied; if it could not, then depreciated replacement cost applied. The "recoverable amount" limit in FRS7 paragraph 9 ensured that no immediate impairment of the asset would be required under FRS11, therefore simply providing coherence; FRS15 itself contained a similar "recoverable amount" limit. The PwC material (and in particular paragraph 25.267 at [114] above) was merely saying that if the alternative accounting rules were being used (i.e. fixed assets were being revalued) then the same basis of valuation should be used in ascribing a fair value for the purposes of acquisition accounting; that was simply not the case here. Nellsar had reached the view, after careful consideration, that FRS7 required the homes to be fair valued at depreciated replacement cost, and its auditors had signed off on accounts prepared on that basis, an endorsement that the Tribunal should be very reluctant to overturn.

172. The key point of divergence between the parties was therefore as to the precise nature of the "identifiable asset" to which a fair value needed to be ascribed. Mr Jones and Mr Lotay argued that it was in each case the nursing/care home, valued as an operational entity; and Mr Farrell and Mr Merris argued that it was in each case the nursing/care home valued simply as land and buildings (whilst recognising that any such valuation would necessarily take into account the trading potential inherent in the land and buildings, which was acknowledged to be conceptually different from personal goodwill that might attach to the business being operated from the premises, which should clearly not form part of any valuation of the land and buildings).

173. Proceeding from their respective starting points, it is therefore easy to see how the two sides reach different views on the existence of an open market by reference to which the properties could be valued.

174. It is agreed that sales of operational nursing/care homes take place in sufficient volume to enable a market value to be established for any particular operating nursing/care home business under consideration. HMRC say that is enough to allow a market value to be ascribed to the homes under consideration in these appeals, which clearly were part of operational entities when Nellsar bought them; all that is necessary is to adjust for the other known assets which were acquired when they were bought.

175. Nellsar says that this would be to decide the market value of apples by reference to sales of pears. The crucial requirement which it says is missed in HMRC's approach is that the premises in each case must be considered as a separate asset and not as an integral part of a business. It acknowledges that the value of the premises should necessarily reflect their suitability for use as part of a profitable nursing/care home business but argues that HMRC's approach would effectively treat the premises <u>as</u> the business and fly in the face of the requirement in FRS7 to value each "identifiable asset" separately. Since there is a very limited market in sales of nursing/care home premises <u>without</u> an associated business (insufficient to enable a market value of similar premises to be derived), it argues there is simply no basis for arriving at a market value under paragraph 9(a) of FRS7, so it must default to depreciated replacement cost under paragraph 9(b).

176. Clearly there were interactions between the accounting issues and the property valuation issues, hence the need for expert evidence in the area identified at [5(2)] above. So far as the conceptual approach to valuation was concerned, Ms Thorneagle (for HMRC) and Mr Lock (for Nellsar) were agreed that interpretation of FRS7 was outside the scope of their expertise, but that they would be able to provide appropriate valuations if given definitive guidance on what was required of them pursuant to FRS7.

177. As expressed in their joint report, the main disagreement between them was as follows:

1.2.1 We disagree on the assumptions to be applied when carrying out a valuation under FRS7 and this is the reason we require definitive guidance as to how a valuer should be instructed.

1.2.2 Mr Lock notes that FRS7 paragraph 2 defines "identifiable assets and liabilities" as "the assets and liabilities of the acquired entity that are capable of being disposed of or settled separately without disposing of a business of the entity". The acquired entity in each case was a trading care home business, including, but not limited to, the property ("bricks and mortar"). As it is agreed between us (see below paragraph 4.1.6) that the "business of the entity" can be separated and transferred to another property Mr Lock is of the opinion that the "identifiable assets and liabilities" are the bricks and mortar and in situ trade furnishings, fixtures and fittings and that, as a consequence, they are required to be valued without the business. Whilst care homes without the business are bought and sold on an open market Mr Lock is of the opinion that such sales are few and far between and comparable sales will be very difficult, if not impossible, to identify. This being the case Mr Lock is of the opinion that guidance to valuers is required on whether under FRS7 it is acceptable to provide a MV on the basis of extrapolation from what is available in the market (information relating to trading care home business sales) to arrive at the bricks and mortar and trade furnishings and fittings elements of the entity or whether, if direct comparables of bricks and mortar and trade furnishings, fixtures and fittings without the business are not available, a DRC approach has to be taken.

1.2.3 Ms Thorneagle is of the view that the properties should be valued as they actually existed on the date of valuation. Ms Thorneagle agrees that a valuation of the "identified assets and liabilities" is required and considers that this would include the land and buildings, the fixtures and fittings, transferable licences and trading potential, as per the Red Book definition of "operational entity". Ms Thorneagle is of the opinion that this definition only includes the value of the property itself and does not include a value of any associated business. The definition of "trading potential" which forms part of the trade-related property valuation specifically reflects the recent trading history of the property. Therefore, Ms Thorneagle considers that there is no requirement to value on a "bricks and mortar" basis, which would disregard the trading history and assume that the care homes were non-operational. A property that has been operational up to the valuation date should not be treated as though it were closed as this would be contrary to the facts…

1.2.4 We have agreed at paragraph 4.1.3 below that a buyer would not pay the same price for a non-operational entity as for a care home that was trading maturely and therefore Ms Thorneagle is of the view that a valuation on the assumption of a vacant property would result in an artificially low valuation. Mr Lock, subject to confirmation of his understanding of FRS7, is of the view that the lower value would reflect the value of the "identifiable assets and liabilities" in accordance with FRS7, i.e. the bricks and mortar and trade furnishings, fixtures and fittings without the business.

178. The following extract from their joint report is also highly relevant:

4.0 Care Home Market

4.1 Areas of agreement

4.1.1 We agree that the majority of care homes are sold as fully equipped operational entities.

4.1.2 We agree that sales of non-operational care homes, either newly built or closed to be re-opened, do occur, albeit it a much lower frequency than operational homes.

4.1.3 We agree that a buyer would not pay the same price for a non-operational entity as for a care home that was trading maturely, as the value of time, cost, risk, bankability and business acumen has to be deducted.

4.1.4 We agree that newly built and closed to be re-opened, fully equipped non-operational care homes are known in the market as turnkey assets.

4.1.5 We agree that the turnkey valuation approach commences with the projected value assuming a mature trading level, from which will be deducted a sum to reflect the time, cost, risk, bankability and business acumen required to create the business. Limited direct comparable sales evidence may be available on occasions.

4.1.6 We agree that there are occasions when a care home business will relocate to a different property, demonstrating the inherent separability of the business from the property.

4.2 Areas of disagreement

4.2.1 We do not agree on whether the turnkey value (which we agree will be less than the mature operational entity value) is the same as the FRS7 definition of "the assets and liabilities of the acquired entity that are capable of being disposed of or settled separately without disposing of a business of the entity". Mr Lock considers that it is, Ms Thorneagle that it isn't.

