Tax Cases: HMRC Information Powers and Share Valuations

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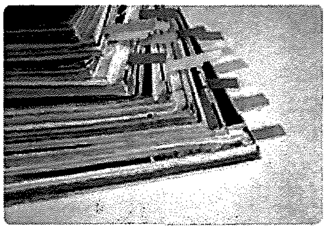

Peter Vaines of Squire Patton Boggs with observations on a couple of recent tax cases involving HMRC's use of Information Notices under FA 2008 Sch 36, and Share Valuations.

HMRC Enquiries and Use of Sch 36 Information Notices

The recent case of **Mathew v HMRC TC 4342** involved appeals against Schedule 36 Notices and covered a great deal of ground. However, two interesting features emerged as part of the discussion in the Tribunal.

The first related to the burden of proof. Mr Mathew said that the burden of proof was on HMRC to show that the information and documents requested by the Schedule 36 Notice were "reasonably required". This looked like a pretty good argument because of the case of **Kevin Betts v HMRC (2013)** where it was common ground that the burden of proof was on HMRC.

It is therefore a bit odd that in this case, HMRC argued that this was wrong and said that the burden of proof was on the taxpayer. There were various authorities in support of the view taken by HMRC and the Court held that there was a presumption that the statutory authority (HMRC) has acted lawfully and in accordance with their duty – and therefore the burden must be on the other party to rebut this presumption.

Clearly the point is arguable – but it does rather raise the question why in 2013 HMRC argued to the contrary.

Without wanting to be too cynical, both the taxpayer and HMRC now have the opportunity to argue whatever they want because each can point to a Tribunal decision in favour of either view. I am not sure that the system is supposed to work like that.

A further interesting aspect was a clear statement by the Tribunal that HMRC are not permitted to use Schedule 36 as a fishing expedition. We all know this of course (in principle) but it is extremely helpful for the Tribunal to say it so clearly. The FTT set out a relevant extract from the case of **R v HMRC ex parte Ulster Bank Limited (1997)** in which it was said that:

> "HMRC may not use their Schedule 36 powers for a fishing expedition ... a broadly drafted request will not be valid if in reality HMRC are saying "can we have all available documents because they form so large a class of documents that we are bound to find something useful". What is required is that the request is genuinely directed to the purpose for which the Notice may be given, namely to secure the production of documents reasonably required for carrying out an investigation or enquiry of any kind into another taxpayer's tax position."

This can obviously be useful in the event of piscatorial excess by HMRC, but I expect that imaginative drafting by HMRC should be able to get over most areas of opposition.

Share Valuations Case

The recent case of **Foulser v HMRC TC 4413** involved a lengthy judgement by the First Tier Tribunal on a valuation of some unquoted shares for capital gains tax purposes. The shareholdings were very different – one being 51% and the other being 9%.

The Tribunal went through the statutory requirements of TCGA 1992 ss 272, 273 and explained all the artificial considerations which are necessary in a valuation of shares for fiscal purposes. There is a hypothetical (and willing) seller; a hypothetical (and willing) prospective purchaser who is a prudent man of business, a sale in the open market and the availability of reasonable information – as well as the existence of a special purchaser.

The case involved contrasting valuations by the taxpayer and HMRC with conflicting expert valuations as well.

The Tribunal sorted it all out and effectively took what they thought to be the best bits from each of the experts' valuation to reach their own conclusion on the matter. Inevitably the decision is heavily fact dependent but one or two interesting features emerged. For example it was suggested that the minority discount applicable to a 51% shareholding should be in the region of 20%. That seems uncontroversial and consistent with prevailing practice but strangely, they said that the minority discount for the 9% valuation should be only 50%. Given that a 51% shareholder controls the entire company (OK, they cannot pass a Special Resolution, but they are in full control of everything else) and if a 20% minority discount is applicable to a 51% holding, one would have thought that a rather higher than 50% discount would be applicable to a 9% holding where the shareholder has no effective rights whatsoever and must just sit and hope that nice things happen.

My experience is that a 9% holding would generally involve a discount of 75% or so. Indeed I would observe that in **Caton v Couch (1995)** HMRC argued that a discount of 60-70% was appropriate to an uninfluential minority holding, which certainly looks closer to normal practice.

The Tribunal had more to say about this 9% holding because the taxpayer claimed that it should be valued on the basis of a dividend yield. However, the Tribunal said that a dividend yield basis is not appropriate if there is no prospect of a dividend being paid. This seems a little odd because I thought that **Salvesen's Trustees v IRC (1930)** was authority for the view that what matters is not the actual dividends paid but the maintainable dividend which is capable of being paid from the maintainable earnings. Otherwise you have the absurd situation that a small minority holding in a company which makes £10 million a year is worth very little if they choose to pay no dividends, but worth a great deal if they do pay dividends. (That would be good – especially if you are one of the shareholders who can determine whether or not dividends are paid.) The idea of a dividend yield basis is to make sense of all this (particularly in the hypothetical environment in which fiscal share valuations take place) by looking at the dividends which are capable of being paid by the company, taking into account distributable profits, cover, cash resources and commitments, so that there is a better chance of ending up with consistent valuations.

The Tribunal went on to explain what I thought was the reason why they rejected a dividend yield approach, which was because there had been a number of bid approaches. (It is perhaps relevant to consider whether this would have been information known to a 9% shareholder – but never mind that for the moment). The possibility of a sale of course makes all the difference. One of the reasons why a minority discount is appropriate is because of unmarketability – the inability for the minority shareholder to realise his investment. However, if there is a bid on or near the table, the prospect of a sale eliminates much of the reason for a discount for unmarketability and the Tribunal indicated that this was clearly a relevant consideration to be taken into account. In principle, that sounds unarguable, except that at the end of the judgement the Tribunal found that a prudent prospective purchaser would not have regarded the relevant offer as likely to succeed. That would seem rather to undermine the basis put forward for the valuation of the 9% minority holding.

Another interesting aspect was the use of PE ratios in connection with the valuation of unquoted shares. The expert for HMRC said that a comparison which quoted PE ratios should be made; the expert for the taxpayer said it should not - and the Tribunal came to yet another conclusion. This is all a bit unsatisfactory because comparisons with the quoted sector are not generally regarded as appropriate and this was certainly the view of the Courts in such celebrated cases such as **Lynall** and **Holt.**

This judgment has lots which will be relevant and useful to anybody interested in the subject and well worth a read.

About The Author

The above item is an extract from 'UK Tax Bulletin' which is published by Squire Patton Boggs, and is reproduced with the kind permission of the author and the firm.

Peter Vaines is a partner in the international law firm of Squire Patton Boggs. He advises clients in the UK and overseas on all aspects of corporate tax and personal tax law including tax investigations, trusts and offshore structures, and frequently acts as a consultant to professional firms, banks and trust companies. He is one of the leading authorities in the UK on the law of residence and domicile. Mr Vaines is a chartered accountant, a barrister, chartered arbitrator and member of the Institute of Taxation. He is a columnist for the New Law Journal and a former member of the editorial board of Taxation.

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