Neutral Citation: [2025] UKUT 00164 (TCC)

Case Number: **UT-2023-000116;**
UT-2023-000116

UPPER TRIBUNAL
(Tax and Chancery Chamber)

Hearing venue: The Rolls Building
Fetter Lane
London
EC4A 1NL

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 – allocation of purchase price to goodwill (available for subsequent amortisation with corresponding corporation tax debits) and underlying real property– UK GAAP – Financial Reporting Standards 6 & 7 – RICS "Red Book" valuation principles – goodwill amounts dependent on property valuations – FTT concluded the properties should be fair valued under UK GAAP using market value rather than depreciated replacement cost – whether FTT's conclusion open to it on the evidence – Edwards v Bairstow
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: 3, 4 and 5 March 2025
Judgment date: 2 June 2025

Before

MR JUSTICE MELLOR
JUDGE GUY BRANNAN

Between

NELLSAR LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS
Respondents

Representation:

For the Appellant: Simon Farrell KC, Jamal Demachkie and Robert Morris, Counsel, instructed by Charles Russell Speechlys LLP

For the Respondent: Michael Jones KC and Harry Winter, Counsel, instructed by the General Counsel and Solicitor to His Majesty's Revenue and Customs

DECISION

Contents

INTRODUCTION

1. This is an appeal brought by Nellsar Ltd ("**Nellsar**") against the decision of the First-tier Tribunal ("FTT"), released on 11 August 2023 ("the Decision"). The FTT panel consisted of Judge Poole, Mr Law FCA CTA and Mr Perry FRICS.

2. Nellsar bought five care homes ("**the properties**") as going concerns between April 2004 and May 2007. The main point at issue in this appeal relates to the amounts to be recognised, capitalised and subsequently amortised for corporation tax purposes in respect of goodwill arising on these acquisitions. Broadly, the amount that Nellsar can amortise for corporation tax purposes depends on the correct accounting treatment of the acquisition. In general terms, the purchase price of the nursing homes has to be allocated between the underlying properties, fixtures and fittings with the remainder of the purchase price being allocated to goodwill.

3. Again, in general terms and at the risk of oversimplification, the greater the amount of the purchase price allocated to the properties under generally accepted accounting practice ("**GAAP**") the smaller the amount that can be allocated to goodwill and, consequently, the smaller the amounts that can be amortised for corporation tax purposes in respect of the acquisition of that goodwill. Conversely, the smaller the amount of the overall purchase price that can be attributed to the properties, the greater the amount that can be allocated to goodwill leading to higher deductions for corporation tax. The value to be allocated to fixtures and fittings was not in dispute. Since the value of goodwill was effectively a balancing item, this appeal revolves around the correct value for GAAP purposes to be allocated to the properties themselves.

4. The FTT decided that Nellsar's accounts, which accounted for the acquisition of the properties using the depreciated replacement cost ("**DRC**") basis, were not prepared in accordance with GAAP. Instead, the FTT decided that GAAP required Nellsar to account for the acquisition of the properties on a market value basis modified by special assumptions.

5. In summary, the main issue in this appeal is whether there was sufficient evidence before the FTT to reach that conclusion. Essentially, therefore, Nellsar challenges the FTT's decision mainly on *Edwards v Bairstow*[1] principles. Nellsar appeals on four grounds in relation to this or associated issues.

6. In addition, the FTT decided an issue relating to Stamp Duty Land Tax ("**SDLT**") concerning the chargeable consideration given for the properties. This issue depended on a "just and reasonable" apportionment between the properties and the other assets in accordance with paragraph 4 of Schedule 4 to the Finance Act 2003. Nellsar also appeals against the FTT's conclusion relating to SDLT – its fifth ground of appeal.

7. Furthermore, the Respondents ("**HMRC**") have also appealed on one particular aspect of the Decision. This concerned the question whether the FTT held that GAAP required certain assumptions to be made in the valuation of the properties.

[1] [1956] AC 14

8. The FTT did not resolve the actual valuation of the properties but rather the principles underlying their valuation in accordance with GAAP. The issue of the actual value of each property is a matter falling within the jurisdiction of the Lands Chamber of the Upper Tribunal.

9. Nellsar appeals with the permission of this Tribunal (Judge Jones) granted on 14 February 2024. The FTT gave permission to HMRC to appeal on 26 October 2023.

10. For the reasons set out below, we dismiss Nellsar's appeal and also dismiss HMRC's appeal and affirm the Decision.

11. We wish to thank counsel and those instructing them for their helpful and informative submissions.

BACKGROUND

12. We summarise the background to this appeal. References in our decision to FTT [**] are references to the Decision, unless otherwise specified. The Decision sets out the background facts at FTT [12]-[76] from which the summary below is taken.

13. Between April 2004 and May 2007 Nellsar acquired five care homes as going concerns:

(1) Loose Valley;

(2) Woodstock;

(3) Silverpoint;

(4) St Winifred's; and

(5) Sonya Lodge.

14. The parties agreed the following values in respect of the purchase consideration(FTT[25][39][41][51][59][72]:

(1) Loose Valley: £1,479,950 in respect of the freehold property, £250,050 in respect of goodwill and £60,000 in respect of fixtures and fittings.

(2) Woodstock: £840,000 in respect of the freehold property, £1,100,000 in respect of goodwill and £60,000 in respect of fixtures and fittings.

(3) Silverpoint: £1 million in respect of the freehold property, £475,000 in respect of goodwill and £75,000 in respect of fixtures and fittings.

(4) St Winifred's: £2,200,000 in respect of the freehold property, £2,225,000 in respect of goodwill and £75,000 for fixtures and fittings.

(5) Sonya Lodge: £1,869,000 in respect of the freehold property, £1,200,000 in respect of goodwill and £74,000 in respect of fixtures and fittings.

15. HMRC launched enquiries into Nellsar's corporation tax returns. HMRC subsequently, on 5 June 2014, issued a discovery assessment (in respect of Nellsar's accounting period ended 31 October 2006) and closure notices (in respect of its accounting periods ended 31 October 2007, 2009, 2010, 2011 and 2012) and a consequential amendment in respect of the accounting

period ended 31 October 2008, all imposing additional corporation tax liabilities on Nellsar on the basis that the amount properly attributable to goodwill in respect of Nellsar's acquisition of:

(1) Loose Valley was £60,000 rather than £250,050;

(2) Woodstock was £75,000 rather than £1,100,000;

(3) Silverpoint was £50,000 rather than £475,000;

(4) Saint Winifred's was £150,000 rather than £2,250,000; and

(5) Sonya Lodge was £93,000 rather than £1,200,000.

16. There was no dispute as to the validity of the assessments and closure notices: FTT [75].

17. On the same date, 5 June 2014, HMRC issued SDLT closure notices in respect of Nellsar's SDLT returns. These were calculated on the basis of the same goodwill valuation figures, with corresponding upward adjustments to the chargeable consideration attributable to the properties of £1,025,000 (Woodstock) and £425,000 (Silverpoint). The SDLT position as regards the other properties did not form part of the appeal before the FTT. This was because the discovery assessments that had been issued in relation to the other properties were apparently withdrawn after it was established that they contained an error: FTT [76].

THE ISSUES BEFORE THE FTT – IN OUTLINE

18. The FTT summarised the issues before it at FTT [77]-[85] as follows:

> "**Corporation tax**
>
> 77. The tax legislation (examined in detail below) effectively permits a tax deduction to be taken by a company in respect of its amortisation of capital expenditure incurred on intangible fixed assets (including goodwill), to the extent that the expenditure and amortisation are reflected in the company's UK GAAP-compliant accounts. There was some disagreement as to the precise consequences if the accounts were found not to be GAAP-compliant, explored in more detail … below. In outline, HMRC argued that relief would then be allowed based on what would have been GAAP-compliant accounts, whereas Nellsar's argument was somewhat more nuanced.
>
> 78. When Nellsar acquired the various nursing/care homes, in each case it acquired a number of different assets, including the freehold property, various fixtures and fittings, inventory and the goodwill of the business.
>
> 79. UK GAAP required Nellsar to include the "identifiable assets" (i.e. those assets capable of being disposed of separately, without disposing of the business as a whole) in its balance sheet at "fair value". Clearly the freehold property in each case was an "identifiable asset" for this purpose. Equally clearly, any goodwill (being "the difference between the fair value of the net identifiable assets acquired and the fair value of the purchase consideration") was not.
>
> 80. The goodwill in each case was therefore simply a balancing figure in accounting terms – what was left over of the purchase price after the "identifiable assets" had been allocated their appropriate "fair values". The key component in the valuation of the goodwill figure in each case was

therefore the freehold property: there was no dispute about the values allocated to the fixtures and fittings in each case, which were the only other "identifiable assets" involved in the purchase.

81. The focus of this case was therefore the correct assessment of "fair value" for the freehold property in each case. Under UK GAAP [FRS 7.9], the general rule for attributing fair value to any tangible fixed asset on acquisition (such as the freehold properties) was that it should be "based on… market value, if assets similar in type and condition are bought and sold on an open market"; however, where this provision did not apply, it should be "based on… depreciated replacement cost, reflecting the acquired business's normal buying process and the sources of supply and prices available to it."

82. The crucial issue in these appeals is therefore whether one can attribute a fair value to the freehold property as a single standalone asset; if so, how that is to be done, and the extent to which the carrying on of the business in the property should be taken into account when doing so.