179. It can readily be seen, therefore, that the professional opinions of the two valuation experts were largely driven by their understanding of the requirements of GAAP, as presented to them by their respective accounting experts. Where they did agree, however, was that there was a recognised method of arriving at a "turnkey" value for a property working backwards from an existing use value of the property as an operational entity (though Ms Thorneagle considered the fact to be irrelevant and Mr Lock considered the method to be somewhat unsatisfactory).

180. When exploring this method in a little more detail, another conflict emerged. Mr Lock's approach was to start by assessing the cost (in cash, time, risk, and so on) which would be incurred in bringing an empty property to its full expected level of trading by a reasonably efficient operator, and then deducting that cost from the price actually paid for the property (i.e. assessing the value of the property as a residual amount, rather than on the basis of any actual valuation of the property itself). Ms Thorneagle's approach was to value the property as a fully operational entity (using the "reasonably efficient operator" methodology), then deduct from that valuation an amount to reflect the cost, time, risk and so on that would be required to bring the empty property into full operation.

SDLT

181. In accordance with the legislation set out at [146] above, the parties are agreed that a "just and reasonable apportionment" of the total price paid by Nellsar on each acquisition is required in order to arrive at a value, for SDLT purposes, of the property in the Woodstock and Silverpoint transactions. Where they parted company was on how such an apportionment should be arrived at.

182. For Nellsar, Mr Farrell argued, on the basis of the decision of the House of Lords in *Leedale v Lewis* [1982] STC 169, 835, that a "wide latitude in judgment" was conferred on Nellsar when making its apportionment, in which context the intentions of Nellsar and the various sellers, as evidenced in the sale documents, was a significant factor. In the

circumstances, the Tribunal ought not to interfere with the figures originally advanced, whatever the basis upon which they had been arrived at. He also submitted, on the basis of the FTT decisions of *Orsman v HMRC* [2012] UKFTT 227 (TC) and *Marcus and Marcus Limited v HMRC* [2022] UKFTT 145 (TC) (the latter issued during the hearing), that market valuations of assets were not determinative on the question of apportionments of value between them. Finally, he highlighted the fact that the RICS guidance notes specifically stated that "apportionments for tax purposes have to be in accordance with specific legislation and are outside the scope of this guidance note"; this clearly steered us away from simply adopting a market value approach based on the content of the rest of the guidance notes.

183. Mr Jones for HMRC referred to HMRC's Practice Note referred to at [149] above. He did not argue that this document was correct and to be followed in all its aspects, but based on the document he argued that the following steps should be taken to arrive at an appropriate apportionment for SDLT purposes:

(1) Estimate the market value of all the tangible assets together as an operational entity;

(2) Identify the sum attributable to goodwill and any other intangible assets included in the sale by deducting the value at (1) above from the sale price (or market value) of the business as a going concern;

(3) Identify the sum attributable to the chattels by estimating their "in-situ" value;

(4) Identify the sum attributable to the property by deducting the value of the chattels from value identified at (1) above;

(5) Stand back and consider whether the answer produced is reasonable in the particular circumstances of the case.

184. In his submission, the key ingredients in this process, for present purposes, were the property value and any goodwill value; and the goodwill value was what was left after deducting all the tangible asset values from the purchase price. There was no place for a "depreciated replacement cost" figure to be included in relation to the property, as it would have no relationship with market value. Therefore in a situation where the value of the loose chattels was not subject to any material dispute, the making of an appropriate apportionment depended almost entirely on the market value of the property – which took us back to the same arguments as were relevant in the corporation tax issue.

185. He pointed out that the facts in *Leedale v Lewis* were very different from the present case, and the FTT in *Marcus* had said this at [78] (in the course of accepting the apportionment approach that had been agreed in principle by the parties (namely on a floor area basis)):

> I accept that market value is not necessarily the only way to determine a "just and reasonable" apportionment, but that does not take us much further. *Leedale v Lewis* suggests that a very broad approach is permissible, but I am mindful of the need to be cautious of applying statements made in the context of one tax to a completely different tax and context, and *Leedale v Lewis* concerned a situation where the relevant interests did not really have an ascertainable market value at all.

The significance of *HMRC v Denning* [2022] EWCA Civ 909

186. Following the hearing, the Court of Appeal issued its decision in the above case, which addressed the valuation of leasehold interests in two nursing homes for the purposes of SDLT and capital gains tax. The valuations were carried out in accordance with the guidance in VPGA4. The question before the Court of Appeal, as identified by it, was:

> Where that valuation method is applied, is the resulting figure the value of the leasehold interest, or the value of both the leasehold interest and "transferrable goodwill"?

187. At their request, the parties made written submissions to the Tribunal, following the hearing, on the relevance of the Court of Appeal decision in *Denning* to the present case.

188. In giving its decision, the Court described five different methods for valuing property, referring to "the profits method, which is used in valuing trade related property". That was the method that had been used in that case.

189. It was common ground that the guidance in VPGA4 applied, accordingly the Court examined that guidance at some length. The experts had also agreed capital values for the leasehold interests (using the FMOP method) after deducting the agreed value of the trade inventory included in the transactions.

190. Before the Upper Tribunal, the taxpayer had successfully argued that those capital values were in fact entirely attributable to the goodwill of the businesses transferred with the leasehold properties and not to the properties themselves (the leases having been granted at what was accepted as market rent).

191. The Court of Appeal disagreed. It held that a valuation under VPGA4 was a valuation of the property alone, which included a reflection of the trading potential inherent in it. To the extent that this included elements of what had been classically referred to as "goodwill", it was nonetheless an intrinsic part of the property. Also, the references to "transferrable goodwill" in GN1 were to a feature which was "simply part of the inherent qualities of the property itself and its trading potential… There is only one asset, namely the property, and the profits method of valuation is, at its description implies, no more than a method of arriving at the value of the property."

192. Accordingly, the Court held that the entire agreed capital values of the leasehold interests were properly attributable to those interests.

193. Mr Jones for HMRC argued that whilst *Denning* was not directly concerned with issues of GAAP, by reinforcing the message set out above that there was "only one asset", the case strongly supported his argument that valuing the properties by reference to their trading potential did not attribute any value to any separate goodwill of the business.

