TC01086

Appeal number: TC/2010/01706

SHARE VALUATION – 1982 valuation – two companies carrying on a related business owned by the same person – whether valued separately or together – separately – whether on the valuation of one company the owner of the other is in the market – yes but with his knowledge limited to what a prudent prospective purchaser would reasonably require – the valuation of each company to assume the continued trading, management and finance provided by the other – our valuation £4.152m for both companies compared to the experts' valuations of £8.425m for the Appellant and £3.1m for HMRC

FIRST-TIER TRIBUNAL

TAX

STEPHEN ANTHONY SOLOMON MARKS **Appellant**

- and -

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

TRIBUNAL: JOHN F AVERY JONES CBE (TRIBUNAL JUDGE)
SANDI O'NEILL

Sitting in public at 45 Bedford Square, London WC1 on 28 February 2011 to 2 March 2011

Ian Morgan, Morgan & Co, chartered accountants, for the Appellant

Michael Gibbon QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

1. Mr Stephen Marks appeals against closure notices and amendments to his self-assessment returns for the years ended 5 April 2001, 2002, 2003, 2004 and 2005.

2. The issue in these appeals is the valuation for capital gains tax of the Appellant's shares in a company or companies comprising the French Connection, of which he is the founder, at 31 March 1982. More precisely at that date he held all of the shares in two separate groups, Stephen Marks Holdings Limited ("SMHL"), which was the UK group, and French Connection Overseas Limited ("FCO") which was the overseas sales group, the purchases being made by a company within the SMHL group. The valuation is a particularly difficult one because first, one has to value something nearly 30 years ago when recollections are poor or non-existent and documents no longer available, to say nothing of the completely different economic scene then applying (for example that clearing banks base rate was 13% at 31 March 1982); secondly, it makes no commercial sense to view the two groups separately when they were run as one, the Appellant being the sole shareholder and director of both; they were put together on the flotation on the Unlisted Securities Market in October 1983, immediately before which SMHL took over FCO on a share for share exchange: the first issue will be whether they can be treated as one or whether a separate valuation of each is required by the tax legislation; thirdly, the Appellant would not have sold the companies at 31 March 1982 when their growth was at an early stage (as we know with hindsight from the fact that they were floated in October 1983 at which time the profits had increased enormously since 31 March 1982); and fourthly the experts are far apart in their valuations: £8.425m for SMHL and FCO combined by the expert called by the Appellant and £3.1m for SMHL and an nominal £100 for FCO by the expert called by HMRC.

3. We had an agreed statement of facts as follows:

(1) Abbreviations used in this statement:

BMB	-	Barclays Merchant Bank Limited.
Euphorbus	-	Euphorbus B.V., a "company" incorporated in the Netherlands.
the Company	-	French Connection Group PLC, a company incorporated in England Wales.
FCO	-	The French Connection Overseas Limited, a company incorporated in England and Wales.

(2) On 20th April 1978, FCO was incorporated with company number 01364202. FCO was incorporated with an authorised share capital of £10,000 divided into 10,000 ordinary shares of £1 each. 2 subscriber shares were allotted to the Appellant, fully paid. On 10 May 1978 a further 98 ordinary shares of £1 each were issued at par to the Appellant for cash consideration. In August 1978, FCO acquired the whole of the issued share capital of Euphorbus BV, a company incorporated in the Netherlands.

(3) On 1st January 1979, the Appellant owned beneficially the entire issued share capital of seven companies, all incorporated in England and Wales, which carried on businesses variously involving the design, manufacture and marketing of ladies' wear and men's wear, as follows:

Company	Principal activity	Date of Incorporation	Company No.
Trading Companies (6)			
French Connection Limited (then The French Connection Limited)	Marketing of ladies' fashion clothing	01.09.1972	1069342
Stephen Marks (London) Limited	Marketing of men's fashion clothing	10.12.1970	996609
The French Connection No. 2 Limited	Marketing of men's fashion clothing	30.12.1975	1238909
French Connection No. 3 Limited (then Tomeden Limited)	Marketing of children's fashion clothing	25.09.1973	1135953
Stephen Marks Manufacturing Limited	Manufacturer of fashion clothing	10.03.1978	1357014
French Connection Retail Limited (then Lilajoy Limited)	Retailer of fashion clothing	08.08.1975	1222335
Investment Company (1)			
The French Connection Overseas Limited (FCO)	Holding company for subsidiaries incorporated, and conducting business, outside the UK	20.04.1978	1364202

5 (4) On 19th January 1979 the Company was incorporated under the name Stephen Marks Holdings Limited with company number 01410568. The Company was incorporated with an authorised share capital of £150,000 divided into 150,000 ordinary shares of £1 each. 2 subscriber shares were allotted to the Appellant, fully paid.

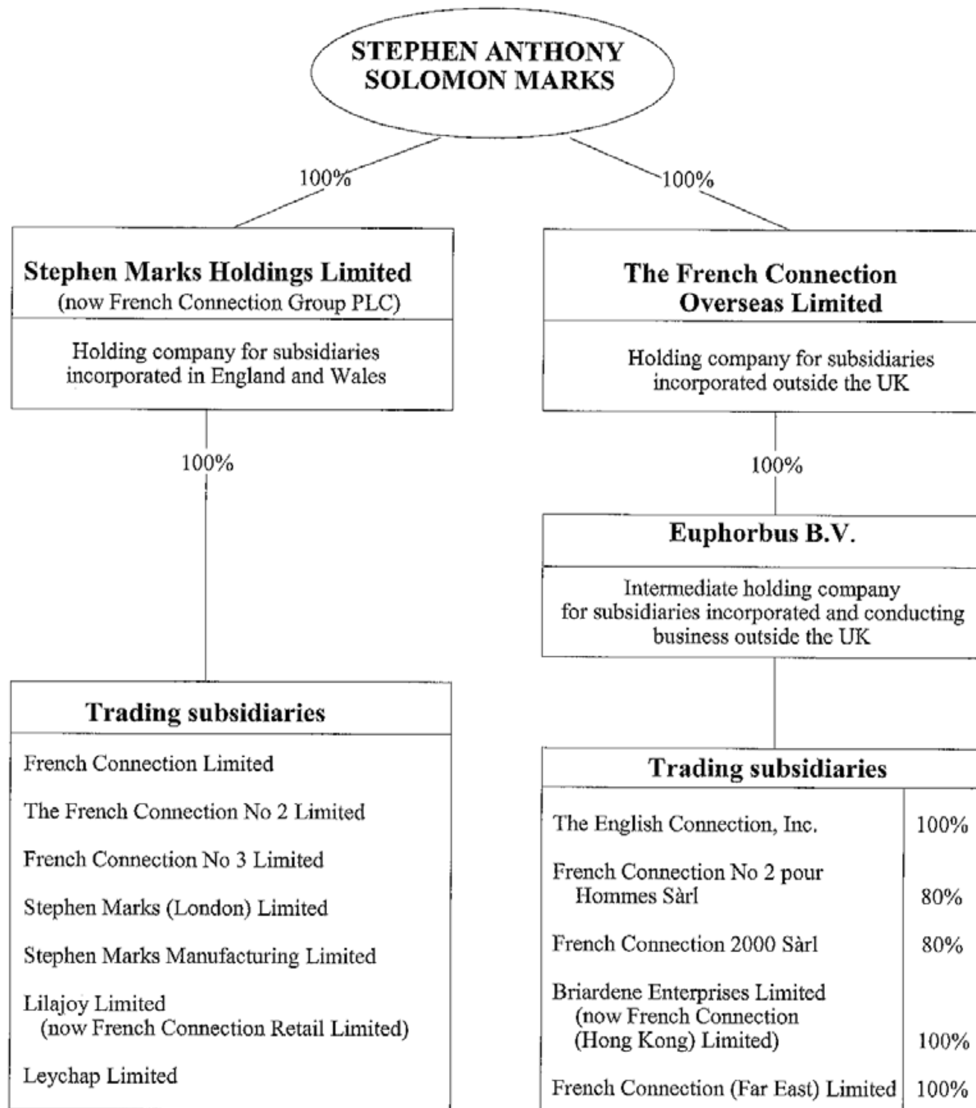
10 (5) On 26th January 1979 a further 101,300 ordinary shares in the Company of £1 each were allotted to the Appellant in exchange for the share capital of the 6 trading companies listed in the table in paragraph 3.