83. It is clearly possible for the freehold of a nursing/care home to be disposed of separately, without disposing of the associated business – which could simply be closed down, for example. Therefore, Nellsar's argument runs, if one is to allocate market value to the freehold property alone, one must be able to identify an open market on which assets of that type (i.e. nursing/care home properties which are not being operated as such) are bought and sold. Since the vast majority of nursing/care home sales take place as part of a sale of the underlying business and not as sales of non-operational premises, there is not a sufficient market in the relevant assets to enable a market value to be derived. Therefore, it is said, GAAP requires Nellsar to fall back on the alternative accounting rule, which requires it to bring the property into its accounts at a fair value which is "based on depreciated replacement cost"; and that is precisely what it did.

84. HMRC's argument, in outline, is that where a freehold nursing/care home is valued for these purposes, the combined effect of the accounting rules and RICS valuation standards is that the property is capable of separate valuation but its value should be determined having regard to the inherent trading potential of the property itself and taking account of the business which is actually being operated from it; and that the effect of doing so is to characterise much or all of what might otherwise be considered as "goodwill" as simply part of the value of the property.

Stamp Duty Land Tax

85. The legislation is different, and requires a "just and reasonable" apportionment of the total purchase price paid amongst the various assets acquired (including goodwill). Nellsar argued that as a matter of law it was to be afforded a "wide latitude" in making such apportionment, and its own apportionment (based on arm's length negotiations) ought to be respected. HMRC argued that any apportionment needed to be based on the market values of the various assets concerned, which led inevitably back to an assessment of the market value of the property in each case being the crucial element of any apportionment."

THE STATUTORY PROVISIONS, FRS AND RICS MATERIALS

Corporation tax

19. The relevant corporation tax legislation was contained in Schedule 29 to Finance Act 2002 ("**Schedule 29**") and Part 8 of Corporation Tax Act 2009, and it was agreed between the

parties that there was no material difference (FTT [86]) and therefore, for convenience, we shall only refer to Schedule 29.

20. Paragraph 5 of Schedule 29 provides:

> "**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. …"

21. Paragraph 105 of Schedule 29 provides:

> "**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."

Stamp Duty Land Tax

22. The relevant provision in relation to SDLT is paragraph 4 of Schedule 4 to the Finance Act 2003 ("FA03"), which provides as follows:

> "**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."

Companies Act, Financial Reporting Standards and RICS Appraisal and Valuation Manual

23. The relevant statutory provision which represents the foundation of GAAP is paragraph 9(2), Schedule 4A, Companies Act 1985 ("**CA85**"), which sets 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."

24. For the purposes of this decision, the relevant extracts from the Financial Reporting Standards ("**FRS**") are recorded in the Decision at FTT [91]-[105] and were not in contention. We set out these paragraphs from the Decision in **Appendix 1** to this decision. We should mention that we have not set out FRS15, which played a major role in HMRC's case before the FTT, but which the FTT considered did not arise and which was not relied upon by either party before us: FTT [216(1)]. We should, however, set out FRS 7.9 which lay at the centre of this appeal and which provided:

> "*Tangible fixed assets*
>
> 9 The fair value of a tangible fixed asset should 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."

25. In **Appendix 2** we set out the FTT's description (at FTT [116]-[145]) of the relevant Royal Institution of Chartered Surveyors ("**RICS**") Appraisal and Valuation Manual (known as the "**Red Book**"). Again, the FTT's description was not in contention.

THE FTT'S DECISION

26. The FTT recorded at FTT [6] that it heard expert accountancy evidence from Mr Merris for Nellsar and Mr Lotay for HMRC. In addition, the FTT heard expert valuation evidence from Mr Lock for Nellsar and Ms Thorneagle for HMRC.

The Decision - Corporation tax legislation

27. Schedule 29 permits a company to obtain a corporation tax deduction in respect of its amortisation of capital expenditure incurred on intangible fixed assets (including goodwill) to the extent that the expenditure and amortisation were reflected in the company's UK GAAP-compliant accounts: FTT [77].

28. There was one point of law as regards corporation tax which was in dispute before the FTT. This concerned the question of the consequences under Schedule 29 if Nellsar's accounts were not GAAP-compliant. This issue depended on the interpretation of paragraphs 5 and 105 of Schedule 29.

29. The FTT observed that paragraph 5 of Schedule 29 essentially provided that, if a company does not draw up its accounts in accordance with GAAP, the relief in Schedule 29 should be calculated as if it had done so: FTT [150].

30. For ease of reference, paragraph 5 of Schedule 29 provides:

> "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."

31. The FTT noted that paragraph 105 of Schedule 29 provided that, where assets are acquired together, values allocated by the company to individual assets in accordance with 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: FTT [151].

32. Again, for ease of reference, paragraph 105 of the Schedule provides:

> "**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."

33. In summary, the FTT agreed with HMRC's submission as to the roles of, and interaction between, paragraphs 5 and 105 of Schedule 29 FTT [202]. The FTT summarised that submission as follows (FTT [153]):

> "[I]f 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."

34. The FTT rejected Nellsar's submission on this issue, which it recorded as follows (FTT [152]):

> "The effect of paragraph 105(3)(b)… 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… paragraph 105, being the more specific provision, overrode paragraph 5 on this point."

35. The FTT's reasons for accepting HMRC's submission were as follows. First, the basic scheme of the legislation was to align the tax treatment of intangibles with their correct accounting treatment: 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: FTT [202].

36. Secondly, Nellsar's fallback argument (that an apportionment decided on the basis of depreciated replacement cost ("DRC") (a valuation basis referred to in accounting standards as appropriate only in certain limited circumstances, returned to below) would "necessarily" be "just and reasonable" because it was a basis recognised by accounting standards) was equally unattractive: FTT [202]. That was because it proceeded from the starting point that the accounts are not GAAP-compliant for the very reason that they adopted a DRC basis of valuation of the properties: FTT [202].

37. Thirdly, there were clearly situations where paragraph 105(3)(b) could 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: FTT [203]. 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: FTT [203]. In that case paragraph 105(3)(b) provided the appropriate mechanism for doing so: FTT [203]. This provided a justification for paragraph 105 which did not put it into conflict with paragraph 5: FTT [203].

38. The FTT therefore concluded that, if Nellsar's accounts were not GAAP-compliant, then the corporation tax goodwill amortisation allowances available to Nellsar in Schedule 29 should be recomputed as if GAAP-compliant accounts had been drawn up. Whether those accounts were GAAP-compliant was a matter to which the FTT then turned.

The Decision - Corporation Tax and the Accounting context:

39. As already noted, Schedule 29 permitted a corporation tax deduction to be taken by Nellsar in respect of its amortisation of capital expenditure incurred on goodwill, to the extent that the expenditure and amortisation were reflected in the company's GAAP-compliant accounts: FTT [77].

40. When Nellsar bought the five care home businesses, it acquired various assets including: (i) the freehold property (i.e. the care home properties), (ii) fixtures and fittings, and (iii) goodwill: FTT [78].

41. GAAP required Nellsar to include the "identifiable assets" in its balance sheet at "fair value": FTT [79]. The definition of "identifiable assets" was to be found in FRS 7.2 and means assets "capable of being disposed of or settled separately, without disposing of the business of the entity": FTT [101].

42. The freehold properties were identifiable assets: FTT [79], as were the fixtures and fittings: FTT [80]. However, the goodwill of each purchased care home business was **not** an identifiable asset: FTT [79]. Goodwill, for GAAP purposes, was simply a balancing figure, viz the difference between the fair value of the net identifiable assets acquired (i.e. each care home property and its fixtures and fittings) and the fair value of the purchase consideration: FTT [80].

43. The purchase consideration for each care home business, in each case a fixed cash price, was not in dispute: FTT [14]. Moreover, there was no dispute about the fair value of the fixtures and fittings: FTT [80]. The focus of the dispute was therefore on the correct assessment of the fair value of the freehold properties (FTT [81]) i.e. the number needed to calculate the value of the goodwill from which the subsequent figures for the amortisation of goodwill for corporation tax purposes could be calculated. There was also no dispute about the principles of the amortisation of goodwill in accordance with FRS 10: FTT [105].

44. Therefore the crucial issue was the fair value of the freehold care home properties to be recognised in Nellsar's accounts in accordance with FRS 7. The relevant paragraph of the accounting standards for GAAP purposes was FRS 7.9, which required that the fair value at which each care home property 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".

45. Hence, market value was to be applied to the relevant "identifiable assets" (i.e. the properties and fixtures and fittings) if, but only if, "assets similar in type and condition are bought and sold on an open market": FTT [212]. If a market value for those assets could not be established, DRC, a different valuation basis, would apply.

46. DRC, the accounting treatment for which Nellsar contended, was defined in Appendix 3 of the Decision as:

> "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."

47. HMRC's case, in a nutshell, was that market value (i.e. FRS 7.9(a)) applied to the care home properties. Nellsar, on the other hand, contended that DRC (i.e. FRS 7.9(b)) was the correct valuation basis and that, consequently, its accounts for the relevant periods which had used DRC were GAAP-compliant.

48. The FTT explained that a method of valuation known as the "profits method of valuation" (the "**Profits Method**") - was set out in an RICS Guidance Note ("GN") GN2 (using materially the same wording as paragraph 3.2 in the previous GN1). The Profits Method calculated a market value on the basis of "a fully equipped operational entity having regard to trading potential subject to any agreed or *special assumptions*": FTT [141] (emphasis added).

49. The basic form of the Profits Method consisted of the following three steps FTT [139]:

(1) assess the fair maintainable turnover ("**FMT**") that could be generated at the property by a reasonably efficient operator ("**REO**")[2],

(2) derive the fair maintainable operating profit ("**FMOP**") from the FMT,

(3) arrive at the market value by capitalising the FMOP at a rate which reflects "the risk and rewards of the property and its *trading potential*" and analysing and applying "evidence of relevant *comparable market transactions*" (emphasis added).