194. Mr Farrell for Nellsar argued that *Denning* did not, importantly, address the context of GAAP, nor did it consider the correctness, in the context of GAAP, of a valuation using the approach in VPGA4 or the predecessor guidance notes (it was common ground that it was the correct approach in the context of the *Denning* case). It also did not consider any questions around the separate valuation of the business carried on in the properties – all of which were significant issues in the context of the present case. He therefore maintained that in a context where GAAP required valuation of the "identifiable assets", it was wrong effectively to allocate all the goodwill to the property valuation as this ignored the reality that there was business goodwill being acquired as well as the property (and, he acknowledged, some value inherent in the property due to its trading potential). This led on to a repetition of his earlier arguments about the lack of comparability between sales of operating care homes and the valuing of the "identifiable assets" involved in the present cases – where either (a) the arms' length agreed values, signed off by the auditors, should be accepted as being GAAP-compliant, or (b) the lack of comparability forced Nellsar to use DRC in arriving at "fair values", or at the very least (c) some adjustment needed to be made to "profit-related valuations" to take account of the necessary extraction of the business from the property for the purpose of the "fair value" exercise.

DISCUSSION

Corporation tax

Interaction of paragraphs 5 and 105, Schedule 29

195. The arguments of the parties on this preliminary point are summarised at [150] to [153] above.

196. In support of his argument on this point, Mr Farrell cited a decision of this Tribunal in *Roger Preston Group Limited v HMRC* [2021] UKFTT 38. In that case, the task before the Tribunal was to resolve the "core arguments" which it summarised as follows:

> 36. HMRC says:
>
> (1) RPGL's accounts are not GAAP compliant because in 2008 there was no goodwill and intangible fixed assets that could properly be recognised in accordance with FRS 10; i.e., there were no assets which answered to the statutory definitions in Schedule 29 of the Finance Act 2002 Paragraphs 2(1) and 4(2);
>
> (2) If the accounts are not drawn up in accordance with GAAP, then they are not 'correct accounts' within the meaning of Schedule 29 Paragraph 5.
>
> 37. The Appellant says:
>
> (1) The purchase of assets in 2008 included the purchase of intangible asset, *[sic]* which were properly recognised;
>
> (2) Those assets had value, were capable of being amortised, and, so amortised, are an allowable deduction.

197. The centre of the dispute before the Tribunal was therefore an analysis of the nature of the relevant asset which had been acquired by the taxpayer company as part of an overall purchase, to see whether it fell within Schedule 29 at all. The taxpayer had acquired the issued share capital of a company carrying on a consulting engineering business in the UK, along with the business of a firm (whose partners owned the shares in the company) carrying on a parallel business outside the UK and, crucially, the benefit of a licence agreement from the firm to the company which allowed the company to use the firm's intellectual property and other assets in carrying on its business, subject to various stringent controls and the payment of a licence fee calculated in accordance with a formula set out in the agreement.

198. The taxpayer subsequently capitalised and amortised its acquisition cost of the licence agreement (to which it allocated the large majority of its overall purchase cost). The dispute before the Tribunal was whether this part of the expenditure had been incurred on assets within the scope of Schedule 29. The Tribunal held that it had.

199. This appears to have decided the issue which the Tribunal had actually been called upon to resolve. However, the Tribunal went on to make what it described at [5] as "some short non-binding observations as to valuation" at the end of its decision. The tentative nature of these views was emphasised at [251] in the course of making them:

> Here, I must tread with caution because I have not heard any valuation evidence nor full submissions on it. The furthest I can safely go is to say, in a non-binding and interlocutory way, that, on the basis of my findings of fact, it seems to me that it would be difficult to contend that the Partnership's rights subject to the Business Sale were of no or no substantial value.

200. The views themselves referred simply to paragraph 105 of Schedule 29 (without any reference to paragraph 5 or the requirements of acquisition accounting), concluding as follows:

> 252. The statutory question in Paragraph 105(3)(a) is whether the allocation was done in accordance with GAAP (and, if it is, then those values "shall" (not may) be accepted for the purposes of Schedule 29). Here, it is also important to note that Parliament chose to adopt a qualitative and not a quantitative test. Even if Paragraph 105(3)(a) were not satisfied, Paragraph 105(3)(b) refers to a "just and reasonable" apportionment, which words are was *[sic]* otherwise unqualified. I simply observe that those seem to establish a broad test, which is not made expressly referable to GAAP.

201. Obviously these tentative views are not binding on us, and since they appear to have been proffered without the benefit of argument from the parties, or any consideration of the underlying requirements of GAAP as to acquisition accounting, we do not consider that they assist us in this case.

202. We prefer the argument of Mr Jones on this point. As he pointed out, the basic scheme of the legislation was to align the tax treatment of intangibles with the correct accounting treatment of them. It would be a strange outcome if paragraph 105(3)(b) gave a company the option of "switching off" the correct accounting treatment under GAAP where intangible assets are acquired as part of a business acquisition, and replacing it with a "just and reasonable apportionment" of the overall acquisition cost. Mr Farrell's fallback argument on the point – that an apportionment decided on the basis of depreciated replacement cost would necessarily be a "just and reasonable" one because it was a basis "approved by accounting standards" – is equally unattractive, because it proceeds from the starting point that the accounts are not "correct" (i.e. GAAP compliant) for the very reason that they adopted a depreciated replacement cost basis of valuation of the properties.

203. As Mr Jones pointed out, there are clearly situations where paragraph 105(3)(b) can fill what would otherwise be a potential lacuna arising from the absence of any requirement under GAAP to value any particular asset in a company's accounts – for example where a company had incurred expenditure on a bundle of intangible assets and GAAP did not require it to allocate individual values to the constituent parts of the bundle; it might be necessary to differentiate between the different parts for tax purposes, in which case paragraph 105(3)(b) provided the appropriate mechanism for doing so. This provided a justification for paragraph 105 which did not put it into conflict with paragraph 5.

Were the accounts GAAP-compliant?

204. It seems to us that the crucial issue here revolves around a precise delineation of the nature of the "identifiable asset" referred to in the companies legislation and, based on that legislation, in FRS6 & 7.

205. Given the parties' agreement that a nursing/care home is an asset that can be disposed of separately from any business carried on within it up to the time of disposal, it is clear to us that the "identifiable asset" with which we are concerned is the land and the buildings on it (including any fixtures which, as a matter of real property law, are so annexed as to become part of the land). Loose chattels (such as movable furniture), consumable stores and the like should not be included as they will constitute separate "identifiable assets".

206. HMRC essentially argue that in spite of this, each property should be valued on the basis that it was an operational entity, because that was its "condition" and to do so would therefore "reflect the conditions" at the time of the sale. They consider this point of view is supported by the terms of FRS15, the RICS valuation guidance, and by such commentary as exists.

207. We reject that argument. We consider that the references in FRS7 to "the condition" of the property and "the conditions" at the time of sale refer, respectively, to the physical condition

of the property and the market conditions at the time of sale and are not intended to widen the scope of the "identifiable asset" that is to be valued.