(6) As a result of this "share for share" exchange, the Appellant became the beneficial owner of 101,302 ordinary shares of £1 each, fully paid, at this time
15 representing the entire issued share capital of the Company.

(7) In October 1979, the Company acquired an off-the-shelf company: Leychap Limited (Company No 1452171), as the vehicle to acquire from the Receiver of

Bus Stop (Chelsea) Limited (which changed its name to Leypil Limited (Company No 1454966)) the leases of twenty-eight “Bus Stop” shops.

(8) On 31st March 1982 the Appellant owned the entire issued share capital of the Company and FCO which owned, directly or indirectly, a number of trading
5 subsidiaries. The position at this date is illustrated in Diagram 1 below:



(9) In September 1983 the Appellant gifted an aggregate 10,000 ordinary shares of £1 each, fully paid, in the Company, to members of his family and the trustees of a family settlement.

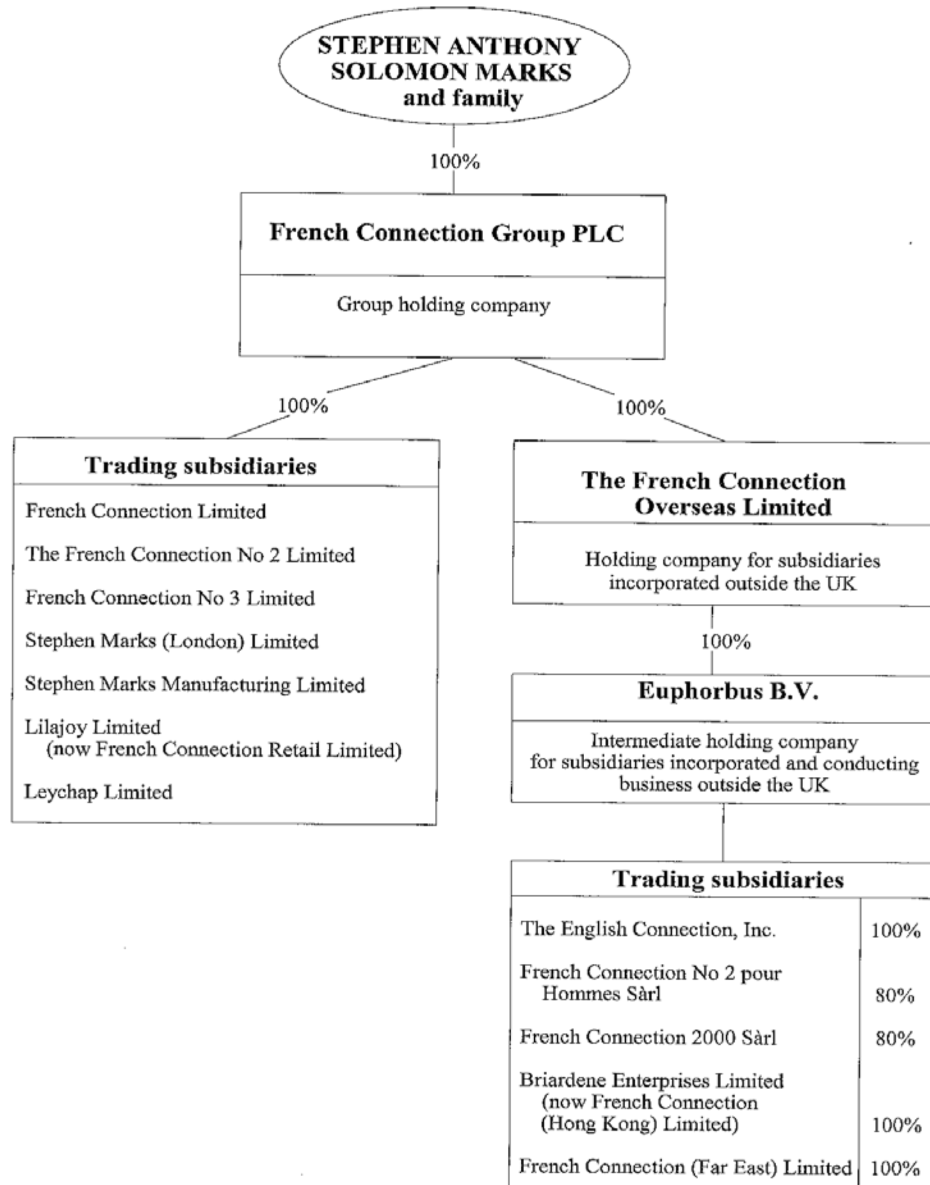
(10) On 7th October 1983 the Company was re-registered as a public limited company and changed its name from Stephen Marks Holdings Limited to French Connection Group PLC.

(11) On 25th October 1983 the Appellant transferred to the Company all his shares in FCO, in exchange for 25,325 new ordinary shares of £1 each allotted to him, credited as fully paid, by the Company.

(12) As a result of this "share for share" exchange, on 25th October 1983 FCO became a wholly owned subsidiary of the Company. The position at this date is illustrated in Diagram 2 below:

DIAGRAM 2

Ownership of *French Connection* as at 25th October 1983



(13) Also on 25th October 1983:

(a) the authorised share capital of the Company was increased from £150,000 to £1,000,000, by the creation of an additional 850,000 shares of £1 each;

(b) the share capital of the Company was sub-divided into 20,000,000 ordinary shares of 5p each; and then

(c) the Company made a bonus issue of 5 new ordinary shares of 5p each, credited as fully paid, for each newly created ordinary share of 5p each.

5 (14) As a result of these changes, by close of business on 25th October 1983, the issued share capital of the Company increased to 15,195,240 ordinary shares of 5p each, fully paid, beneficially owned as follows:-

	No of shares
Appellant	13,995,240
Donees	
- derived from gifts made by the Appellant in September 1983	1,200,000
	15,195,240

(15) By an agreement dated 26th October 1983, BMB agreed to acquire from the Appellant 12% of the issued ordinary share capital of the Company, comprising 1,823,429 ordinary shares of 5p each, fully paid, for 123p per share. This acquisition was conditional on the Council of The Stock Exchange granting permission for all the issued ordinary shares of the Company to be dealt in on the Unlisted Securities Market, which permission was duly obtained.

(16) BMB then proceeded to make a public offer for sale of 1,823,429 ordinary shares of 5p each, fully paid, in the Company also at 123p per share.

(17) On its flotation on The Stock Exchange, the Company did not issue any new shares to raise additional working capital.

(18) The Appellant made the following disposals of shares in the Company during the 5 years ended 5 April 2005:

Tax Year	**Date of disposal**	**No. of shares**	**Consideration £**
2000/01	6 April 2000	300,000	2,544,899
2001/02	26 April 2001	300,000	1,050,000
2002/03	11 April 2002	450,000	4,264,311
	21 March 2003	500,000	5,236,874
2003/04	9 June 2003	100,000	1,296,749
	10 June 2003	50,000	648,374
2004/05	1 July 2004	8,894,853	35,773,744

(19) On 6 November 2009, the Respondents issued closure notices to amend *inter alia* the chargeable gains reported in the Appellant's self-assessment returns in respect of the disposals set out in paragraph 18. On 2 December 2009, the Appellant's tax agent, Wilder Coe, appealed against each of these amendments.