50. The valuation term "trading potential" that was taken into account by the Profits Method, according to GN2, meant:

> "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": (FTT [144]).

[2] See Appendix 4 to the FTT Decision at paragraph 2.4. This defines the concept of an REO as: "A market-based concept whereby a potential purchaser, and thus the valuer, estimates the maintainable level of trade and future profitability that can be achieved by a competent operator of a business conducted on the premises, acting in an efficient manner. The concept involves the trading potential rather than the actual level of trade under the existing ownership so it excludes personal goodwill."

51. The FTT noted that there was also a recognised method of adjusting the Profits Method, which changes the result of the method from the market value of an operational care home property to the market value of an "empty" (i.e. without the trade inventory, licences, etc.) care home property "having regard to trading potential": FTT [142-143]. This involved the same valuation process as for the operational entity, but with an adjustment to reflect the difference in the state of the property. 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": FTT [142].

The Decision - The Court of Appeal decision in *Denning*

52. Following the hearing of the appeal before the FTT, the Court of Appeal issued its decision in *HMRC v Denning* [2022] EWCA Civ 909 ("***Denning***"), which addressed the valuation of leasehold interests of 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 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"?"

53. At the request of the FTT, the parties made written submissions on the relevance of *Denning* to the present appeal: FTT [187].

54. The Court of Appeal 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 usually referred to as "goodwill", it was nonetheless an intrinsic part of the property. Also, the references to "transferrable [sic] goodwill" in GN 1 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, [as] its description implies, no more than a method of arriving at the value of the property."

The Decision - The FTT's main conclusions on accounting and valuation:

55. The FTT considered that the crucial issue revolved around a precise delineation of the nature of the "identifiable asset" referred to in the Companies Acts and, based on that legislation, in FRS 6 & 7. Given the parties' agreement that a nursing/care home was an asset that can be disposed of separately from any business carried on within it up to the time of disposal, the FTT concluded that the "identifiable asset" was 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 were not to be included because they constituted separate "identifiable assets": FTT [204-205].

56. The FTT rejected HMRC's argument that 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: FTT [206]. The references in FRS 7 to "the condition" of the property and "the conditions" at the time of sale referred, 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: FTT [207].

57. The FTT acknowledged that it was clear from the RICS guidance notes (and reinforced by the Court of Appeal decision in *Denning* at [66]) that in using the profits-based method of

valuing a trade-related property, the valuation which was arrived at was 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 was equally clear that the property which was primarily in contemplation in both the RICS guidance notes and *Denning* was a property which was being valued as an integral part of, albeit independently of, a going concern business which is being operated from it: FTT [208].

58. The FTT noted (FTT [209]):

> "The RICS guidance has, throughout all the versions of GN1, GN2 and VPGA4[3] 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."

59. The FTT began its analysis of whether market value or DRC applied by considering the nature of the identifiable assets which were to be assessed for FRS 7.9 purposes. The FTT stated at FTT [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 <u>capable</u> of being carried on, rather than as an integral part (or even the embodiment) of an existing business <u>being</u> 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" (underlining in the original).

60. The FTT did not accept that the absence of a sufficiently active market in sales of non-operating nursing/care homes necessarily meant that Nellsar was forced back on using DRC for the purposes of ascribing a fair value to the property: FTT [211].

61. The FTT recorded that the parties were agreed that there was an open market in operating nursing/care homes being sold as going concerns: FTT [212]. The question therefore arose as to whether , under GAAP, operating nursing/care homes were sufficiently "similar in type and condition" (FRS 7.9 (a)) to the "identifiable assets" to enable market values for the latter to be derived from prices paid on open market sales of the former: FTT [212].

62. In answering this GAAP question, the FTT held that the "only material difference" between an operating care home and the "identifiable assets" was that the latter properties would lack the loose chattels, staff, residents, permits, contracts, and so forth which would convert the land and buildings into a business: FTT [213]. The FTT considered that the RICS guidance on the valuation of trade-related properties as going concerns "sets out a clear method for approaching such valuations", based on the 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: FTT [213]. The FTT continued at FTT [213]:

[3] A later version of the GNs

> "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*]"

63. The FTT therefore concluded (at FTT [214]) that the expert valuation evidence showed that there was a "recognised means of adjusting" an "operational entity" valuation in order to produce a non-trading valuation of the underlying property. The FTT commented that the expert valuation witnesses for both parties (Mr Lock – the expert valuer for Nellsar – and Ms Thorneagle – the expert valuer for HMRC) "agreed as much, though Ms Thorneagle regarded the fact as irrelevant and Mr Lock expressed some reservations about its usefulness." Given that fact the FTT considered it to be self-evident that the "identifiable asset" represented by the properties as described above, i.e. non-trading care homes (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 satisfied FRS 7.9(a).

64. At FTT [215] the FTT rejected Nellsar's valuation approach. The FTT could see no basis in the RICS guidance for the approach which Mr Lock advanced for making this adjustment. 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. It seemed to the FTT that, rather than value the property, this approach was 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.

65. The relevance of FRS 15 did not in the FTT's view, arise. However, the FTT's approach to FRS 7 did not, in the FTT's view, conflict with FRS 15 in that both proceeded on the basis of market value rather than DRC. FRS 7 simply imported a specific concept of the "identifiable asset" which went beyond what was found in FRS15, which was primarily concerned with revaluations of assets which would be operational nursing/care homes: FTT [216(1)].

66. The FTT's conclusion was, therefore, that "open market" fair values could properly be allocated to the care homes the subject of the appeal under FRS 7.9(a) and therefore the allocation of DRC figures under FRS 7.9(b) would not have complied with FRS 7, meaning that Nellsar's relevant accounts were not drawn up in accordance with GAAP: FTT [217].

67. The FTT then outlined the consequences of its decision: FTT [218]-[221]

68. Since the FTT considered that Nellsar did not draw up its relevant accounts in accordance with GAAP, for the reasons given above, and since the FTT preferred HMRC's argument as to the consequences (see paragraphs 33-38 above), the FTT considered that the allowances available to Nellsar should, in principle, be recomputed as if "correct accounts" had been drawn up on the basis of revised valuations of the various properties: FTT [218].

69. The FTT emphasised that it was not laying down any particular assumptions or adjustments which it considered should apply in preparing the revised valuations – that was a

matter for professional valuation opinion upon which the Lands Chamber of the Upper Tribunal would in due course, if necessary, adjudicate: FTT [219].

70. The FTT recorded that the parties were agreed that the role of the FTT in relation to this appeal was 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 value must be carried out: FTT [10]. In the light of that agreement, the FTT's decision was limited to stating that in valuing the properties in question, the method to be adopted was to value them pursuant to paragraph 9(a) of FRS 7 on the basis set out in the RICS guidance referred to above but in accordance with FRS 6 and 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 the 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: FTT [220].

71. At FTT [221], the FTT stated:

> "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."

The Decision - Stamp Duty Land Tax

72. The dispute concerned what was the "chargeable consideration" given for the care home properties: FTT [146]. This depended on a "just and reasonable" apportionment between the land and the other assets in accordance with paragraph 4 of Schedule 4 to the Finance Act 2003.

73. Nellsar argued that, on the basis of the decision of the House of Lords in *Leedale v Lewis* [1982] STC 169, there was "a wide latitude in judgment" conferred on Nellsar when making its apportionment. Accordingly, the FTT should not interfere with the figures which it originally advanced. Nellsar also argued 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".

74. HMRC's submission was that the following five steps, taken from a 2013 Practice Note ("the 2013 Practice Note") published by HMRC, should be followed to arrive at the necessary "just and reasonable" apportionment: FTT [183] and [149]. These were:

(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 the first step 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 step one above.

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

75. HMRC also submitted that the key ingredients in that process were the property value and any goodwill value; the goodwill value was what was left after deducting all the tangible asset values from the purchase price: FTT [184]. There was, according to HMRC, no place for a DRC figure to be included in relation to the property, as it would have no relationship with market value FTT [184]. 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; that took one back to the same arguments as were relevant for corporation tax purposes FTT [184].

76. The FTT accepted HMRC's submissions as to the appropriate method for the "just and reasonable" apportionment: FTT [222] and [223]. *Leedale v Lewis* concerned a very different legal and factual context which did not provide much assistance in the present case. In particular, that was because HMRC's method (as set out in the 2013 Practice Note) was "anchored in the independent market values of the separate assets acquired (which DRC obviously was not): FTT [223]. Having held that the relevant apportionments for SDLT purposes were to be carried out following the five-step approach proposed by HMRC (based on HMRC's 2013 Practice Note), the FTT added that the market values of the relevant assets were to be calculated in the same way as for the corporation tax issues FTT [228].

The Decision – the FTT's summary and conclusions

77. The FTT (at FTT [224]-[228]) summarised its conclusions as follows:

> "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 FRS 7 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 FRS 7; 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)."

NELLSAR'S GROUNDS OF APPEAL

78. Permission to appeal was granted by the Upper Tribunal on the following five grounds. As will be seen, Grounds 1-4(1) are closely linked.

Ground 1: The FTT erred in considering whether there was an open market in assets similar in type and condition to the identifiable assets.

Ground 2: The FTT imported a valuation technique which was not prescribed by FRS 7.9.

Ground 3: The FTT misconstrued FRS 7.9 by holding that if there was a possible valuation technique available (starting with market value), then FRS 7.9 (b) could not apply.

Ground 4: (1) The FTT erred in concluding that Nellsar's accounts were not compliant with GAAP and (2) in any event the allocation was just and reasonable.