208. We acknowledge that it is clear from the RICS guidance notes (and reinforced in *Denning*) that in using the profits-based method of valuing a trade-related property, the valuation which is arrived at is a valuation of the property (which includes its inherent trading potential but no separate element of goodwill specific to the owner's business). Nonetheless, it is equally clear that the property which is primarily in contemplation in both the RICS guidance notes and *Denning* is a property which is being valued as an integral part of, albeit independently of, a going concern business which is being operated from it.

209. The RICS guidance has, throughout all the versions of GN1, GN2 and VPGA4 provided to us, recognised that it is possible, by the application of appropriate adjustments, to convert an "operational entity" valuation to an "empty property" (or similar) valuation. Both experts agreed with this proposition. The effect of this is that whilst it is still "the property" that is being valued, that property can nonetheless be valued in different "states" whilst complying with RICS guidance.

210. We consider that the paramount requirement under FRS7 to ascribe a fair value to the property which comprises the "identifiable asset" means, when the true nature of that asset is properly considered, that the property must be valued as a separate asset from which a business is capable of being carried on, rather than as an integral part (or even the embodiment) of an existing business being carried on from the property. In doing so, the focus should be on the property itself, with loose chattels of any type which do not, in law, form part of the property, being excluded, along with contractual rights and obligations of the business, staff, residents, associated permits, etc. This simply reflects the requirement of FRS6 & 7 to evaluate each identifiable asset and liability separately.

211. But equally, we do not accept that, in the absence of a sufficiently active market in sales of non-operating nursing/care homes, this necessarily means that Nellsar is forced back, as it maintains, on using depreciated replacement cost for the purposes of ascribing a fair value to the property.

212. The reason for this is that FRS7 requires fair value to be based on market value (rather than DRC) "if assets similar in type and condition are bought and sold on an open market". The parties are agreed that there is an active open market in operating nursing/care homes being sold as going concerns. The question that arises is whether operating nursing/care homes are sufficiently "similar in type and condition" to the "identifiable assets" we are here concerned with to enable market values for the latter to be derived from prices paid on open market sales of the former.

213. The only material difference between the two for these purposes is that the identifiable assets being valued for FRS7 purposes are the physical land and buildings, as referred to above, without the loose chattels and without the staff, residents, permits, contracts, etc which would convert the land and buildings into a business. The RICS guidance on valuation of trade-related properties as going concerns sets out a clear method for approaching such valuations, based on assessing the fair maintainable operating profit ("FMOP") that would be expected to be generated by a reasonably efficient operator from the property, then arriving at a capital value by applying an appropriate multiple to the FMOP. However, as is made explicit in VPGA4, this capital value should then be moderated by reference to appropriate assumptions. One possible assumption is that the property is "non-trading", in which case it is specifically stated that the difference between an "operational entity" and a "non-trading" valuation could reflect the "cost and time involved in purchasing and installing the trade inventory, obtaining new licences, appointing staff and achieving FMT *[fair maintainable turnover]*".

214. In other words, it is clear that there is a recognised means of adjusting an "operational entity" valuation so as to provide a "non-trading" valuation of the underlying property. Both experts agreed as much, though Ms Thorneagle regarded the fact as irrelevant and Mr Lock expressed some reservations about its usefulness. Given that fact, we consider it to be self-evident that the "identifiable asset" represented by the properties as described above (on the one hand) and operating care/nursing homes (on the other) are sufficiently "similar in type and condition" to allow for market values of the former to be established by reference to the open market in the latter in a way which satisfies paragraph 9(a) of FRS7.

215. Incidentally, in passing, we would observe that we cannot see any basis in the RICS guidance for the approach which Mr Lock advanced for making this adjustment. In essence, his approach involved assessing a separate goodwill value for the business, based on the time, cost and risk of building up to the FMT, and then deducting that value from the purchase price (also deducting appropriate values for the loose chattels), thereby arriving at what he considered to be the value of the property by means of a "residual" approach. Rather than value the property, this approach seems to us to be an attempt to derive a property value by reference to deductions from the price actually paid – thereby having no regard to the open market itself.

216. In passing, we would also mention that:

(1) the issue of the relevance of FRS15 does not really arise, given the views we have expressed above. We would only observe that the approach summarised above to FRS7 does not appear to us to conflict with FRS15, in that both proceed on the basis of market value rather than DRC being an appropriate method of valuation of nursing/care home properties, but FRS7 simply imports a specific concept of the "identifiable asset" which goes beyond what is found in FRS15 (which is of course primarily concerned with revaluations of assets which, in that context, would be operational nursing/care homes); and

(2) the text from the PriceWaterhouseCoopers technical manual to which we were referred (see [114] above), in particular paragraph 25.267, does not affect our view. In context, the relevant paragraph seems to us to be focusing more on the effect for accounting purposes of an intended change of use post-acquisition from "use in the business" (normally valued on Expected Use Value basis) to "surplus to requirements" (normally valued on Open Market Value basis), and does not focus clearly on the issues which are front and centre in this appeal. It is at best only secondary evidence of what constitutes GAAP and we do not consider it sufficiently clear and comprehensive to be given much weight in considering the specific issues before us.

217. It follows from all the above that we consider "open market" fair values could properly be allocated to the homes the subject of this appeal under paragraph 9(a) of FRS7 and therefore the allocation of DRC figures under paragraph 9(b) would not have complied with FRS7, meaning that Nellsar's relevant accounts were not drawn up in accordance with GAAP.

Consequences

218. Since we consider that Nellsar did not draw up its relevant accounts in accordance with GAAP for the reasons given above, and since we preferred HMRC's argument as to the consequences (see [195] to [203] above), in principle we consider that the allowances available to Nellsar should be recomputed as if "correct accounts" had been drawn up on the basis of revised valuations of the various properties.

219. We should emphasise that in saying this, we are not laying down any particular assumptions or adjustments that we consider should apply in preparing the revised valuations

– that is a matter of professional valuation opinion upon which the Lands Chamber of the Upper Tribunal will in due course, if necessary, adjudicate when it comes to determining actual valuations.

220. In view of the agreement referred to at [10] above, therefore, our decision is limited to stating that in valuing the properties in question, the method to be adopted is to value them pursuant to paragraph 9(a) of FRS7 on the basis set out in the RICS guidance referred to above, but in accordance with FRS6 & 7 valuing only the "identifiable asset" in each case, i.e. assuming there to be no current staff, residents, contracts, permits or other accoutrements of a business and excluding any chattels which, as a matter of real property law, did not form part of the land at the time of Nellsar's purchase.