4. We heard evidence from the Appellant and from two expert witnesses, Mr Keith R Eamer called by the Appellant, and Miss Angela Mary Hennessey FCA FCIArb, called by HMRC. We also had two lever arch files of documents plus numerous exhibits produced by the experts. In finding further facts we shall in some cases draw

on information about the companies in the prospectus of October 1983 which would of course not have been available at 31 March 1982. In all cases we do so on the basis that the information would have been made available to a purchaser at 31 March 1982. We find the following additional facts:

5 (1) The prospectus of October 1983 is a nearly contemporary description of the group's products, which we find was the same as at 31 March 1982:

> "In 1972, Stephen Marks, recognising the potential for a range of less expensive clothes with a wider appeal, started to market garments under the 'French Connection' label. To maintain competitive prices, 10 these garments were manufactured under contract in the Far East and India. The success of this label has provided the Group with the resources and impetus to extend its operations into retailing, to develop and market its own range of menswear, and to expand into overseas markets.
>
> 15 The Group first became involved in retailing in 1973, when Stephen Marks was invited to open a concession in the Oxford Street Top Shop. In the United Kingdom, the Group now operates eleven shops, most of which trade under the name 'Connections,' and three concessions….
>
> In 1976, the Group began to market a menswear range under the label 20 'French Connection No.2.'
>
> The Group's ranges of clothing are designed to have international appeal, and significant sales volumes have been achieved in overseas markets, principally France and the United States....".

(2) The Appellant described his involvement as totally "hands-on." He spent a 25 lot of time travelling and worked long hours six days a week. He ran the business with short lines of communication, short meetings, and a minimum of formal correspondence and minutes. At 31 March 1982 either there was no formal estimate of future results or any documents that there were no longer exist.

(3) The Appellant identified the following unique features of the business: 30 coordinating the retailing in their shops of ladies' fashion clothing under the French influence of the designer, Nicole Farhi; and arranging the manufacture of quality fashion garments in India and the Far East to harness the embroidery and other skills of the local workforces and benefit from the lower unit cost of production. We accept that there were unique features that make the Group 35 particularly difficult to value. No comparable company had been floated in the previous ten years.

(4) The Appellant was not sure why FCO was owned by him separately from the SMHL group but he thought it could have been connected with a prohibition of importing into the UK from Hong Kong and re-exporting. Unfortunately the 40 Appellant could not be more definite about this.

(5) The following figures in £000 relating to SMHL are extracted from the prospectus or the accounts:

Year to 31 January	1979	1980	1981	1982
UK wholesale turnover	5,226	5,824	6,657	7,109
UK retail turnover	202	768	1,929	1,902

Total UK turnover	5,428	6,592	8,586	9,011
Sales to FCO companies[1]				500
Total turnover as SMHL accounts	5,428	6,592	8,586	9,511
Trading profit		104	310	203
Tax		70	(83)	(32)
Profit after tax (before extraordinary items)		174	227	171

(6) The only year for which consolidated accounts are available for FCO is the year to 31 January 1982, which are as follows (in £000):

Turnover[2]	2,415
Loss before tax	(58)
Overseas taxation	(14)
Loss after tax	(72)
Retained loss carried forward	(216)

The prospectus records that the United States business had developed on a different basis from the UK and France and consisted of a licensing arrangement with an independent company, Best of All Clothing, and a 50% joint venture, The English Collection Imports Ltd (selling men's clothing), with the owner of Best of All Clothing which was not consolidated.

In the prospectus the French and other non-UK turnover was shown as £1,994K with the commission being shown separately, the figures for which were (in £000):

Year to 31 Jan 1979	1980	1981	1982
26	60	78	144

We do not know the reason for the £277K difference between the accounts figure of £2,415K and the prospectus figure of £1,994K plus £144K = £2,138, but it may be associated with sales of an unauthorised branch in Brussels which was closed in the year to 31 January 1982. An odd feature of FCO's accounts is that they state that sales to, rather than by, the branch are included in the group's turnover. The existence of the branch was not known to management until discovered by Mr Selwyn.

(7) It is difficult to identify when the decision to float was made. While this was no doubt in the Appellant's mind at 31 March 1982 the two groups were not in a suitable state to float and nor were the recent years' profits. While the Group

[1] This is the difference between the sales in the prospectus and the SMHL accounts, which Miss Hennessey assumed was export sales eliminated on consolidation in the prospectus.

[2] The turnover relating to France in the prospectus is given as £1,984K, and relating to other countries as £10K. Commission income from the US (£144K) is excluded from the turnover in the prospectus and is treated as a receipt after gross profit but included in the accounts as turnover on a cash received basis.

had a long-term relationship with Barclays it is not clear that Barclays Merchant Bank Limited had been identified as the Issuing House.

(8) The SMHL companies had computer problems in the time before 31 March 1982, having spent 18 months trying to make a system work. The prospectus records that:

> "…in 1981 profit before taxation was adversely affected by an unsuccessful initial attempt to implement computerised management systems and controls. This led to the decision to introduce an IBM System 34, which was operating successfully by July 1982.
>
> The successful establishment of a sound and well spread base of operation and the steps taken to strengthen both the Group's management and its reporting systems have, in the last two years, led to a dramatic increase in profitability. In the current year in particular, major gains in efficiency have been made in the control of purchases and stock to match sales and this is one of the most important factors in the increase in profit before taxation as forecast by the Directors."

The Appellant recollected that a new computer adviser had promised to make it work in one month but it took two or three, suggesting that the change was around, or just after, 31 March 1982. At the time a manual accounting system was relied upon. The changes referred to in the second quoted paragraph as arising in the last two years would make the start of the changes October 1981. While these systems had benefits they did not alter the fact that the Appellant's judgment about what would sell was all important.

(9) The French subsidiaries made losses which the prospectus attributes to poor local management. Mr Stuart Selwyn who joined the group in January 1982 after 15 years with Marks and Spencer effected a complete reorganisation of the French operations which became profitable for the first time in the year to 31 January 1983.

(10) The prospectus also records that:

> "A group of shops acquired by the Group in October 1979 continued to make losses until the beginning of 1982 when a programme of rationalisation and reorganisation had been substantially completed."

This relates to the acquisition of 28 "Bus Stop" shops which were later re-branded as "French Connections." From December 1979 the UK group opened its first two retail shops, initially branded as "Connections" and then from about mid-1981 as "French Connections."

(11) At 31 March 1982 one can assume that even though the accounts to 31 January 1982 were not finalised until 25 August 1982 the UK results would have been known fairly accurately. The delays in completing the accounts for the FCO group indicate that their results would have not been known with any accuracy at 31 March 1982. The FCO accounts to 31 January 1981 comprising only the balance sheet of the non-trading parent company were signed on 17 February 1983. They were not consolidated because of accounting difficulties experienced by the subsidiaries such that the resulting expense would have been out of

proportion to their value to the members of the company. The FCO accounts to 31 January 1982 were signed on 4 May 1983.

(12) Looking ahead, at 31 March 1982 the group was only two months into the 1983 accounting period but the nature of the business was such that the trading results for the summer collections would be predictable as these were delivered between January and March 1982. This was not true of the winter 1982 collection since initial orders would be taken in March 1982 for delivery in August to November 1982 and accordingly the retail customers' reaction to them would not be known. The winter collection was more important for profits than the summer accounting for about two-thirds of the profit. As the Appellant stressed, fashion is inherently a risky business. The Appellant said (and we accept) that management knew whether collections are being well or badly received within three days of being released for sale in French Connection shops and within 7 to 10 days of going on sale in customers' shops. Re-ordering was important to the success of the business. Where the companies had stock this could be delivered rapidly but further manufacture could take 4 to 6 weeks and the ability to offer suitable alternatives was important. In spite of the risks turnover was growing throughout at a rapid rate: between 1980 and 1982 at a compound annual rate of 20%.