Ground 5: The FTT erred by rejecting Nellsar's apportionment of the consideration paid for the care homes for SDLT purposes as not "just and reasonable".

HMRC'S GROUNDS OF APPEAL

79. The FTT granted HMRC permission to appeal on the following two grounds.

Ground 1: the FTT erred when it stated at FTT [220] that GAAP required the valuation of "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".

Ground 2: in relation to SDLT, to the extent that the FTT wrongly laid down particular assumptions referred to in Ground 1, that error also affected the FTT's conclusions on SDLT and constitutes an error of law.

NELLSAR'S APPEAL - GROUNDS 1, 2, 3 AND 4(1)

Submissions in outline – Grounds 1, 2, 3 and 4(1)

80. In our view, Grounds 1, 2, 3 and 4(1) are closely related and are most conveniently dealt with together.

81. Mr Farrell KC, appearing with Mr Demachkie and Mr Morris, for Nellsar, drew our attention to five paragraphs in the Decision (FTT [211]-[214]) which, in his submission, indicated that the FTT had developed its own theory about the correct accounting treatment and reached a conclusion which was not supported by the evidence. Although not an authority

referred to in Nellsar's skeleton argument, this was a challenge based on *Edwards v Bairstow* [1956] AC 14 principles.

82. This error in approach, Mr Farrell said, meant that the FTT erred when it concluded that:

(1) Operational care homes could be treated as similar in type and condition to non-operational care homes and this was "self-evident";

(2) The correct method for valuing the identifiable assets was FRS 7.9(a) and not 7.9(b);

(3) The accounts were not GAAP-compliant because the properties had been valued in accordance with FRS 7.9(b) and not FRS 7.9(a);

(4) The apportionment of the assets was not "just and reasonable,"

83. Mr Farrell drew attention to the Decision at [214] which he submitted misrepresented the views of the valuation experts. In short, Mr Farrell's submission was that the expert witnesses gave a more "nuanced" opinion than the FTT disclosed in the Decision. Mr Farrell based his submission on passages in the oral evidence[4]. Whilst both experts agreed that there was a possible method of valuing a non-operational care home by reference to an operational care home, Mr Farrell contended that neither valuation expert agreed that this was an "appropriate" method of valuation and Mr Lock expressed reservations to the effect that he was not in fact comparing comparable assets and that this would result in "a lot of opinion" to derive an appropriate valuation if one started with the market value of operational care homes.

84. Mr Farrell also relied on the evidence of Mr Merris, Nellsar's accountancy expert witness, and argued that neither accountancy expert had considered that FRS 7.9 could be supplemented by the use of special assumptions. Therefore this was not a finding of fact that the FTT were entitled to reach. Although the RICS Red Book, which did deal with special assumptions, was before the FTT, the FTT was not entitled to fly in the face of the expert evidence.

85. The decision of the Upper Tribunal in *Ball UK Holdings Ltd v HMRC* [2018] UKUT 407 (TCC) (Falk J and Judge Cannan) ("***Ball UK***") established that a finding as to the correct accounting treatment was a finding of fact and not of law. However, the Upper Tribunal in that case at [41] indicated that the FTT was not entitled to "develop its own theory" as regards the appropriate accounting treatment. On that basis, the FTT were, therefore, wrong to conclude that FRS 7.9 permitted a valuation of one asset which could be derived from a comparison with the sales of others of different types.

86. Mr Farrell submitted that in carrying out a valuation under FRS 7.9, to arrive at a valuation for the property alone (and not the business carried on in the care home), it was necessary to find a comparison with a closed care home – what he described as a "turnkey care home" i.e. one that was closed but ready to operate. HMRC's valuation expert, Ms Thorneagle, did not attempt to find such a comparison, because of the way HMRC put their case (i.e. relying on FRS 15, a standard which was inapplicable in the present case and applied to revaluations).[5]

[4] (Transcript Day 3 page 67 line 21 *et seq*, Mr Lock, Transcript Day 3 pages 71-73, Mr Lock and Day 4 page 3 line 20 *et seq*, Ms Thorneagle)

[5] Mr Farrell drew attention to footnote 43 in FRS 15 which relevantly stated: "The term 'revaluation' does not encompass … a determination of the cost of an asset acquired as a result of a business combination stated at the fair value at the date of acquisition, in accordance with FRS 7 'Fair Values in Acquisition Accounting'."

Mr Lock, Nellsar's valuation expert, did seek to find a comparison in the relevant periods but concluded that there was insufficient evidence relating to closed care homes. This, Mr Farrell said, was the reason why Nellsar, in its accounts, used the DRC method of valuation.

87. The whole point of Financial Reporting Standards, Mr Farrell argued, was to give clear guidance to accountants – they are supposed to be, as Mr Merris' evidence indicated, straightforward and are simply worded.

88. Mr Jones KC, appearing with Mr Winter for HMRC, argued that because the question of the correct accounting principles under GAAP was a question of fact and not of law (*Ball UK*), Nellsar could only challenge the FTT's findings concerning the correct accounting treatment on *Edwards v Bairstow* principles. In other words, Nellsar had to show that there was no reasonable basis upon which the FTT, on the evidence before it, could reach the findings that it did. Nellsar, in Mr Jones' submission, had come nowhere close to meeting the exacting standards of the *Edwards v Bairstow* test.

89. Mr Jones submitted that FRS 7.9 required that the identifiable assets should be valued on a market value basis if a market value could be reliably ascertained. The DRC basis of valuation was a "last resort" (so described by Lewison LJ in *Denning*) and applied to assets in respect of which there was no open market e.g. power stations and airports. It was agreed that the identifiable assets in the present case were not "specialised properties".

90. Mr Lock's valuation evidence, in Mr Jones' submission, was to the effect that there were recognised methods of adjusting the open market value of operating care homes to reach a value for a non-operating care home but that Mr Lock was not confident that this method of valuation would comply with FRS 7.9(a). But the question whether this particular method of valuation complied with FRS 7.9(a) was not a valuation question, Mr Jones argued, but rather was one for expert accounting evidence.

91. The key question, according to Mr Jones, was whether for the purposes of FRS 7.9(a) "assets similar in type and condition" were bought and sold on the open market. Mr Lotay, HMRC's accounting expert witness, considered that if an open market value could be reliably ascertained for the identifiable assets then that value should be used in preference to DRC. Indeed, according to Mr Jones, both experts agreed that if an open market value could be reliably ascertained, it should be used instead of DRC.

92. Mr Jones drew attention to the evidence of Ms Thorneagle. She considered that the profits method of valuation provided a means of establishing a market value for the properties. She further considered that the DRC method of valuation was inappropriate – this was reserved for "specialised properties" which were not frequently traded on the open market (e.g. refineries, power stations, docks and specialised manufacturing facilities, public facilities, churches, museums[6]).

Relevant general principles- Grounds 1, 2, 3 and 4(1)

93. A right of appeal to this Tribunal from a decision of the FTT lies only on a point of law: section 11(1) Tribunals, Courts and Enforcement Act 2007.

[6] See Section 12 of Ms Thorneagle's witness statement of 20 August 2020.

94. It was common ground that the determination of the correct accounting treatment in this appeal was a question of fact and not of law. Both parties cited and relied upon the decision of this Tribunal in *Ball UK*.

95. In *Ball UK* the taxpayer company argued that a derivative transaction had changed the company's functional currency from sterling into US dollars, with the result that a foreign exchange loss arose in the relevant year. HMRC disagreed and argued that the company's functional currency continued to be sterling and that the accounts should have been prepared on that basis. That issue turned on whether the company's accounts were prepared in accordance with GAAP. The FTT held that the accounts had not been prepared in accordance with GAAP and dismissed the company's appeal. On appeal to the Upper Tribunal, the issue arose as to whether the correct approach to accounting standards could be characterised as a matter of law or a matter of fact. If it were a question of law, the Upper Tribunal could consider the matter afresh. If it were a question of fact, the role of the Upper Tribunal was limited to determining whether the FTT's conclusions were unsupported (or not sufficiently supported) by the evidence, such that the findings were not ones that it was entitled to make.

96. The Upper Tribunal said:

> "[40] In our view the question of what is generally accepted accounting practice, as well as the question whether a particular set of accounts are prepared in accordance with it, is a question of fact to be determined with the assistance of expert evidence. Professional accountants are best placed to understand accounting statements in their context, and in particular their 'spirit and reasoning'. For example, and relevant to this case, the purpose and significance of the concept of functional currency is not clear without an understanding of accounting concepts and the wider context. We agree therefore with the approach of Arnold J in *Smith*[7].
>
> [41] What is a matter for a court or tribunal, however, is the proper assessment of expert evidence. Clearly a judge may prefer the evidence of one expert to that of another, but this should be fully reasoned and the judge should not simply 'develop his own theory' (see for example *Devoran Joinery Co Ltd v Perkins* [2003] EWCA Civ 1241, [2003] All ER (D) 140 (Sep), at [24])."

97. The Upper Tribunal considered that the FTT had properly considered the conflicting expert evidence and had explained why it preferred the evidence of HMRC's expert to that of the company's. Therefore, the company's appeal was dismissed.

98. Mr Farrell placed particular emphasis on the final sentence of [41] and argued that in the present case the FTT had developed its own theory about the correct accounting treatment.