221. We should emphasise that in doing so, regard may be had to the trading history of each property, which we consider to be, at least in part, an inherent aspect of the property itself. Both valuation experts agreed that in valuing a closed down nursing home, some account may well be taken of the "stigma" attached to the property, depending on the reason for the closure. Obviously no such stigma should be assumed in the present cases, and it may be that the valuers' view of the risk, cost and time involved in reaching FMT will be informed, at least in part, by the trading history of the relevant property. We would also consider that the status of a property as effectively "grandfathered" for the purposes of National Minimum Standards would also be assumed to continue for the purposes of the valuation exercise: the fact that the property must in our view be separately valued as an "identifiable asset" in the way we have outlined does not mean that it should be regarded as closed and would therefore require bringing up to National Minimum Standards before it could be re-opened.

Stamp Duty Land Tax

222. We prefer Mr Jones' arguments on the principles to be applied in approaching the apportionment of the total purchase prices for the purposes of SDLT. *Leedale v Lewis* was concerned with the question of how much of the gains made by an offshore discretionary family settlement should be apportioned to the grandchildren of the settlor identified in a "letter of wishes" as the intended primary beneficiaries of the settlement. Like the FTT in *Marcus*, we do not consider the observations of the House of Lords in a very different legal and factual context as providing much assistance in the present case.

223. We consider that an approach to apportionment which is anchored in the independent market values of the separate assets acquired provides a much more appropriate method. Accordingly, we agree with Mr Jones that the approach set out in the Practice Note of HMRC to which he referred is the appropriate one in this case. Since the working through of the apportionment will therefore depend largely upon the valuation placed on each property (which is of course properly subject to the jurisdiction of the Upper Tribunal if it cannot be agreed between the parties) we do not consider it appropriate to say any more on the matter, save to say that we do not see any reason why the market values of the respective "identifiable assets" should not be used as the basis of the apportionment.

SUMMARY AND CONCLUSION

224. We have therefore reached the following conclusion in principle.

225. We consider that since we regard operational nursing/care homes to be sufficiently similar in type and condition to the "identifiable asset" which is required to be valued in each of the present appeals, it is possible to ascribe market values pursuant to paragraph 9(a) of FRS7 to each such "identifiable asset" by reference to sales of operational nursing/care homes on the open market by applying appropriate adjustments as contemplated by RICS guidance (see [212] to [214] above).

226. Accordingly, it was not open to Nellsar to recognise the homes in question at depreciated replacement cost pursuant to paragraph 9(b) of FRS7; the relevant accounts of Nellsar were therefore not drawn up in accordance with generally accepted accounting principles and accordingly were not "correct accounts" for the purposes of Part 1 of Schedule 29 FA02 or the successor legislation; and the legislation should therefore apply as if "correct accounts" had been drawn up, recognising the fair values of the respective properties on acquisition at their respective market values (see [218] above).

227. For this purpose, "market value" should be assessed on the basis of the homes as standalone assets, without staff, residents, contracts, permits, chattels of any kind (apart from those so affixed at the time of sale as to be part of the property under the general law) or any other accoutrements of a business (see [220] above). The market value will, in line with RICS guidance, reflect the trading potential of the property in each case.

228. As to the relevant apportionments for SDLT purposes, these are to be carried out following the basic methodology set out in the HMRC Practice Note, but using market values of the relevant assets (see [223] above).

229. If the parties are unable to agree any market values required in order to implement this decision in principle, then such market values will ultimately need to be determined by the Upper Tribunal (Lands Chamber).

230. The parties are at liberty to apply to the Tribunal for any further Directions which may be considered necessary to implement the decision in principle set out above. They are also directed to notify the Tribunal within 28 days if and when the matter is finally resolved, whether by agreement or following a decision of the Upper Tribunal.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

231. 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.

KEVIN POOLE
TRIBUNAL JUDGE

Release date: 11 August 2023

APPENDIX 1

EXTRACTS FROM RELEVANT PROVISIONS OF SCHEDULE 29

PART 1

Introduction

1 Gains and losses in respect of intangible fixed assets

(1) A company's gains in respect of intangible fixed assets are chargeable to corporation tax as income in accordance with this Schedule.

(2) This Schedule also has effect for determining how a company's losses in respect of intangible fixed assets are brought into account for the purposes of corporation tax.

(3) Except where otherwise indicated, the amounts to be brought into account in accordance with this Schedule in respect of any matter are the only amounts to be brought into account for the purposes of corporation tax in respect of that matter.

2 Intangible assets

(1) In this Schedule "intangible asset" has the meaning it has for accounting purposes.

…

3 Intangible fixed assets

(1) In this Schedule an "intangible fixed asset", in relation to a company, means an intangible asset acquired or created by the company for use on a continuing basis in the course of the company's activities.

…

4 Goodwill

(1) Except as otherwise indicated, the provisions of this Schedule apply to goodwill as to an intangible fixed asset.

(2) In this Schedule "goodwill" has the meaning it has for accounting purposes.

5 Company not drawing up correct accounts

(1) If a company does not draw up accounts in accordance with generally accepted accounting practice ("correct accounts")—

> (a) the provisions of this Schedule apply as if correct accounts had been drawn up, and
>
> (b) the amounts referred to in this Schedule as being recognised for accounting purposes are those that would have been recognised if correct accounts had been drawn up.

(2) If a company draws up accounts that rely to any extent on amounts derived from an earlier period of account for which the company did not draw up correct accounts, the amounts referred to in this Schedule as being recognised for accounting purposes in the later period are those that would have been recognised if correct accounts had been drawn up for the earlier period.

(3) The provisions of this paragraph apply where the company does not draw up accounts at all as well as where it draws up accounts that are not correct.

…

PART 2

Debits in respect of intangible fixed assets

7 Introduction

(1) This Part provides for debits to be brought into account by a company for tax purposes in respect of—

(a) …

(b) writing down the capitalised cost of an intangible fixed asset—

(i) on an accounting basis (see paragraph 9)…

9 Writing down on accounting basis

(1) Where in a period of account a loss is recognised in determining the company's profit or loss in respect of capitalised expenditure on an intangible fixed asset—

(a) by way of amortisation, or

(b) as a result of an impairment review,

a corresponding debit shall be brought into account for tax purposes.

(2) …

(3) The amount of the debit for tax purposes in respect of expenditure on an asset is, in the period of account in which the expenditure is capitalised:

$$Accounting\ Loss\ x\ \frac{Tax\ Cost}{Accounting\ Cost}$$

where—

Accounting Loss is the amount of the loss recognised for accounting purposes,

Tax Cost is the amount of expenditure on the asset that is recognised for tax purposes, and

Accounting Cost is the amount capitalised in respect of expenditure on the asset.

(4) Subject to any adjustment required for tax purposes, the amount of the expenditure on the asset that is recognised for tax purposes is the same as the amount of expenditure on the asset capitalised by the company.