(13) Where we have referred to comparables in the experts' reports and in our conclusions we find the material as a fact.

One or two valuations?

5. As mentioned, one of the points of difference on the law is whether both groups are to be valued separately (as HMRC contend) or together (as the Appellant contends), which we shall deal with first. Rather than set out the contentions of Mr Morgan and Mr Gibbon it is easier to set out our conclusions as it is a matter of statutory interpretation.

6. We start with the fact that on 31 March 1982 the Appellant beneficially owned 101,302 shares in SMHL (100%) ("the original SMHL shares") and 100 shares in FCO (100%) ("the FCO shares"). On 25 October 1983, immediately before the flotation, the FCO shares were exchanged for 25,325 further shares in SMHL (now re-registered as French Connection Group plc, but we shall continue to refer to it as SMHL) ("the new SMHL shares"). The following provisions, which we take from the Taxation of Chargeable Gains Act 1992 and have applied throughout, are relevant:

> 126(1) For the purposes of this section and sections 127 to 131 "reorganisation" means a reorganisation or reduction of a company's share capital, and in relation to the reorganisation—
>
> (a) "original shares" means shares held before and concerned in the reorganisation,
>
> (b) "new holding" means, in relation to any original shares, the shares in and debentures of the company which as a result of the reorganisation represent the original shares (including such, if any, of the original shares as remain).

> 127. Subject to sections 128 to 130, a reorganisation shall not be treated as involving any disposal of the original shares or any acquisition of the new holding or any part of it, but the original shares (taken as a single asset) and the new holding (taken as a single asset) shall be treated as the same asset acquired as the original shares were acquired.
>
> 135.—(1) Subsection (3) below has effect where a company ('company A') issues shares or debentures to a person in exchange for shares in or debentures of another company ('company B') and—
>
> (a) company A holds, or in consequence of the exchange will hold, more than one-quarter of the ordinary share capital (as defined in section 832(1) of the Taxes Act) of company B, or…
>
> (2) …
>
> (3) Subject to sections 137 and 138, sections 127 to 131 shall apply with any necessary adaptations as if the 2 companies mentioned in subsection (1) above or, as the case may be, in section 136 were the same company and the exchange were a reorganisation of its share capital.

7. Applying that to the facts, the FCO shares are the original shares and the new SMHL shares are the new holding. The original SMHL shares are neither since they were not "concerned in the reorganisation." Their position is the same as the ordinary shares in *Unilever (UK) Holdings Ltd v Smith* (2002) 76 TC 300 that Unilever held before and after the cancellation of the preference shares, in which if there had been a reorganisation (which the Court held there was not) the Court decided that the ordinary shares would not have been concerned in the reorganisation because they were unchanged. Therefore the "reorganisation" (meaning the share for share exchange) was not treated as involving a disposal of the FCO shares but the new SMHL shares (taken as a single asset) and the FCO shares (taken as a single asset) are treated as the same asset acquired as the FCO shares were acquired. The base value of the new SMHL shares is the same as the base value of the FCO shares. Immediately after the share for share exchange the Appellant owned the original SMHL shares and the new SMHL shares which had two separate base values.

8. The Finance Act 1988 introduced re-basing at 31 March 1982 for disposals on or after 6 April 1988 of assets which were held on 31 March 1982. Section 96(2) provided:

> 96.—(1) This section applies to a disposal on or after 6th April 1988 of an asset which was held on 31st March 1982 by the person making the disposal.
>
> (2) Subject to the following provisions of this section, in computing for the purpose of capital gains tax the gain or loss accruing on the disposal it shall be assumed that the asset was on 31st March 1982 sold by the person making the disposal, and immediately re-acquired by him, at its market value on that date.

9. Applying this to the facts the assets held on 31 March 1982 were the original SMHL shares and the FCO shares (which from 25 October 1983 are to be treated as

the same asset as the new SMHL shares). There is nothing to say that the original SMHL shares and the new SMHL shares are to be treated as one asset. It should be mentioned that there are situations in which an asset not held on 31 March 1982 but acquired after that date on certain no gain/no loss disposals (such as transfers between husband and wife) are treated as being held on that date, but that is not applicable here: see para 1 Sch 8. Mr Morgan points to another such provision in Sch 8:

> 5. Section 96 of this Act shall have effect with the necessary modifications in relation to a disposal of an asset which on 31st March 1982 was not itself held by the person making the disposal, if its value is derived from another asset of which account is to be taken in relation to the disposal under section 36 of the Capital Gains Tax Act 1979.

Mr Gibbon contends that this is inapplicable. We agree. It is applicable to assets derived from other assets if the value of the asset disposed of is derived from another asset to which s 36 applies. This relates to assets which have been merged or divided or have changed their nature, or rights or interests in or over assets have been created or extinguished, and has no application to share for share exchanges which are governed by a separate provision that deems the new holding to be the same asset as the original shares and so the value of the new holding cannot logically be derived from *another* asset.

10. We conclude that the Appellant held two separate assets on 31 March 1982, which on their deemed disposal on that date are to be valued separately. The cases on death duties under which related assets can be grouped together in order to obtain a better price for both (such as the combination of the deceased's management shares and voting preference shares so as to give voting control in *Attorney-General of Ceylon v Mackie* [1952] 2 All ER 775), which was relied on by Mr Morgan, in our view have no application to capital gains tax. While death duties are computed on the value of the estate as a whole, for which one has to split the assets into saleable parcels, capital gains tax is computed on the disposal of each asset separately.

11. We regard the issue of pooling as an entirely different one that concerns computation. Throughout these changes in the legislation, in general, pooling applied to the computation of the gain, so that on a disposal a proportion of the total base values of the elements in the pool is set against the disposal proceeds. This does not mean that the base values are not separate; indeed it can only apply where there are separate base values.

12. One can trace the history of pooling of shares as follows. Leaving aside assets acquired before 6 April 1965 (which is not the case here), s 65(2) of the Capital Gains Tax Act 1979 provides:

> (2) Any number of securities of the same class held by one person in one capacity shall for the purposes of this Act be regarded as indistinguishable parts of a single asset (in this section referred to as a holding) growing or diminishing on the occasions on which additional securities of the class in question are acquired, or some of the securities of the class in question are disposed of.

13. When indexation was introduced in 1982 shares acquired after 5 April 1982 (for individuals) were not pooled with existing shares. Existing shares were to continue to be regarded as a single asset. Paragraph 8 of Sch 13 to the Finance Act 1982 provides:

> "8.—(1) The provisions of this Part of this Schedule have effect in relation to a number of securities of the same class which, immediately before the operative date [6 April 1982 for shares held by an individual], are held by one person in one capacity and, by virtue of section 65 of the Capital Gains Tax Act 1979 are to be regarded for the purposes of that Act as indistinguishable parts of a single asset (in that section and in this Part of this Schedule referred to as a holding).
>
> (2) Subject to paragraph 9 below, on and after the operative date,—
>
> > (a) the holding shall continue to be regarded as a single asset for the purposes of the Capital Gains Tax Act 1979 (but one which cannot grow by the acquisition of additional securities of the same class); and
> >
> > (b) the holding shall be treated for the purposes of section 86 of this Act as having been acquired twelve months before the operative date; and
> >
> > (c) every sum which, on a disposal of the holding occurring after the operative date, would be an item of relevant allowable expenditure shall be regarded for the purposes of section 87 of this Act as having been incurred at such a time that the month which determines RI, in the formula in subsection (2) of that section, is March 1982.
>
> (3) Nothing in sub-paragraph (2) above affects the operation of section 78 of the Capital Gains Tax Act 1979 (equation of original shares and new holding on a reorganisation etc.) in relation to the holding, but without prejudice to paragraph 5 above."