99. The reference in *Ball UK* to the decision of Arnold J in *Smith* is also relevant to the present appeal. In that case, which involved a question of the timing of when income should be recognised for accounting and tax purposes, Arnold J at [52] noted that both members of the FTT were chartered accountants (although the judge had ceased to practice in 1980 whilst the other member of the tribunal was still in practice). Arnold J observed:

> "52. *The tribunal was thus a specialised tribunal not merely by virtue of its function, but also by virtue of the expertise of its members*. That is significant

[7] *Smith v HMRC* [2011] STC 1724 (Arnold J)

> in the present case because the central issue which it faced was whether Mr Smith's [the taxpayer's] accounts had been prepared in accordance with generally accepted accounting practice. It follows, for the reasons given above, that particular deference is to be given to its decision.
>
> **[53]** Secondly, the tribunal's decision was given after a four-day hearing at which a number of witnesses gave oral evidence. In addition to Mr Smith, these included Mr Tidbury and two expert witnesses, Lee Elsworth FCA (for Mr Smith) and Anil Mathew FCCA (for HMRC). In its decision the tribunal considered the evidence of each of the three accountants in detail. This tribunal does not have the advantage, which the tribunal did have, of seeing the witnesses give evidence. *It follows, for the reasons given above, that this tribunal should be slow to conclude that the tribunal was not entitled to reach the conclusions it reached….*
>
> **[54]** Thirdly, counsel for HMRC submitted that in reality the appeal was an attempt by Mr Smith to re-argue questions of fact and evaluation which had been decided by the tribunal with a view to trying to persuade this tribunal to take a different view. In my judgment this submission is well founded." (Emphasis added)

100. We consider that the observations of Arnold J in *Smith* are particularly relevant in the present case. As already noted, the FTT in the present appeal consisted not just of an experienced judge but also a Fellow of the Institute of Chartered Accountants in England and Wales and a Fellow of the Royal Institution of Chartered Surveyors. The FTT had the benefit of extensive written and oral evidence and was able to question the expert witnesses (both on accounting and valuation issues), bringing to bear its own expertise. We did, however, have a full transcript of the hearing before the FTT, unlike the Upper Tribunal in *Smith*. Like Arnold J, we consider that considerable deference should be given to the FTT's views and that we should be slow to conclude that its decision was one which could not reasonably be reached on the evidence before it.

101. The *Edwards v Bairstow* principle is well known and has been summarised in a number of authorities. Briggs J (as he then was) summarised the position in *Megtian Ltd (In Administration) v HMRC* [2010] STC 840 at [11]:

> "The question is not whether the finding was right or wrong, whether it was against the weight of the evidence, or whether the appeal court would itself have come to a different view. An error of law may be disclosed by a finding based upon no evidence at all, a finding which, on the evidence, is not capable of being rationally or reasonably justified, a finding which is contradicted by all the evidence, or an inference which is not capable of being reasonably drawn from the findings of primary fact".

102. We are also referred to the well-known decision of the Court of Appeal in *Georgiou v Customs and Excise Commissioners* [1996] STC 463 ("*Georgiou*), in relation to appeals said to involve points of law of the kind identified in *Edwards v Bairstow*. Evans LJ (with whom Saville and Morritt LJJ agreed) said at 476-468:

> "As I have said, it seems to me that one cannot take a more advantageous line for the taxpayer than to regard that as the applicable principle when considering the function of the court in relation to the tribunal's findings in this kind of case. This is indeed the nature of the questions of law that are raised or sought to be raised in the present case, that the findings were unsupported by the evidence or contrary to the evidence that was given.

> It is right, in my judgment, to strike two cautionary notes at this stage. There is a well-recognised need for caution in permitting challenges to findings of fact on the ground that they raise this kind of question of law. That is well seen in arbitration cases and in many others. It is all too easy for a so-called question of law to become no more than a disguised attack on findings of fact which must be accepted by the courts. As this case demonstrates, it is all too easy for the appeals procedure to the High Court[8] to be misused in this way. Secondly, the nature of the factual inquiry which an appellate court can and does undertake in a proper case is essentially different from the decision-making process which is undertaken by the tribunal of fact. The question is not, has the party upon whom rests the burden of proof established on the balance of probabilities the facts upon which he relies, but, was there evidence before the tribunal which was sufficient to support the finding which it made? In other words, was the finding one which the tribunal was entitled to make? Clearly, if there was no evidence, or the evidence was to the contrary effect, the tribunal was not so entitled.
>
> It follows, in my judgment, that for a question of law to arise in the circumstances, the appellant must first identify the finding which is challenged; secondly, show that it is significant in relation to the conclusion; thirdly, *identify the evidence, if any, which was relevant to that finding*; and, fourthly, show that that finding, on the basis of that evidence, was one which the tribunal was not entitled to make. What is not permitted, in my view, is a roving selection of evidence coupled with a general assertion that the tribunal's conclusion was against the weight of the evidence and was therefore wrong. A failure to appreciate what is the correct approach accounts for much of the time and expense that was occasioned by this appeal to the High Court" (*emphasis added*)

103. Although often cited, the terms of Evans LJ's judgment repay careful attention. In particular, Evans LJ emphasised the need for a party relying on the *Edwards v Bairstow* principle to "identify the evidence… which was relevant to that finding [i.e. the finding in dispute]."

104. Also, in *HMRC v Marlborough DP Ltd* [2024] UKUT 98 (TCC) (Edwin Johnson J and Judge Brannan) ("*Marlborough*") the Upper Tribunal said at [180]:

> "Where an appeal is made on *Edwards v Bairstow* grounds, it is important to particularise, in advance of the hearing, the parts of the relevant decision and the parts of the evidence before the FTT which are the subject matter of the appeal."

105. We return to this issue later.

106. There is, relevant to this appeal, a further circumstance in which this Tribunal may interfere with a decision of the FTT: we may set aside a decision of the FTT if it took into account irrelevant considerations or failed to take into account relevant considerations. On this ground, it must further be shown that the considerations wrongly taken into or left out of account must be material in the sense that they might (not would) have affected the outcome:

[8] Now, in relation to tax appeals, replaced by the Upper Tribunal: Tribunals, Courts and Enforcement Act 2007

see Henderson LJ in *Degorce v HMRC* [2017] EWCA Civ 1427 at [95] and Lord Millett in *Begum v Tower Hamlets LBC* [2003] 2 AC 430 at [99].

HMRC v Denning [2022] EWCA Civ 909 ("Denning")

107. Before us both parties referred to the decision of the Court of Appeal in *Denning* which was released after the hearing before the FTT. As we noted above, the FTT sought and received written submissions from the parties on the relevance of the decision in the present case.

108. Denning was a CGT and an SDLT case. The taxpayer owned several care homes and granted leasehold interests in them to companies that she owned. The leasehold interests were valued on behalf of the taxpayer following the guidance in VPGA4. The issue was whether the valuation method in VPGA4 resulted in a valuation of the leasehold interest or in both the leasehold interest and transferable goodwill. The taxpayer's argument was that the result of VPGA4 was a valuation of both the leasehold interest and goodwill. What was relevant for tax purposes in that case was the value of the leasehold interest.

109. At [10]-[15] Lewison LJ described the different methods of valuation. Lewison LJ noted that there are a number of different methods by which property can be valued. The most common and first method was by the comparable method. Secondly, there was the investment method. Third, there was the residual approach. Fourth, there was DRC, which Lewison LJ described at [13] in the following terms:

> "... this involves assessing the cost of replacing the land and the building with a modern equivalent, including all associated costs and then making appropriate deductions for depreciation and obsolescence of the actual buildings. *It is used only in cases of specialised property; and it, too is regarded as a method of last resort*."(Emphasis added)

110. Fifth, there was the profits method, which was used in valuing trade-related property; and was the relevant method used in that case.

111. HMRC argued that the agreed capital values for the leasehold interests were their open market values reflecting trading potential. The case for the taxpayer was that that included both the value of the leasehold interest itself and also 'transferable goodwill'. The taxpayer argued that because the experts agreed that the rents payable under the leases were market rents it followed that a leasehold interest in property let at a market rent did not have a capital value. The Upper Tribunal accepted the taxpayer's argument. The Court of Appeal reversed the Upper Tribunal's decision.

112. At [49] Lewison LJ said:

> "VGPA 4 is, in my judgment, clear that (like other methods of valuation) what it is aiming at is a valuation of property (i.e. a freehold or leasehold interest). The profits method of valuation is guidance on how to value property of a particular type. VGPA is replete with references to the valuation of property…."

113. Lewison LJ continued at [50]:

> "50. All these passages stress that what is being valued is the property asset, how to value it is by the profits method, and the inclusion of trading potential as part of that property valuation reflects value that is inherent in the property asset itself. Trading potential refers to future profits, rather than actual profits.

> That potential is available to any reasonably efficient operator who acquires the property. On the basis that goodwill is what brings in custom, it will be reflected in the turnover and the profit of the actual business. Yet it was common ground that the valuation by the profits method was based on the market's perception of fair maintainable trade and fair maintainable operating profit; and that that method of valuation applied both to freehold and leasehold property. Even if no business is being conducted on the property, the profits method is still the appropriate way to value it, as section 7 of VGPA 4 explains.
>
> 51. Put shortly, VPGA 4 does not recognise the concept of "transferable goodwill" as an asset separate from the property interest. It does, however, recognise "personal goodwill" which is excluded from the valuation under para 2.10. Apart from that personal goodwill, VPGA 4 does not refer to goodwill at all."

114. Mr Jones drew particular attention to the final sentence of [50].

115. In conclusion, at [65]-[66], Lewison LJ said:

> "65. The error of law which, in my judgment, the UT made was to disaggregate property value on the one hand, and 'transferable goodwill' on the other. VPGA4 is aimed at the valuation of property interests. That they are valued by reference to trading potential does not mean that two separate assets are being valued. …The error that the UT made was in attempting to extricate the value of the business use from the property value.
>
> 66. In so far as there is a concept of transferable goodwill of a hypothetical business, it is simply part of the inherent qualities of the property itself and its trading potential, as stated in VGPA4 ... There is only one asset, namely the property, and the profits method of valuation is, as its description implies, no more than a method of arriving at the value of the property."