(5) The amount of the debit for tax purposes in respect of expenditure on an asset is, in the period of account in which the expenditure is capitalised:

$$Accounting\ Loss\ x\ \frac{Tax\ Value}{Accounting\ Value}$$

where—

Accounting Loss is the amount of the loss recognised for accounting purposes,

Tax Value is the tax written down value of the asset immediately before the amortisation charge is made or, as the case may be, the impairment loss is recognised for accounting purposes, and

Accounting Value is the value of the asset recognised for accounting purposes immediately before the amortisation charge or, as the case may be, the impairment review.

(6) In the paragraph "capitalised" means capitalised for accounting purposes.

…

31 Asset held for the purposes of trade

Credits and debits to be brought into account in any accounting period in respect of an asset held by the company for the purposes of a trade carried on by it in that period are given effect by treating –

(a) credits as receipts of the trade, and

(b) debits as expenses of the trade,

in calculating the profits of the trade for tax purposes.

…

105 Assets acquired or realised together

(1) Any reference in this Schedule to the acquisition or realisation of an asset includes the acquisition or realisation of that asset together with other assets.

(2) For the purposes of this Schedule assets acquired or realised as a result of one bargain are treated as acquired or realised together even though —

(a) separate prices are, or purport to be, agreed for separate assets, or

(b) there are, or purport to be, separate acquisitions or realisations of separate assets.

(3) Where assets are acquired together —

(a) any values allocated to particular assets by the company in accordance with generally accepted accounting practice shall be accepted for the purposes of this Schedule;

(b) if no such values are allocated by the company, so much of the expenditure as on a just and reasonable apportionment is properly attributable to each asset shall be treated for the purposes of this Schedule as referable to that asset.

…

APPENDIX 2

EXTRACTS FROM RELEVANT PROVISIONS OF CORPORATION TAX ACT 2009 PART 8

711 Overview of Part

(1) This Part sets out how a company's gains and losses in respect of intangible fixed assets are calculated and brought into account for corporation tax purposes.

(2) For the meaning of "intangible fixed assets" and rules about the assets to which this Part applies, see—

(a) sections 712 to 715,

…

(3) For how such gains and losses are calculated and brought into account, see, in particular, Chapter 6 which—

(a) deals with the use of credits and debits in respect of some intangible fixed assets in calculating the profits and losses of trades, businesses and other concerns (see sections 747 to 750),

…

(4) …

(5) This Part operates by reference to the accounts of companies and amounts recognised for accounting purposes.

(6) For the meaning of "amounts recognised for accounting purposes" and other expressions related to accounting and for rules about "GAAP-compliant accounts", see sections 716 to 719.

(7) Chapters 2 to 6 contain basic rules about the credits and debits to be brought into account for corporation tax purposes in respect of intangible fixed assets.

…

712 "Intangible asset"

(1) In this Part "intangible asset" has the meaning it has for accounting purposes (and includes an internally-generated intangible asset).

…

713 "Intangible fixed asset"

(1) In this Part an "intangible fixed asset", in relation to a company, means an intangible asset acquired or created by the company for use on a continuing basis in the course of the company's activities.

…

715 Application of this Part to goodwill

(1) This Part applies to goodwill as it applies to an intangible fixed asset.

(2) Subsection (1) is subject to any indication to the contrary.

(3) In this Part “goodwill” has the meaning it has for accounting purposes (and includes internally-generated goodwill).

(4) For the purposes of this Part, goodwill is treated as created in the course of carrying on the business in question.

716 “Recognised” amounts and “GAAP-compliant accounts”

(1) References in this Part to an amount “recognised” in determining a company's profit or loss for a period are to—

(a) an amount recognised in—

(i) the company's profit and loss account, income statement or statement of comprehensive income for that period,

(ii) the company's statement of total recognised gains and losses, statement of recognised income and expense, statement of changes in equity or statement of income and retained earnings for that period, or

(iii) any other statement of items brought into account in calculating the company's profits and losses for that period, and

(b) an amount that would have been so recognised if such an account or statement had been drawn up for that period in accordance with generally accepted accounting practice.

…

(4) In this Part “GAAP-compliant accounts” means accounts drawn up in accordance with generally accepted accounting practice.

…

717 Companies without GAAP-compliant accounts

(1) If a company—

(a) draws up accounts that are not GAAP-compliant accounts, or

(b) does not draw up accounts at all,

this Part applies as if GAAP-compliant accounts had been drawn up.

(2) References in this Part to amounts recognised for accounting purposes are references to the amounts which would have been recognised if GAAP-compliant accounts had been drawn up for the period of account in question and any relevant earlier period.

(3) For this purpose a period of account is relevant to a later period if the accounts for the later period rely to any extent on amounts derived from the earlier period.

…

726 Introduction

(1) This Chapter provides for debits to be brought into account by a company for tax purposes in respect of—

(a) …,

(b) writing down the capitalised cost of an intangible fixed asset—

(i) on an accounting basis (see section 729), or

…

729 Writing down on accounting basis

(1) If in a period of account a loss is recognised in determining a company's profit or loss in respect of capitalised expenditure on an intangible fixed asset—

(a) by way of amortisation, or

(b) as a result of an impairment review,

a corresponding debit must be brought into account for tax purposes.

(2) …

(3) In the period of account in which expenditure on an asset is capitalised the amount of the debit for tax purposes in respect of the expenditure is—

$$L\,x\,\frac{E}{CE}$$

where—

L is the amount of the loss recognised for accounting purposes,

E is the amount of expenditure on the asset that is recognised for tax purposes, and

CE is the amount capitalised in respect of expenditure on the asset.

(4) For the purposes of subsection (3), subject to any adjustments required by this Part or Part 4 of TIOPA 2010 (provision not at arm's length), the amount of expenditure on the asset that is recognised for tax purposes is the same as the amount of expenditure on the asset capitalised by the company.

(5) In a subsequent period of account the amount of the debit for tax purposes in respect of the expenditure on an asset is—

$$L\,x\,\frac{WDV}{AV}$$

where—

L is the amount of the loss recognised for accounting purposes,

WDV is the tax written-down value of the asset (see section 742) immediately before the amortisation charge is made or, as the case may be, the impairment loss is recognised for accounting purposes, and

AV is the value of the asset recognised for accounting purposes immediately before the amortisation charge or, as the case may be, the impairment review.

(6) In this section "capitalised" means capitalised for accounting purposes.

…

745 Introduction

(1) Credits and debits to be brought into account for tax purposes under this Part are given effect in accordance with this Chapter.

(2) Credits and debits in respect of assets held for the purposes mentioned in any of the following sections are given effect in accordance with that section—

(a) section 747 (assets held for purposes of trade),

…

747 Assets held for purposes of trade

(1) This section applies if credits or debits are to be brought into account in an accounting period in respect of an asset held by a company for the purposes of a trade carried on by it in that period.

(2) The credits are given effect by treating them as receipts of the trade in calculating the profits of the trade for tax purposes.