Although in general the single asset cannot grow by the acquisition of additional securities of the same class, this rule was not affected by the reorganisation provisions and so on a reorganisation the single asset could grow. This means that after the share for share exchange there was a pool comprising the original SMHL shares and the new SMHL shares.

14. Section 109 of the 1992 Act provides:

> 109.—(1) This section has effect in relation to any 1982 holding, and in this section '1982 holding' means a holding which, immediately before the coming into force of this section, was a 1982 holding for the purposes of Part II of Schedule 19 to the Finance Act 1985.

[By para 6 Sch 19 Finance Act 1985 "a holding of securities, as it exists immediately before the 1985 date [1 April 1985], is a 1982 holding if, by virtue of paragraph 8(2) of Schedule 13 to the Finance Act 1982, it is regarded for the purposes of the Capital Gains Tax Act 1979 as a single asset." Accordingly the original SMHL shares and the new SMHL shares are a "1982 holding."]

(2) Subject to subsections (3) to (5) below—

(a) the holding shall continue to be regarded as a single asset for the purposes of this Act, but one which cannot grow by the acquisition of additional securities of the same class, and

(b) every sum, which on a disposal of the holding, would be an item of relevant allowable expenditure shall be regarded for the purposes of section 54 as having been incurred at such a time that the month which determines RI in the formula in subsection (1) of that section is March 1982.

Securities of a company shall not be treated for the purposes of this section as being of the same class unless they are so treated by the practice of a recognised stock exchange or would be so treated if dealt with on a recognised stock exchange.

(3) Nothing in subsection (2) above affects the operation of section 127 in relation to the holding, but without prejudice to section 131.

By subs (2) the 1982 holding continues to be regarded as a single assets but one which cannot grow by the acquisition of additional shares of the same class, and the indexation allowance is calculated from March 1982. This is subject to subs (3) so that subs (2) is not to affect the operation of the share for share exchange provision, but without prejudice to s 131(which deals with giving consideration for the new holding on the reorganisation, and is not relevant here). This means that for pooling purposes the single asset did grow by the acquisition of the new SMHL shares (or we consider more precisely had already grown before 1 April 1985). There was therefore still a pool comprising the original SMHL shares and the new SMHL shares.

15. Accordingly, we favour Mr Gibbon's contention that we have to value the two groups separately.

Statutory provisions on share valuation for capital gains tax

16. The following provisions of the 1992 Act are applicable:

272 *Valuation: general*

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

(2) In estimating the market value of any assets no reduction shall be made in the estimate on account of the estimate being made on the assumption that the whole of the assets is to be placed on the market at one and the same time.

….

273 *Unquoted shares and securities*

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

(2) The assets to which this section applies are shares and securities which are not quoted [*listed*, from 19 July 2007] on a recognised stock exchange at the time as at which their market value for the purposes of tax on chargeable gains falls to be determined.

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

The Experts

17. At this point we summarise the approach of the two experts, which unfortunately were primarily directed to different answers to the one or two valuations question we have dealt with. As an introduction we can say that both experts agreed that there was no really comparable quoted company.

18. Mr Eamer took six quoted companies in the stores sector and six in the textiles sector and found that their average PE ratio according to the Investors Chronicle (which assumed a full tax charge of 52%, unlike the Financial Times which took the actual earnings after tax) was 14.5. He adjusted this by adding a 30% premium for control (4.3) = 18.8; deducting 30% for lack of quoted status (5.6) = 13.2; deducting 10% for the recovery position at 31 March 1982 (1.3) = 11.9; and adding 30% for reputation, innovation and above average increase in sales (3.5) = 15.4.

19. He estimated that the combined turnover of SMHL and FCO in the year to 31 January 1983 would be £13m. By looking at the average gross profit over the years 1979 to 1982 (as shown in the prospectus) he took a gross margin (gross profit over turnover) of 32.5% which applied to the prospective turnover of £13m gave a gross profit of £4.225m. He then took 27% of the gross profit as the profit before tax, namely £1.14m, which is £547,000 after tax. Applying the PE ratio of 15.4 to that profit after tax gives a value of £8.423m, which he rounds to £8.425m as the combined value. If he were forced to value the two groups separately he would apportion his total in proportion to their 1982 turnover (SMHL 86% of the total, FCO 14% of the total—this excludes the £500K mentioned at paragraph 4(5) above), resulting in a value of £7.2455m for SMHL and £1.1795m for FCO.

20. As mentioned, Miss Hennessey approached the valuation of the two companies separately. For valuing SMHL she did not want to start with the profits because in the year to 31 January 1082 the profits of SMHL of £171K after tax (before extraordinary items) were affected by the inclusion of management fees receivable of £213K, which the accounts stated was from an overseas company that were invoiced in 1982 in respect of the three years ended 31 January 1982 (apart from this item, the trading profit before interest was £108K and interest payable was £118K).

21. She looked at possible comparable quoted companies and, while not finding any true comparables, she considered that SMHL had some similarities with the Lee

Cooper Group which manufactured trousers, jeans, skirts and casual wear and was a well-known mass market fashion brand at the time. It had a PE ratio of 6.3 (on a full tax charge basis); was trading at around its asset value; had a market capitalisation of £19.3m, a turnover of £77m and a value to turnover ratio of 0.25; was not highly geared (19.0%) and had performed better than average in terms of earning growth and had the highest net margin at 11.8% of the selected possible comparables.

22. She used the reported turnover to 31 January 1982 of SMHL of £9.511m and applied the turnover multiple of 0.25 to give an "as if listed" value of £2,377,750. This implied a PE ratio of 13.9 on the reported profits after tax (before extraordinary items) of £171K. This implies a premium of 67% to its net asset value. She considered that such a value builds in considerable expectations for future growth. She then applied a premium for control of 30% (based on a survey in the journal The Investment Analyst of October 1981 which found an average 29% rise in the share price of target companies taken over and 31% rise where the bid lapsed). This resulted in a value of £3.1m, amounting to a premium over net assets of 121% and a PE ratio of 18.1. Her valuation assumed that the Appellant and Miss Farhi would continue in the business, that SMHL could function as a stand-alone entity, that supplies could continue to be sourced from the Far East and India with no additional setting up costs resulting from its operating independently of FCO, and that the turnaround plans that had been started in October 1981 would be likely to succeed and profitability would increase substantially.

23. For FCO she had been able to use consolidated results for the year to 31 January 1982 only; accounting difficulties meant that the cost of preparing consolidated accounts for the previous year would be out of proportion to their value to the members of the company and are not available. The 1982 accounts showed turnover of £2.415m (although the prospectus showed £1.994m plus commission shown separately of £144K, total £2.138m)); a loss of £72K after overseas tax, resulting in a loss carried forward of £216K; and fixed assets of £127K, net current liabilities of £348K, (including £696,498 due to SMHL group companies) and net liabilities of £221K. According to the prospectus the French subsidiaries made losses in the years ended 31 January 1980, 1981 and 1982. She considered that FCO was a creature of SMHL for management services, garment design and financial resources. It could not exist on a stand-alone basis. There were no comparables. The prospectus showed that adjustments had been made to the results as if it had been in the group from 1 February 1978 onwards but their nature was not specified and by comparing the figures with the accounts the adjustments appeared to be considerable (for 1982 a reduction in profits of both groups of £100K). A prospective purchaser would be faced with a loss-making group without proper accounting records or consolidated audited historical financial accounts, and having management problems. She valued it at a nominal £100.