116. Mr Jones argued that it was clear from Lewison LJ's judgment that in using the profits-based method of valuation VGPA4 was valuing the property rather than the business. Also, there was, in his submission, no requirement in that method to assume that staff, residents, chattels etc that actually are in the property did not exist. Mr Jones accepted that the staff, residents and chattels etc. actually in use at the care home were distinct from the properties as identifiable assets, but it did not follow from that distinction that it was necessary to assume that those things did not exist.

117. Mr Farrell submitted that, essentially, *Denning* was irrelevant to the present appeals, which concerned not the treatment of goodwill within the trading potential of the property, but the extent and means by which effect was given to the separability of the property and the business actually run from the property. Mr Demachkie also submitted that Lewison LJ's passing reference to DRC was *obiter*.

118. We consider that *Denning* is of relatively limited relevance to the present appeals. These appeals concern, as Mr Farrell and Mr Demachkie put it, the extent and means by which it was necessary to give effect to the separability of the property from the business actually run from the property. *Denning* recognised that for the purposes of VPGA 4 there was a valuation of the single asset i.e. the property (which included its inherent trading potential).

119. We note, however, Lewison LJ's comments, albeit *obiter*, about DRC being a "method of last resort" and agree with that comment. We also note that both parties in that appeal agreed that the valuations should be carried out in accordance with VGPA 4, which was introduced in

2014, even though the acquisitions took place in 2011. Lewison LJ raised no objection to the valuation being carried out on this basis.

120. With this background in mind we now turn to consider Grounds 1, 2, 3 and 4(1).

Discussion: Grounds 1, 2, 3 and 4(1)

121. The main disputed paragraphs in the Decision were as follows:

> "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[9] regarded the fact as irrelevant and Mr Lock[10] 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."

122. In short, Mr Farrell's submission was that the expert witnesses gave more "nuanced" evidence. Mr Farrell highlighted the following exchange between Judge Poole and Mr Lock:

[9] The expert valuation witness for HMRC.
[10] The expert valuation witness for Nellsar.

> "JUDGE POOLE: Yes. The crux of whether 9(a) can and should be used is really the question of whether the trading care homes in which there is a market are assets similar in type and condition to what we are trying to establish the value of, namely, not an empty property but, yes, a property that is not trading that can be sold separately. When unpacking that concept of assets similar in type and condition, and bearing in mind that no two assets are ever going to be the same –– you are always looking at degrees of similarity –– is there a case for saying that, well, the test of whether something is sufficiently similar or not is whether there is some kind of generally acknowledged method of deriving the one from the other? Like, for example, along the lines that you have here.
>
> MR LOCK: Yes, absolutely. I agree. I think the question is whether the amount of subjectivity that takes place in that spreadsheet that we looked at is –– we all know valuation is an art not a science, how much of that is acceptable within this process, and how much of it is truly valuer opinion and takes us beyond that point of comparability."
>
> [Transcript Day 3 page 67 line 21 *et seq*]

123. Mr Farrell also pointed to the following exchange between Judge Poole and Mr Lock:

> JUDGE POOLE: And your attitude to the question of –– going back to FRS 7 and this requirement for "assets similar in type and condition" to be your comparables, I think your attitude on that was you said you are effectively –– you said throughout your report you were kind of steered by the accounting advice to only regard direct comparables as falling within this.
>
> MR LOCK: I suppose my own opinion of that is that I think there is an awful lot of valuer opinion in getting to this goodwill piece by the route of the schedule. There is a lot of opinion in that. So how comparable is a trading care home to being able to value a non–trading care home? I am not overly comfortable that the trading care home values are sufficiently comparable, I have to say. But I agree that –– I asked the question: what would I be instructed to do? And the answer that I got to that would be to value the property only by reference to (inaudible).
>
> JUDGE POOLE: Sorry, by reference to ...?
>
> MR LOCK: If I was going to be instructed by you, what would I be asked to do? And the answer was you would be asked to value the property without the business by reference to comparables. My answer to that is I think that is very difficult, because there aren't. And I believe your question to me was: are trading care homes that you can adjust sufficiently comparable? I have to say, because there is a lot of opinion in getting between trading care home values and non–trading care homes values, I am not sure that I think I am totally comfortable with that as comparable enough.
>
> JUDGE POOLE: Yes.
>
> MR LOCK: I can get there, but there is a lot of opinion involved.
>
> [Transcript Day 3 pages 72-73]

124. As regards HMRC's valuation expert, Ms Thorneagle, Mr Farrell drew attention to the following exchange with Judge Poole[11]:

[11] The words in italics were quoted in Nellsar's skeleton argument.

> "MS THORNEAGLE: I think there is a slight difference between the bricks and mortar valuation and the approach that Mr Lock has taken, because I think he has made some allowance for the fact that it's a care home and that it is ready to trade et cetera, it wouldn't necessarily be considered a bricks and mortar valuation, I don't think. But in terms of his approach, *if I was valuing a care home that was empty and ready to trade, and effectively a turnkey property, which I think is the approach that Mr Lock has taken, then I would adopt something very similar to him. I think I wouldn't be valuing the goodwill or calling it goodwill and deducting that, but I was valuing a turnkey care home I would do essentially what I have done already, which is to do the fair maintainable operating profit and capitalise that, and then I would be deducting something for a build−up of trade which is what he has done. I wouldn't personally be saying, well, this is going to be three times the profit and we will deduct that and call it goodwill, but in terms of the basics of what he has done, I think it would be broadly similar*.
>
> *JUDGE POOLE: Right. So in broad terms the way he has approached it is a recognised approach as far as you are concerned, it is just that you don't agree that it's appropriate in this situation, and you might have some sort of slight nitpicky points* about the detail of how he has done it?
>
> MS THORNEAGLE: Correct."
> [Day 4 page 3 line 20 *et seq*]

125. The FTT was therefore wrong, Mr Farrell submitted, to conclude that:

(1) Operational care homes could be treated as similar in type and condition to non-operational care homes and this was "self-evident";

(2) The correct method for valuing the identifiable assets was paragraph 7.9(a) and not 7.9(b);

(3) The accounts were not GAAP-compliant because the properties had been valued in accordance with paragraph 7.9(b) and not paragraph 7.9(a);

(4) The apportionment of the assets was not "just and reasonable".

126. Mr Farrell argued that the FTT reached its findings having imported a valuation technique, which sought to moderate the valuation of operational to non-operational care homes, which was not prescribed by FRS 7. This was not an approach recommended by either accountancy expert and was not supported by the evidence or the wording of FRS 7. It was the FTT devising its own theory, in the absence of expert evidence, on how GAAP should operate.

127. We reject Mr Farrell's submissions. In our view, there was sufficient evidence to enable the FTT to reach the conclusions that it did. As always, in an appeal brought on *Edwards v Bairstow* grounds, the question is not whether we agree with the FTT's decision but whether there was sufficient evidence to support it.

128. As Mr Jones observed, the issue between the parties concerned what he described as the "junction" between accounting and valuation evidence. Mr Merris and Mr Lotay gave accounting evidence for Nellsar and HMRC respectively and Mr Lock and Ms Thorneagle gave valuation evidence for Nellsar and HMRC respectively.

129. Mr Merris' opinion was that market value in the context of FRS 7 must be based on market evidence of the property (not including the value of the business) being sold without

the trade being attached and not a valuation technique. Due to a lack of suitable transactional evidence, it was not possible to obtain an open market value for the individual asset (i.e. excluding the business) as care homes are rarely sold without the trade attached. Hence, as market value was not available for care home properties without the attached business of goodwill, their fair value should be determined using DRC in accordance with FRS 7 paragraph 9(b). Where there was little or no market evidence for the individual assets (i.e. without the attached business) DRC was the only applicable method of determining the fair value of the properties under FRS 7. Market value of the assets could not be determined, as market value was established only where similar assets (i.e. excluding the attached business) are sold on an open market. Furthermore, the determination of market value should not involve the use of a different basis of valuation adopting a different definition of the asset to be valued using for example FRS 15.

130. Mr Lotay's opinion was that market value should be determined using one of the valuation techniques in FRS 15. This would mean that fair value for the property assets should be determined by using Existing Use Value taking into account their trading potential. He considered that the requirements of FRS 7.9(a) were met as he was advised by HMRC's valuation expert that it was possible to obtain a market value for the properties. On the basis that market values could be established for the properties then FRS 7.9(b) would not be relevant. However, if market value could not be established, then DRC would be used to determine fair value of the property assets acquired. Because such care home businesses were frequently bought and sold (and were trade-related properties), there was an open market and hence it was possible to establish a market value for the care home properties as required by FRS 7.9(a). We note, in this context, that Mr Merris in cross-examination accepted that the real question is whether a market value could be reliably ascertained for each property, although he added that the property was the property without the trade.