(3) The debits are given effect by treating them as expenses of the trade in calculating the profits of the trade for tax purposes.

856 Assets acquired or realised together

(1) Any reference in this Part to the acquisition or realisation of an asset includes a reference to the acquisition or realisation of that asset together with other assets.

(2) For the purposes of this Part assets acquired or realised as a result of one bargain are treated as acquired or realised together even though—

(a) separate prices are, or purport to be, agreed for separate assets, or

(b) there are, or purport to be, separate acquisitions or realisations of separate assets.

(3) If assets are acquired together, any values allocated to particular assets by the company in accordance with generally accepted accounting practice must be accepted for the purposes of this Part.

(4) If no such values are so allocated, so much of the expenditure as on a just and reasonable apportionment is properly attributable to each asset is treated for the purposes of this Part as referable to that asset.

…

APPENDIX 3

RICS DEFINITIONS ADOPTED FOR FRS15

Specialised properties: those which, due to their specialised nature, are rarely, if ever, sold on the open market for single occupation for a continuation of their existing use, except as part of a sale of the business in occupation. Their specialised nature may arise from the construction, arrangement, size or location of the property, or a combination of these factors, or may be due to the nature of the plant and machinery and items of equipment which the buildings are designed to house, or the function, or the purpose for which the buildings are provided. Examples of specialised properties, which are usually valued on the Depreciated Replacement Cost (DRC) basis, are:

(a) oil refineries and chemical works where, unusually, the buildings are no more than housings or cladding for highly specialised plant;

(b) power stations and dock installations where the buildings and site engineering works are related directly to the business of the owner, it being highly unlikely that they would have a value to anyone other than a company acquiring the undertaking;

(c) properties of such construction, arrangement, size or specification that there would be no market (for a sale to a single owner occupier for the continuation of existing use) for those buildings;

(d) standard properties in particular geographical areas and remote from main business centres, located therefore operational or business reasons, which are of such an abnormal size for that district, that there would be no market for such buildings there;

(e) schools, colleges, universities and research establishments where there is no competing market demand from other organisations using these types of property in the locality;

(f) hospitals, other specialised healthcare premises and leisure centres where there is no competing market demand from other organisations wishing to use these types of property in the locality; and

(g) museums, libraries, and other similar premises provided by the public sector.

Non-specialised properties: all properties except those coming within the definition of specialised properties. Hence they are those for which there is a general demand, with or without adaptation, and which are commonly bought, sold or leased on the open market for their existing or similar uses, either with vacant possession for single occupation, or (whether tenanted or vacant) as investments or for development. Residential properties, shops, offices, standard industrial and warehouse buildings, public houses, petrol filling stations, and many others, are usually *non-specialised properties*.

Open market value: An opinion of the best price at which the sale of an interest in property would have been completed unconditionally for cash consideration on the date of valuation, assuming:

(a) a willing seller;

(b) that, prior to the date of valuation, there had been a reasonable period (having regard to the nature of the property and the state of the market) for the proper marketing of the interest, for the agreement of the price and terms and for the completion of the sale;

(c) that the state of the market, level of values and other circumstances were, on any earlier assumed date of exchange of contracts, the same as on the date of valuation;

(d) that no account is taken of any additional bid by a prospective purchaser with a special interest; and

(e) that both parties to the transaction had acted knowledgeably, prudently and without compulsion.

Depreciated replacement cost (of property): The aggregate amount of the value of the land for the existing use or a notional replacement site in the same locality, and the gross replacement cost of the buildings and other site works, from which appropriate deductions may then be made to allow for the age, condition, economic or functional obsolescence, environmental and other relevant factors; all of these might result in the existing property being worth less to the undertaking in occupation than would a new replacement.

Existing use value: An opinion of the best price at which the sale of an interest in property would have been completed unconditionally for cash consideration on the date of valuation, assuming:

[(a) to (e) as above];

(f) that the property can be used for the foreseeable future only for the existing use; and

(g) that vacant possession is provided on completion of the sale of all parts of the property occupied by the business.

APPENDIX 4

RICS GUIDANCE NOTE GN1 (2007 VERSION) PARAGRAPHS 1-4

1 Introduction

1.1 The commentary to PS 3.2 indicates that special consideration must be given to the application of *Market Value* to certain categories of *property* that are normally bought and sold on the basis of their trading potential. Examples of this type of *property* include hotels, bars, restaurants, theatres or cinemas, fuel stations, and care homes. The essential characteristics of *properties* that are normally sold on the basis of their trading potential is that they are designed, or adapted, for a specific use and that ownership of the *property* normally passes with the sale of the business as an operational entity.

1.2 this guidance note is restricted to *trade related property valuations*. It considers the additional criteria that need to be considered by the valuer in these cases but does not concern itself with methods of *valuation*, which will vary depending upon the *property* to be valued.

2 Terms used in this guidance note

2.1 it is essential that the valuer recognises, and understands, that the terms used in this guidance note may have different meanings when used by other professional advisers. In particular the term *'property'* in *valuation* terms is defined in the glossary whereas in other contexts it includes intangible *assets* as well as intellectual *property*. Unless stated otherwise the term *'property'* is used in this guidance note as defined in the glossary. In this guidance note the following terms will be used as defined in the following paragraphs.

2.2 **Trade related** ***property***. Property with trading potential, such as hotels, fuel stations, restaurants, or the like, the Market Value of which may include assets other than land and buildings alone. These properties are commonly sold in the market as operating assets and with regard to their trading potential, also called property with trading potential.

[Note: this definition was marked to show it originated from the International Valuation Standards Council guidance notes.]

2.3 **Valuation of the operational entity**. The assessment of the value of the operational entity will usually include:

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

Consumables and stock in trade are normally excluded.

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

[Note: this definition was marked to show it originated from the International Valuation Standards Council guidance notes.]

2.5 **Goodwill**.

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

[Note: this definition was marked to show it originated from the International Valuation Standards Council guidance notes.]

2.5.1 in previous RICS guidance *transferable goodwill* has also been referred to as inherent goodwill. In the *valuation* context these terms are identical. Other professional advisers, may use other definitions of types of goodwill, such as 'free goodwill', which do not have any bearing on the *valuation of property*. In relation to a *trade related property valuation*, goodwill is either capable of transfer with the *property* interest or it is not.

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

[Note: this definition was marked to show it originated from the International Valuation Standards Council guidance notes.]

2.5.2 *Personal goodwill*, where it can be identified, remains with the operator and, in principle, may be transferred to another *property*. The comment that the *personal goodwill* would be 'extinguished' refers to that element of *personal goodwill* to be excluded from the consideration of the maintainable level of trade of the subject *property* and not the *personal goodwill* itself which is an intangible *asset*.