24. These approaches are hard to compare principally because first, Mr Eamer used the consolidated figures for both groups taken from the prospectus. Secondly, Mr Eamer's PE ratio is applied to prospective profits, while Miss Hennessey's is applied to the 1982 (SMHL) profits. If Mr Eamer had calculated a PE ratio by dividing his valuation of £8.425mn by the 1982 actual post-tax profit of £7K in the prospectus

(which we do not suggest would have been a fair way to proceed as it is so low), the ratio would have been 1203 (equivalent, but not comparable, to Miss Hennessey's 18.1, since this was based on actual after-tax profits, while Mr Eamer's PE ratios are based on profits after the full nominal rate of tax: see paragraph 34(2) below). Thirdly, if Mr Eamer had used a multiple of the consolidated turnover of £11.0m in the prospectus for 1982, his valuation would have been a multiple of 0.76 (equivalent to Miss Hennessey's 0.25).

The law on valuation

25. Our decision that we have to value the two groups separately gives rise to a number of difficulties in applying the statutory hypothesis. We consider that the general approach is not in dispute but rather the application of it to the facts.

26. One issue raised in this appeal, we believe for the first time, is the extent to which if one is considering the sale of SMHL by a hypothetical vendor the Appellant, as owner of FCO, is in the market (and vice versa). Mr Gibbon posed the issue more generally as whether even in relation to the sale by a hypothetical seller of SMHL (or FCO) viewed in isolation the Appellant is in the market.

27. A related issue was dealt with by the Court of Appeal in *Walton v IRC* [1996] STC 68. This concerned the valuation of the deceased's interest in an agricultural tenancy as a partner with one of his sons (J). The freehold was owned by the deceased and his two sons (J and F). The Lands Tribunal had valued the tenancy on the basis that one should assume that the deceased retained his identity as landlord. The Court approved this approach, citing Lawton L in *Trocette Property C Ltd v Greater London Council* (1974) 28 P&CR 408 at 420:

> "It is important that this statutory world of make-believe should be kept as near as possible to reality. No assumption of any kind should be made unless provided for by statute or decided cases."

In *Trocette* the landlord was the planning authority which had a planning intention for the land in question and so a purchaser would know that there was no possibility of its acting in such a way so that a share of the "marriage value" could be obtained for the leasehold interest. In *Walton* Peter Gibson LJ said at 88a:

> "It is not necessary for the operation of the statutory hypothesis of a sale in the open market of an interest in a tenancy that the landlord should be treated as a hypothetical person, and it is a question of fact to be established by the evidence before the tribunal of fact whether the attributes of the actual landlord would be taken into account in the market. I would add that the same logic requires that in the case of a deceased partner owning an interest in a tenancy which is a partnership asset, regard should be had to the actual intention of the actual surviving partner and not to a hypothetical partner."

28. Applying the same principle here, the statutory hypothesis does imply the existence of a hypothetical purchaser but does not require one to ignore the characteristics of any actual potential purchasers. It is inherent in the recognition of a special purchaser in *IRC v Clay* [1914] 3 KB 466 that a real prospective purchaser,

there the owner of the neighbouring property which wanted to extend it, was known to be in the market. There is also no doubt that the Appellant's separate ownership of the two groups would be known to the other potential purchasers in the market. As Hoffmann LJ said in *IRC v Gray* [1994] STC 360 at 372 also in relation to a valuation of land:

> "The hypothetical vendor is an anonymous but reasonable vendor, who goes about the sale as a prudent man of business, negotiating seriously without giving the impression of being either over-anxious or unduly reluctant. The hypothetical buyer is slightly less anonymous. He too is assumed to have behaved reasonably, making proper inquiries about the property and not appearing too eager to buy. But he also reflects reality in that he embodies whatever was actually the demand for that property at the relevant time. It cannot be too strongly emphasised that although the sale is hypothetical, there is nothing hypothetical about the open market in which it is supposed to have taken place. The concept of the open market involves assuming that the whole world was free to bid, and then forming a view about what in those circumstances would in real life have been the best price reasonably obtainable. The practical nature of this exercise will usually mean that although in principle no one is excluded from consideration, most of the world will usually play no part in the calculation. The inquiry will often focus on what a relatively small number of people would be likely to have paid. It may have to arrive at a figure within a range of prices which the evidence shows that various people would have been likely to pay, reflecting, for example, the fact that one person had a particular reason for paying a higher price than others, but taking into account, if appropriate, the possibility that through accident or whim he might not actually have bought. The valuation is thus a retrospective exercise in probabilities, wholly derived from the real world but rarely committed to the proposition that a sale to a particular purchaser would definitely have happened."

On that basis there seems no need to exclude an actual potential purchaser from the market. It is interesting that the RICS Red Book relating to valuations of land does include the actual owner as a potential purchaser and so this is recognised in other valuation contexts. One further problem that arises in relation to share valuation is that the actual owner's information about the asset being valued is bound to be greater than the information that a prudent prospective purchaser might reasonably require. However, there is no theoretical difficulty in assuming that that the actual owner cannot use any information beyond that reasonably required in deciding how much to offer.

29. We do not consider that the presence of the Appellant, with his knowledge treated as limited to what a prudent prospective purchase would reasonably require, would affect the value of each company viewed in isolation because all potential purchasers would use a similar valuation method based on a multiple of earnings. Where we consider that it would make a difference is that if the Appellant, as owner of FCO, is in the market as a potential purchaser of SMHL from a hypothetical vendor (and vice versa). As owner of the company not being valued he has an interest in buying the company being valued from the hypothetical vendor so that he can continue to own

both companies and continue the existing relationship between them. For example, on a valuation of FCO and treating it as a vehicle for SMHL selling outside the UK, the Appellant, as owner of SMHL, would want to continue to have such a sales outlet rather than set up a new one; and he would want to continue to have Briardene Enterprises' (an FCO group company) continued function as purchasing agent for the SMHL group. And on a valuation of SMHL the Appellant, as owner of FCO, would want to continue to be able to continue to use the trade marks owned within the SMHL group. We consider that this factor removes any issue of each group being worth less because it needs the existence of the other to continue to make profits in the same way as in the past. For example, it could be argued that FCO is worth less to an independent buyer because its established turnover is of French Connection clothes which the buyer would have to replace from another source and then persuade the existing customers to buy under another label. Similar arguments could be made that FCO did not have an assured continuation of its existing funding. But if the Appellant, as owner of SMHL is in the market as a potential purchaser of FCO he will value FCO on the basis that it will continue to be able to sell "French Connection" clothes to the existing customers, and that the funding of the FCO group by the SMHL group will continue. In other words, the valuation is on the basis that the business will continue as before.

30. A similar issue relates to what assumption should be made about the management of the two groups. In the real world we have no doubt that the Appellant, as a typical successful entrepreneur, would not work for either group if he were not substantially the owner. The law is silent on this, perhaps because it has developed mainly in relation to death duties, but we consider that we should assume the continuation of the present management. We note that the Special Commissioner in *Marks v Sherred* [2004] STC (SCD) 362 made the same assumption at [20]. Fortunately Miss Hennessey proceeds on this assumption and so the possibility of the management leaving is not in issue as a reason for reducing the value.

31. A further issue where the experts disagreed was in relation to the provision of information that a prudent prospective purchaser would reasonably require but which was not in fact available. Miss Hennessey assumed that it was unlikely that reliable financial information about FCO would have been available to the prospective purchaser on 31 March 1982. Mr Eamer worked on the basis that the purchaser would not be subject to the unsatisfactory state of the accounting information of FCO and assumed that the correct information would be provided. He based this on the statement of the Special Commissioners in *Hawkings-Byass v Sassen* [1996] STC (SCD) 319, 333:

> "Experts and we ourselves alike are at a serious disadvantage through the accounts of GB Cayman being so unreliable. A real potential purchaser in the market on 31 March 1982 would have had the accounts restated."