131. Mr Lock considered that the "identifiable assets" were the bricks and mortar and in situ trade furnishings, fixtures and fittings and that, consequently, they were required to be valued without the business. Whilst care homes without the business were bought and sold on an open market Mr Lock was of the opinion that such sales are few and far between and comparable sales will be very difficult, if not impossible, to identify. Therefore, Mr Lock took the view that guidance to valuers was required on whether under FRS 7 it was acceptable to provide a market value 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

132. Ms Thorneagle considered the market value of each property in accordance with her interpretation of the RICS guidance on valuing trade-related property. She considered that there were adequate examples of reliable market transactions that did not include goodwill and therefore an assessment of market value could be made. She valued the properties on the basis that the care homes were open and operational, in line with the facts on the valuation date. Ms Thorneagle considered the FMT and FMOP of each home under the operation of the REO and used this to determine a market value for each property. In other words, she used the profits method of valuation. She did not consider that DRC was an appropriate method of valuing the properties. Quoting the Red Book she considered that DRC should only be used for

"Specialised Properties" (i.e. properties much more specialised in nursing homes).[12] She was aware that the accountants, informed by their valuation experts, disagreed about whether a market value could be established. Ms Thorneagle considered that a market value for the identifiable assets could be established.

133. Ms Thorneagle also considered that RICS guidance was clear that even if a property met the definition of specialised property, it should only be valued on a DRC basis if there was no alternative method of valuation. A care home was considered to be a trade-related property that could be valued by reference to their trading potential. In Ms Thorneagle's opinion it would therefore be contrary to RICS guidance to value care homes using the DRC method.

134. We consider that it is clear that the FTT rejected Mr Merris' evidence that the building should be accounted for on a DRC basis and preferred that of Mr Lotay, although it did not fully accept his evidence, as we shall see. In particular, as regards Mr Lotay, the FTT did not accept (FTT: [206]) that each property should be valued on the basis that it was an operational entity. It disagreed with Mr Lotay's view that, because each property was an operational entity, this was its "condition" for the purposes of FRS 7.9(a). Instead, it considered (FTT: [207]) that the reference in FRS 7.9(a) to the "condition" of the property was to the physical condition of the property and the market conditions at the time of sale and was not intended to widen the scope of the "identifiable asset" which had to be valued.

135. In our view, the FTT was perfectly entitled to reach these views on the evidence before it. Mr Lotay's evidence was that if there was a reliable method of valuing the properties then market value should be used under FRS 7.9(a). Ms Thorneagle considered that there was a reliable valuation method, albeit that the FTT, for the reasons given above, rejected the view that the properties should be valued on the basis that they were operational. It was common ground that there was an open market in operational care homes. Thus, in effect, the starting point for the valuation was that of operational care homes and these were care homes which were "assets similar in type and condition are bought and sold on an open market."

136. The FTT then considered that the RICS guidance (FTT [209] and [213]) allowed adjustments to be made so that so that a value for non-operational care homes could be derived from the open market values for operational care homes. It is this step, in particular, to which Mr Farrell objected in his submissions.

137. However, in our view, there *was* evidence which entitled the FTT to reach this conclusion.

138. The FTT had before it the text of the FRS 7 which, in the explanation section, included the following commentary on the concept of "fair value":

> "42. Although the FRS contains specific requirements for determining fair values of different classes of assets and liabilities, the concept of fair value underlying the specific rules is the value at which the asset, or liability, could be exchanged in an arm's length transaction between informed and willing parties.
>
> 43. Where similar assets are bought and sold on a readily accessible market, the market price will represent the fair value. Where quoted market prices are

[12] the Red Book gave examples of specialised properties, referring to them as "properties which are rarely, if ever, sold in the open market", "[E]xamples include refineries, power stations, docks, Specialized manufacturing facilities, public facilities, churches, museums"

> not available, market prices can often be estimated, either by independent valuations, *or valuation techniques such as discounting estimated future cash flows to their present values*. In some cases, where quoted market prices are not available, subsequent sales of acquired assets may provide the most reliable evidence of fair value at the time of the acquisition.
>
> 44. Where a fair value is based on a market price, it is important to ensure that such price is appropriate to the circumstances of the acquired business. For example, it may be possible to obtain a price for secondhand plant and machinery of the type used in the business, but the secondhand market may deal in very small volumes; or the items may not be identical in terms of the ability to obtain maintenance or technical support from the manufacturer or for the machinery to be customised to the requirements of the business. In general, unless the acquired business is genuinely able to consider the purchase of second-hand equipment as a viable alternative to purchasing direct from the manufacturer, the fair value of plant and machinery is more appropriately determined from the replacement cost of an equivalent new asset, depreciated where appropriate to reflect its age and condition." (Emphasis added)

139. It seems to us that paragraph 43 clearly envisages that, as Mr Jones submitted, direct compatibility was not a requirement for the purposes of FRS 7.9(a) and that "valuation techniques" could be used to establish an open market value.

140. As regards the Red Book, Practice Statements ("PS") are binding on valuers whereas, as their name suggests, Guidance Notes ("GN") are intended to guide valuers but are not binding. We note, in particular, PS3.2 and GN1 and the Appendix 2.3 to PS3, all of which (apart from Appendix 2.3), were before the FTT. Later versions of GN1 (GN2 and VPGA4) were also before the FTT.

141. Furthermore, PS3.2 of the Red Book, headed "Market Value", provided that:

> "Valuations based on Market Value (MV) shall adopt the definition, and the interpretive commentary, settled by the International Valuation Standards Committee."

142. After that definition some additional commentary was added, which included the following at paragraphs 2 and 6:

> "2. In order to apply Market Value to certain property types it may be necessary to add a statement clarifying both what is being valued and any Assumptions that are inherent in the valuation. Examples include property that is normally sold having regard to its trading potential, and Plant & Machinery, both of which are discussed below. *The circumstances of the valuation may also require Special Assumptions to be made (see Appendix 2.3)*. However, it should be recognised that although additional words may be required to clarify the application of Market Value, this is not a different basis, but rather the same core basis with additional Assumptions.
>
> …
>
> 6. There are certain categories of property designed or adapted for particular uses which change hands in the open market as fully operational business units for a strictly limited use at prices based directly on trading potential. The price will include trade fixtures, fittings, furniture, furnishings and equipment. This type of property includes: hotels, bars, some restaurants, movie theatres or cinemas, gasoline or petrol stations. *In these cases the valuer will need to*

> *supplement Market Value with additional words clarifying whether the valuation assumes that the property changes hands as a fully-equipped, trading entity, or on some other Assumption or Special Assumption (see Appendix 2.2 and Appendix 2.3)*. Further information on this type of trade-related valuation is also contained within GN1."(Emphasis added)."

143. In the Decision the FTT noted, in a footnote to the above extract from PS3.2, in relation to Appendix 2.2 and Appendix 2.3 to PS3.2: "These Appendices were not included in the copy of Practice Note 3 included in our bundle." It is not clear why Appendix 2.3, in particular, was not provided. We were however provided with a copy. Appendix 2.3 was titled "Special Assumptions" and at paragraph 4 it provided:

> **"4. Trading property**
>
> 4.1 In the case of a trading property the Special Assumptions may include that:
>
> …
>
> - the businesses is closed when it is actually trading from the property;
>
> …"

144. Guidance Note GN1, entitled "Trade-related valuations and goodwill", went through a number of versions over the relevant period. The FTT was provided with versions from May 2003, September 2003, January 2006 and unknown dates in 2007 and 2008. In the 2006 version, its title was changed to "Specialized Trading Property valuations and goodwill", and for the 2007 and 2008 versions its name was changed again to "Trade related property valuations".

145. As the FTT noted, the introduction to GN1 remained largely the same throughout these versions. The FTT set out the following text which shows the original version from 2003, with alterations made in the 2007 version (and carried through to the 2008 version) noted in italics:

> **"1. Introduction**
>
> 1.1 The commentary to PS3.2 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, movie theatres *[movie theatres replaced by "theatres" in 2007 version]* or cinemas, gasoline or petrol stations *["gasoline or petrol stations" replaced by "fuel stations" in 2007 version] [", and care homes" added in 2007 version]*. 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" added in 2007 version]* considers the additional criteria that need to be considered by the valuer in these cases. It *[". It" replaced by ", but" in 2007 version]* does not concern itself with methodology *["methodology" replaced by "methods of valuation" in 2007 version]*, which will vary depending upon the trading *["trading" deleted in 2007 version]* property to be valued."

146. The FTT also set out paragraph 4 of GN2 (a later iteration of GN1) and VPGA4 (a later iteration of GN2) also referred to "Valuation special assumptions", as follows:

> "4.1 A *trade related property* will usually be valued to *market value* or *market rent*, but valuers are commonly asked for valuations subject to *special assumptions*.
>
> Typical *special assumptions* are:
>
> (a) on the basis that trade has ceased and no trading records are available to prospective purchasers or tenants
>
> (b) on the same basis as (a) but also assuming the trade inventory has been removed
>
> (c) as a fully equipped operational entity that has yet to trade (also known as 'day one' valuation) and
>
> (d) …" (Emphasis in the original)

147. Mr Lock touched on the use of "special assumptions" in his evidence (Mr Lock's report dated 14 October 2019). He said:

> "8.5 I consider a property only valuation could have been provided in accordance with Red Book as a Special Assumptions valuation and those assumptions would need to be agreed with the client. In the accounting circumstances we are reviewing I would consider such assumptions may have been:
>
> a) The property is non-operational;
>
> b) TFFF&E [Trade Furnishings, Fixtures, Fittings and Equipment] are present or not as per client instructions;
>
> c) The property is in its existing physical condition;
>
> d) There are no adverse circumstances that led to the property being non-operational;
>
> such as administration, forced closer under regulation or major new competition.
>
> 8.6 Such assumptions would allow a valuer to consider the property as closely as possible to the actual circumstances but without the business.
>
> 8.7 There may well be difficulty in assessing the value of the property directly to examples of other non-operational properties that sold in the open market where the Special Assumptions also applied as there would be very few such sales. It would also be difficult in most instances to identify examples of any non-trading care home sales whatever the circumstances of closure as, overall, there are very few sales of non-operational care homes in any one year. I return to this below.
>
> 8.8 The vast majority of care homes are sold as fully equipped operational entities. I note FRS 7 does not give any guide as to frequency of sales but, for a valuer, the frequency is very likely to be too little for there to be reliable comparable sales on which to directly base a valuation of the property only. *In those circumstances, and I would fully expect those circumstances to arise in all but the rarest of cases, the valuer would normally apply a residual approach to the valuation, commencing with a valuation as a fully operational entity and then making deductions therefrom (as is market practice) to arrive at a non-operational property value that reflects what the market would pay. However, it does not seem to me that FRS 7 allows the valuer to use this alternative approach.*

> 8.9 It would be for the client to decide whether such an approach would be acceptable for the purposes of paragraph 9 a) of FRS 7 and the valuer would be instructed accordingly."(Emphasis added)

148. In the italicised words in paragraph 8.8, Mr Lock accepted that a valuer would be able to apply "a residual approach to valuation". In our view, he explicitly recognised an analogous approach to that adopted by the FTT in the Decision. His only misgiving was whether this approach would comply with FRS 7. However, the requirements of FRS 7, as both Mr Lock and Ms Thorneagle explicitly recognised, were not matters on which they were competent to opine.