3 Valuation assumptions

3.1 *Trade related property* will usually be valued is subject to specific *assumptions*.

3.2 Where the *property* is trading and the trade is expected to continue a typical *assumption* would be:

***Market Value* as a fully-equipped operational entity having regard to trading potential.**

3.3 Where the *property* is empty either through cessation of trade or it is a new *property* with no existing trade to transfer different *assumptions* are made. For example, an empty *property* may even have been stripped of all or much of its trade equipment, (or a new *property* may not have the trade equipment installed) but it could still be valued having regard to its trading potential.

3.4 Also the closure of a business, and the removal of some, or all, of the trade equipment, may have a significant effect on the value of the *property*. It will, therefore, often be appropriate to express the value on the basis of one or more *special assumptions*, as well as on a basis reflecting the status quo. This is often a requirement when advising a lender as to the value of *trade related property* for loan security purposes. It does not follow that the difference between this *special assumption* and the value reflecting the status quo represents the value of *transferable goodwill*, and valuers should not indicate any such apportionment. For example, the differences could reflect the cost and time involved in removing the fixtures and purchasing new equipment. Other examples of *special assumptions* are given in appendix 2.3.

3.5 In these cases the typical *assumption* will be:

***Market Value* of the empty *property* having regard to trading potential [subject to the following *special assumptions*…]**

4. The valuation approach

4.1 The *valuation* of a *trade related property* necessarily assumes that the transaction will be of the *property* interest, together with all the equipment required to continue operating the business (if it is assumed to be 'fully-equipped'). In this context equipment includes *plant & equipment*, fixtures, fittings and furnishings. However, care must be taken because this *assumption* does not necessarily mean that all such equipment is to be included in the *valuation*. For example, in the case of a *valuation* in connection with a proposed transaction or for security purposes some equipment may be owned by third parties and would therefore not form part of the interest being valued. In order to avoid misunderstanding the valuer should always establish what is to be included in the *valuation* when settling the *terms of engagement*, and make this clear in the *report*.

4.2 Where *assets* that are essential to the running of the entity are either owned separately from the land and buildings, or are subject to separate finance leases or charges, an *assumption* may need to be made that the owners or beneficiaries of any charge would consent to the transfer of the *asset* as part of a sale of the *operational entity*. If it is not certain that such an *assumption* could be made, the valuer must consider carefully, and comment in the *report* on, the potential impact on the *valuation* that would be caused by the lack of availability of those *assets* to anyone purchasing the operation.

4.3 The valuer needs to be aware of the distinction between the *Market Value* of an operational entity, and the value to the particular operator (its *worth* to that operator). The operator will derive *worth* from the current and potential net profits from the business operating in the chosen format. Whilst the present operator will be one potential bidder in the market, the valuer will need to understand the requirements and the achievable profits of all other potential bidders, and the dynamics of the open market to come to an opinion of value.

4.4 A *valuation* on the basis of *Market Value* should only reflect the *transferable goodwill* that relates to the trading potential of the *property*. The *valuation* should exclude any *personal goodwill* to the present owner or operator which would not be passed to a purchaser of the *property*. For example an operator may attract a significant custom (*personal goodwill*) to a specific *property* as a result of their celebrity status, or a corporate operator may attract

significant custom as a result of their brand identity or that of a brand under licence. Such additional custom would move with that person, or company to a new location managed by them but would not transfer on the sale of the *property* to any purchaser. It may even be terminated by a licensor.

Assessing the potential

4.5 *Trade related properties* are considered as individual trading concerns and typically are valued on the basis of their potential earnings before interest, taxes, depreciation and amortisation (EBITDA) on the *assumption* that there will be a continuation of trading. The EBITDA of the actual business will often be different from the valuer's EBITDA which is based on an assessment of the market's perception of the potential earnings.

4.6 The task of the valuer is to assess the fair maintainable level of trade and future profitability that could be achieved by a *reasonably efficient operator* of the business upon which a potential purchaser would be likely to base an offer. Where trading information is provided by the actual operator the valuer should not assume that it represents the fair maintainable trade. Just as a valuer of investment *property* should test whether a passing rent is in-line with current open *market rent*, a *trade related property* valuer should test by reference to comparables whether the present trade represents a reasonably maintainable trade in current market conditions.

4.7 When assessing future trading potential, the valuer should exclude any turnover and profit that is attributable solely to the personal skill, expertise, reputation and/or brand name of a licensor, the existing owner or management. However, in contrast, the valuer should include any additional trading potential might be realised under the management of a *reasonably efficient operator* taking over the existing business at the *date of valuation*.

4.8 When valuing *properties* by reference to trading potential, the valuer will need to compare trading profitability with similar types and styles of operation. Therefore a proper understanding of the profit potential of those *property* types, and how they compare to one another, is essential.

4.9 The valuer should endeavour to establish the accuracy and reliability of trading information provided for the purpose of the *valuation*. If any doubt of its accuracy exists, or the underlying *assumptions* supplied, the valuer should recommend verification.

4.10 For many trading entities the vehicle for a transfer of the going concern business will be the sale of a freehold or leasehold interest in *property*. Such transactional evidence can be used as comparable evidence in the *valuation* of *trade related properties*, so long as the valuer is in a position to exclude the value of the component parts of the transaction that are not relevant to the *valuation* of a *trade related property*, for example stock, consumables, cash and intangible *assets*.

4.11 A secondary basis of comparison may be by reference to physical factors, for example, when comparing one hotel with another using a value per bedroom approach. However, when using such a method it is essential that the basis used for comparison is truly relevant, as regards style, location, trading circumstances, and so on.

4.12 New competition can have a dramatic effect on profitability, and hence value. The valuer should be aware of the impact of current, and expected future, levels of competition and, if a significant change from existing levels is anticipated, should clearly identify this in the *report* and comment on the general impacted might have on profitability and value.

4.13 Outside influences, such as the construction of a new road or changes in relevant legislation, can also result in a very substantial effect on the value of *property* valued with regard to its trading potential.

4.14 Particular care must be taken, where the *valuation* is for the purposes of *financial statements*, to ensure that other items in the *financial statements* are not already included in the *valuation*.

Regulatory licences, consents, certificates, permits and approvals

4.15 When *properties* are sold as fully-equipped operational entities, the purchaser will normally need to renew licences or other statutory consents and takeover the benefit of existing approvals, certificates and permits. For *trade related property valuations* it is normally assumed that all licences and permits will be transferred or granted on the date of transfer of the *property* interest, so where the valuer is making any different *assumption* it should be clearly stated as a *special assumption*.

4.16 The valuer should, where possible, inspect the licences, approvals, consents, permits and certificates relating to the *property*. Where this is not possible the *assumptions* made should be identified in the *report*, together with a recommendation that their existence should be verified by the client's lawyers.