Mr Gibbon contended that only information actually available was assumed to be provided. We agree with Mr Gibbon. It is inherent in the hypothesis that the information is available to be supplied. The assumption relates to the information that he might reasonably require if he were proposing to purchase the asset from a willing

vendor by private treaty and at arm's length. If one assumes a sale by private treaty the purchaser cannot be put in a better position than the seller if the seller does not have the information that the purchaser reasonably requires. The quotation from *Hawkings-Byass* relates to what a *real* purchaser would have done; the hypothetical purchaser has to take the company in its actual state.

Reasons for our valuation

32. At this stage we have concluded that each group must be valued separately and that both are to be treated as businesses that would continue as before. The first thing we would want to do is then to separate out any trading between the two groups so that this is not counted twice. This is information that we find would have been reasonably required by a prudent prospective purchaser and could easily have been made available to him at the time from the sales ledgers. However, it is not available to us. What we have is the retrospectively consolidated figures for both groups in the prospectus (although not the adjustments made on consolidation), and we have the consolidated accounts for each group (although only for the year to 31 January 1982 for FCO) but insufficient information in the individual SMHL group company accounts to separate the intra-group trading. Part of our lack of information may stem from the fact that Mr Eamer valued the two groups together, which we have decided is wrong in law (although commercially sensible). We suspect that the information was available in the accountants' report for the flotation but we must work with what we have. The only assumed adjustment to eliminate trading between the groups is that the UK sales in the prospectus for the 1982 year is £500K less than the figure in the SMHL consolidated accounts, which Miss Hennessey considered was probably export sales by the SMHL group to the FCO group that was eliminated in the consolidation in the prospectus. The existence of such trading is supported by the fact of the debt due to SMHL from the French companies of £696,498 in the 1982 accounts. We find as a fact that this was the case. It is odd that the difference arises only in that year because, even if the FCO group accounts were never available, the figure would have been available to SMHL's auditors and the Joint Reporting Accountants. Miss Hennessey worked on the £9,511K figure for the turnover of SMHL but did not use the FCO turnover for valuation purposes; Mr Eamer (on the alternative basis that he had to value the two groups separately) worked on the £9,511 figure for the SMHL group and reduced the FCO group turnover by the £500K to £1,494K. We need to use a consistent figure and we consider that it is safer to use the £9,511 figure for SMHL and £1,494K for FCO on the basis that the turnover in the SMHL accounts represented sales to FCO as wholesaler in France that we assume were at an arm's length price as if SMHL had sold to any other wholesaler. For FCO we reduce its turnover by the sales from SMHL so as not to count them twice, which will have the effect of including any increase in price over that paid to SMHL as turnover of FCO.

33. We also know that the SMHL group accounts for the 1982 year included management fees of £213K (a significant figure bearing in mind that the trading profit was £203K), from "an overseas company" in respect of fees for the three years ended 31 January 1982. We do not know whether it was from the FCO group. The consolidated pre-tax profit for the year ended 31 January 1982 in the prospectus is

£28K, In the separate accounts it is £203.2K for SMHL and a loss of £58.17K for FCO. We do not know what adjustments were made on consolidation although this is information that a prudent prospective purchaser would reasonably require and would be given. In the absence of further information we shall use the figures in the SMHL audited accounts. However, because of the receipt of three years' management fees of £213K being included in the 1982 accounts figure which Miss Hennessey considered made it unreliable we consider that it is safer to use a three-year average of the profits for the years ended 31 January 1980, 1981 and 1982 of 206K pre-tax and £191K post-tax (the odd combination arises because the tax for the year to 31 January 1980 is negative caused by a provision for deferred tax of £97,801 not being required), even though we accept that normally a PE ratio is calculated on the latest years' profits only.

34. We make the following findings in relation to the expert evidence.

(1) We have decided above that we must follow Miss Hennessey's approach of valuing the companies separately.

(2) The PE ratios are on the face of it similar: Mr Eamer 15.4 (including the bid premium) (based on a full tax charge), and Miss Hennessey 18.1 (13.9 adjusted for the bid premium) (based on the actual tax charge). This was in the time of 100% first year allowances and stock relief and so the actual tax charge could be very different from the nominal tax rate on the accounting profit and so the difference between the two bases is significant. For SMHL the actual tax charge for the year to 31 January 1982 was 16% (all deferred tax) compared to the 52% nominal tax rate. Miss Hennessey's PE ratio of 18.1 (after the bid premium) based on the profits after actual tax would equate to a PE ratio of 31.7 based on a full tax charge (the limit of the marginal relief of the small companies rate was £200K). On a consistent full tax charge basis therefore Miss Hennessey's PE ratio is twice that of Mr Eamer's basis and so they are not as similar as they appear at first sight. The PE ratio of Miss Hennessey's comparable, Lee Cooper, was almost the same on both bases: 6.3 on the full tax charge, and 6.2 on the actual tax charge, but the average PE ratios for the companies used as comparables by Mr Eamer was 14.5 on a full tax basis and 9.7 on an actual tax charge basis. We believe that Miss Hennessey, having calculated a PE ratio of 13.9 (before bid premium) as a check on her valuation derived from a turnover multiple then compared it to Hepworth's PE of 23.8 and those of other companies all of which are based on a full tax charge and which are not comparable; the PE ratio for Hepworth based on the actual tax charge was 15.2.

(3) Mr Eamer made a number of adjustments to the PE ratio derived from the average of some quoted companies as set out in paragraph 18 above. He did not provide any evidence to support these and we regard the adjustments as his estimate of a suitable PE ratio. Both experts applied a 30% bid premium for valuing the controlling holding (although as shown above Mr Eamer applied his percentage adjustments successively to the total after the previous adjustments with the 30% bid premium at the beginning of his calculation).

(4) The other significant difference in their valuations is caused by applying their PE ratios to different profit figures: Mr Eamer to an estimated consolidated

profit for SMHL and FCO for the year to 31 March 1983 of £1.14m before tax and £547K after a full tax charge; Miss Hennessey the actual profit of SMHL for the year to 31 March 1982 of £203K before tax and £171K after an actual tax charge.

(5) We do not accept Mr Eamer's approach of applying a PE ratio derived from retrospective figures for quoted companies to a forecast of the 1983 profit. This is not to compare like with like. A high PE ratio for a quoted share (based on the latest known profits after-tax) indicates that the market believes that the profits will increase and so the same ratio cannot sensibly be applied to the estimated future profits. By way of illustration and not for the purposes of our valuation, in the prospectus for the flotation, the PE ratio based on the forecast profits was 11.1 (based on the estimated actual tax charge) but if it had been based on the 1983 actual profit after tax it would have been 31.1. Nor do we accept Mr Eamer's figure for the profit before tax as being 27% of the gross profit when the actual figures, based on the consolidated results of both groups on which he was working, were: 1979 34.4%, 1980 4.4%, 1981 3.1%, 1982 0.7%. The 1979 figure is clearly out of line and was when UK retail sales were only 4% of the total and so the trading pattern of the group was very different.

(6) Miss Hennessey's approach depends heavily on Lee Cooper being a sufficiently close comparable. The Appellant said that there was no similarity as it was 95% jeans and denim, and he had declined an offer to buy it. While this may be right from the fashion point of view, we consider that as a fashion brand for the young it has the potential to be comparable. Our concern about its comparability is that it did not have any retail outlets, and by the year to 31 January 1982 sales through SMHL's own retail shops were significant at 21% of the total UK sales. The closest retailer in the possible comparables was Hepworth which was at the time rapidly establishing its *Next* shops, which has the advantage of being a high street fashion retailer for the young. It is, however, less comparable because it was at a later stage of growth than SMHL. For example Hepworth purchased 78 Kendall stores in the year to 31 August 1981. The Hepworth accounts to 31 August 1982 (which would not have been available at 31 March 1982) but the information in them about the re-branding of shops when they launched *Next* in the Spring of 1982 and the plans to have 100 *Next* shops trading by the end of 1982 would have been in the public domain. By 31 March 1982 it would therefore be known that they had embarked on a large retail expansion in a similar field to French Connection but one that French Connection was too small to match in size and speed of opening. As mentioned, SMHL had acquired 28 "Bus Stop" shops in October 1979 that were re-branded as French Connection. The Hepworth turnover multiple was 0.6 (compared to Lee Cooper's 0.25 that Miss Hennessey used).

(7) In relation to FCO while the loss position prevents the use of a PE ratio Miss Hennessey's method of using a turnover multiple would have been available, although she did not use it because she was not confident that turnover was a reliable figure for external sales because of the Brussels branch (information about which might not have been available to a purchaser either).

(8) We should like to add a plea to experts in cases like this in future that it would be helpful if they could separate the effect of their using different bases to measure the same thing, such as how PE ratios are calculated, from other differences in their views.

35. In our view the following factors indicate that, when viewed at 31 March 1982, the future was likely to be much more successful than the past. It was then unknown how long it might take to improve profits but the problems were being seriously addressed.

(1) Mr Selwyn had joined in January 1982 after spending 15 years with Marks and Spencer, which would no doubt have been regarded as a good indicator of his likely expertise, and had started to turn the French operation round, but it can be inferred that this had only just started at 31 March 1982. It could well have been that he had identified the problems and knew what he had to do to solve them by 31 March 1982.

(2) After 18 months of computer problems a major effort was being made around 31 March 1982 to engage a new consultant to correct these, and when this had been achieved "major gains in efficiency… in the control of purchases and stock to match sales" could be expected as a result. The new consultant had said that it could be working in one month but we do not know whether this was before or after March 1982. (With the benefit of hindsight, which we cannot use, we know that it was working by July 1982.)

(3) The group had demonstrated in the year to 31 January 1979 an ability to make profits before tax of £609K on a turnover of £5,453K. The turnover grew strongly in all spheres from then. Later years' profits had been affected by items outside normal trading, such as the purchase of retail shops (which it would then be known had become profitable from the beginning of 1982), and by computerisation costs in 1981. Once these were solved growth in profits might be expected to match the growth in turnover.

(4) The directors were young, all being aged between 34 and 37 at the time of the prospectus which was 18 months after the valuation date, and were likely to be energetic and in touch with the clothing market for younger customers.

Taking these factors into account we consider that, although we agree with Miss Hennessey's approach, she has not taken future growth into account as much as a purchaser would have done. We would use a higher turnover multiple than 0.25, namely 0.3, which is derived as an increase of 14% of the difference between Lee Cooper's 0.25 and Hepworth's 0.6 so as to reflect the factors that gave SMHL some similarity to Hepworth. This gives an 'as listed' valuation of £2,853K and a PE ratio of 14.9 based on the three-year average of profits we are using and the actual tax charge (compared to Miss Hennessey's 13.9). Increasing this by 30% for control gives our valuation of SMHL at £3,709K, which is a PE ratio (including bid premium) of 19.4 (comparable to Miss Hennessey's 18.1).

36. We have less assistance from the experts about how to value FCO because Mr Eamer merely apportioned the total group turnover (allowing for intra-group trading as above) and Miss Hennessey considered that it was worth a nominal figure only.

We consider that it should be valued on the basis that it was an established wholesaler with good trading contacts with retailers in France. Since we have decided that it should be valued on the basis that supplies continue as before it must have more than nominal value in spite of its having negative assets. We also consider that the
5 commission mainly from the US should be valued independently as it is a royalty and treated separately from normal wholesale turnover in the prospectus which indicates that a purchaser at the valuation date would regard it as different in nature. Miss Hennessey agreed that it would be possible to use her turnover multiple basis to value FCO but she did not do so because of the difficulty in knowing the turnover figure
10 because of the Brussels branch.

37. For FCO we favour use of a turnover multiple using the revised turnover of £1,484K (see paragraph 32 above). The Lee Cooper turnover multiple of 0.25 is obviously unsuitable for a company that is just a wholesaler. Neither expert gave us evidence of a suitable turnover multiple and we do not consider that we should give
15 the parties an opportunity to provide further evidence on this. The lowest multiples on Miss Hennessey's table of possible comparables is 0.13 for Steinberg (a manufacturer of ladies' wear and handbags, which was also loss making in the latest year (but was not otherwise considered comparable), and 0.14 for Ellis & Goldstein (whose business was design, manufacture and retailing of ladies' wear). We consider
20 that a purchaser would pay something for an established turnover of nearly £1.5m and the sales contacts with leading French retailers. If one applies a multiple of 0.1 this would give a value of £148K or say £150K for the wholesaling activities.

38. There is no information in the prospectus about the duration of the contract under which the commission was payable, but it states that "The Directors believe that
25 overseas markets, in particular the United States, offer excellent opportunities for growth and that the Group's high reputation places it in a very strong position to exploit these markets." We infer that the licencing arrangements were not short term otherwise reference would have been made to their expiry in the prospectus. These trading arrangements would have been information available to a purchaser at the
30 valuation date. We do not consider that we should give the Appellant an opportunity to provide further evidence on this and there is no point in asking for further expert evidence on valuation if the expert does not know the facts either. Using the tribunal's knowledge we consider that such commission income would be valued on a discounted cash flow basis of the present value of the expected future income stream.
35 If one discounts a level 5 years' future commission at 40% pa to reflect the then high interest rates (bank base rates were then 13%) and the uncertainty factor of the commission continuing at the same rate because of changes in fashion the result is a value of about two years' commission. Accordingly we value the commission at £293K. We should mention that in the absence of any information we have not
40 placed any value on Briardene Enterprises Limited, which is part of the FCO group and is the buying agent in Hong Kong for all SMHL and FCO companies.

39. Our valuation is therefore £3,709K for SMHL and £443K (£150K plus £293K) for SCO and we allow the appeal to the extent of the increase over the valuation used in the closure notice. We leave it to the parties to agree the tax payable with liberty to
45 apply for us to determine this.

40. We would do a credibility check on these values using the prospectus figures, not to use hindsight but to see how it compares to the offer. Our valuation equates to 27.3p per share compared to Miss Hennessey's 20.4p, and Mr Eamer's 55.4p and the offer price of 123p. For the combined group the offer price represented a PE ratio of 31 (or 40 on a post-bid premium basis comparable to the ones we have quoted) on post-tax profits of £601K for the year to 31 January 1983 (with a forecast pre-tax profit of £2.8m for 1984 (compared to £803K for 1983) which was made after 8 months of trading and which the market would expect would be achieved.) We do not consider these circumstances are at all comparable as the combined group achieved considerable growth in profits from the pre-tax figure of £28K and post-tax of £7K for 1982. Another factor is that the stock market had risen between the two dates and the PE ratio for stores was then 55% higher than on 31 March 1982, which suggests that an equivalent PE ratio at 31 March 1982 would have been 20 (or 26 on a post-bid premium basis). If the PE ratio we had arrived at were as high as this we would not have regarded it as being credible, but it does not cause us to review our PE ratio of 14.9 (before the bid premium) or 19.4 (after the bid premium) for SMHL. For FCO alone the share for share exchange implies a value of £3.707m in a transaction between two companies which were wholly owned by the Appellant, although we accept that immediately before a flotation the groups had plenty of access to professional advice and would therefore have used a figure that they considered to be realistic. But the French companies had become profitable for the first time in the year to 31 January 1983 and so were not in a comparable position. We consider that no credibility check is possible.

41. 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.

JOHN F AVERY JONES

TRIBUNAL JUDGE
RELEASE DATE: 1 April 2011

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