149. Drawing these threads together, it seems to us that taking account of PS 3.2, GN1 and Appendix 2.3 to PS3, which was echoed later in GN2 and VPGA 4, taken together with Mr Lock's evidence in paragraph 8.8 of his report dated 14 October 2019 and Mr Lotay's view in relation to FRS 7, that if a market value could be reliably established then market value should be used instead of DRC, there was sufficient evidence before the FTT to support its Decision (at FTT [212]-[214]).

150. It is fair to say that the FTT did not fully accept the evidence of any of Mr Merris, Mr Lotay, Mr Lock and Ms Thorneagle. Instead, it will be apparent from any fair reading of the Decision that the FTT carefully picked its way through the evidence, being selective in which evidence it accepted – accepting some parts and rejecting others. In adopting this approach the FTT was playing its proper role, as Arnold J said in *Smith*, as "a specialised tribunal not merely by virtue of its function, but also by virtue of the expertise of its members" and we consider that we should give particular deference to its reasoning and conclusions.

151. We should add that in his reply Mr Farrell suggested (somewhat tentatively in our view) that the FTT had been wrong to take account of GN2 (which dated from 2011) and of VPGA4 (which dated from 2014) on the basis that that valuation guidance post-dated the transactions in question.

152. Mr Jones objected to Mr Farrell's submission. First, no objection had been made to using these materials before the FTT. Secondly, in his submissions before us and before the FTT, Mr Farrell had also relied on these materials as supporting his submissions. Thirdly, Nellsar did not have permission to appeal on this ground.

153. We agree with Mr Jones' submissions. It was far too late for this point to be raised and, in any event, permission to appeal had not been granted on this point and we did not understand Mr Farrell to be applying for leave to appeal on that issue. In any event, it seemed to us that the various versions of GN1, GN2 and of VPGA represented a gradual evolution in approach rather than a materially different set of valuation principles. GN2 and was an expanded version of GN1 whilst VPGA4 "entirely echoed" GN2: see FTT [129], [137] and [145].

154. Therefore, for the reasons advanced by Mr Jones, we see no grounds for impugning the Decision on this basis.

155. In the present case, Mr Farrell took us to parts of the evidence of Mr Lock, Ms Thorneagle and Mr Merris in order, in his submission, to demonstrate that the FTT's conclusion was not supported by the evidence before it. In our judgment, that exercise was deficient. It was necessary for Nellsar fairly to lay out *all the relevant evidence* before the FTT, both that which supported the FTT's conclusion and that which might be said to contradict it. In accordance with *Georgiou*, the criterion is that of *relevance* to the subject matter of the appeal. Otherwise,

a party basing its appeal on *Edwards v Bairstow* can simply put forward selectively only those parts of the evidence which it considers supports its case. In our view, Nellsar simply failed to put forward all the relevant evidence. Instead, Nellsar selectively cited those passages (mainly) of the oral evidence which it considered supported its case. That is simply insufficient to sustain an *Edwards v Bairstow* challenge. It amounts to a roving selection of evidence of the sort that was deprecated in *Georgiou*. If nothing else, for an appellant to be required to lay out all the relevant evidence will bring home to it an understanding of the formidable hill which must be climbed in order to succeed on an *Edwards v Bairstow* appeal.

156. Finally, although it does not form part of our reasoning, we merely observe that in relation to Sonya Lodge three different valuations setting out different market values were provided by the valuers at the time of its acquisition. Those valuations are summarised by the FTT at FTT [66]. All three valuations involved the use of Special Assumptions. The third valuation included four Special Assumptions, one of which was that the business was closed. It appears that reaching a market value on the basis of an assumption that the business was closed was not an unusual valuation technique.

157. Accordingly, we dismiss Nellsar's appeal on Ground 1.

158. As regards Ground 2, Nellsar argues that the FTT misconstrued FRS 7.9(a) and imported a valuation technique there was not prescribed by FRS 7.9. Mr Farrell accepted that Ground 2 largely overlapped with Ground 1.

159. Ground 2 appears to be a challenge to the FTT's finding of fact in relation to the correct accounting treatment i.e. what GAAP required in the circumstances. It follows, therefore, that Ground 2 also fails for the same reasons as Ground 1. In any event, we accept HMRC's submission that FRS 7 does not prescribe any valuation techniques but only principles, although it does recognise that valuation techniques may need to be applied (FRS 7.44). In addition, we note that Mr Farrell submitted that the fact that there were possible valuation techniques does not mean that they should be read into FRS 7.9 (a) without clear words. Mr Farrell cited FRS 7(43) in support of his case. However, as we pointed out at paragraph 139 above, FRS 7(43) supports HMRC's case by contemplating the use of valuation techniques in order to establish market prices.

160. We therefore dismiss Nellsar's appeal on Ground 2.

161. In relation to Ground 3, Mr Farrell argued that the FTT's conclusion was inconsistent with FRS 7.44 and paragraph "e" of the Summary to FRS 7. We note that FRS 7.44 was not referred to in argument before the FTT. Again, this is effectively an attack upon the FTT's findings of fact, viz the correct treatment under GAAP. In our view, for the same reasons given in respect of Grounds 1 and 2, Ground 3 falls well short of what is required under the *Edwards v Bairstow* principle. In relation to paragraph "e" of the Summary to FRS 7, this provision states:

> "Unless they can be measured at market value, the fair values of non-monetary assets will normally be based on replacement cost."

162. It seems to us that, rather than supporting Nellsar's argument, this paragraph contradicts it. As we read this provision, it indicates that it is only if the fair values of non-monetary assets cannot be measured at market value that the use of DRC is required.

163. We therefore dismiss Nellsar's appeal on Ground 3.

164. In relation to Ground 4(1), Nellsar argued that the FTT erred in concluding that its accounts were not GAAP-compliant and that, in any event, the allocation was just and reasonable.

165. Mr Farrell submitted that for the reasons set out in Grounds 1-3 the FTT had incorrectly concluded that FRS 7.9 required that the value of the properties had to be assessed by market value with assumptions being applied. Therefore, it was said, Nellsar was entitled to take the view that it was not appropriate to base the value on market value given the difference in type and condition between the hypothetical identifiable asset and the nature of the open market in operational care homes. FRS 7.9 was expressed disjunctively and therefore DRC was an appropriate method of calculation.

166. However, because Ground 4(1) is predicated on Grounds 1-3 and because we have dismissed Nellsar's appeal on Grounds 1-3, it seems to us that Ground 4(1) must also fail.

NELLSAR'S APPEAL - GROUND 4 (2)

167. In relation to Ground 4(2), Nellsar contend that the FTT erred in holding that the apportionment method adopted by Nellsar for corporation tax purposes was not just and reasonable. Nellsar relies on paragraph 105(3) of Schedule 29 which requires a "just and reasonable" apportionment in certain circumstances (which the FTT did not consider applied in this case).

168. In those circumstances, pursuant to paragraph 105 (3) of Schedule 29, where assets are acquired together:

> "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*." (Nellsar's emphasis)

169. Mr Farrell submitted that the FTT erred in preferring HMRC's argument that paragraph 5 of Schedule 29 took precedence over paragraph 105. To the extent that there were multiple possible methods of assessing value for the purposes of FRS 7.9, the FTT erred in concluding that Nellsar's accounts were not compliant with GAAP.

170. This ground of appeal is effectively a re-run of the argument that failed before the FTT.

171. The FTT dealt with this argument at FTT [202]-[203] as follows:

> "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."

172. We agree with the reasoning and the conclusion of the FTT on this point. In particular, we accept Mr Jones' submission, which was also accepted by the FTT, that the starting point of Nellsar's argument is the very premise which made its accounts non-compliant with GAAP in the first place i.e. the use of DRC as a valuation method. It would, therefore, be neither just nor reasonable to revert to the same incorrect method to arrive at a valuation under paragraph 105(3)(b).

173. Accordingly, we dismiss Nellsar's appeal on Ground 4(2).

NELLSAR'S APPEAL - GROUND 5

174. Nellsar's Ground 5 is that the FTT erred by rejecting Nellsar's apportionment of the consideration paid for the care homes for SDLT purposes as not "just and reasonable".

175. The relevant legislation (paragraph 4 of Schedule 4 to the Finance Act 2003) is set out at paragraph 22 above. Essentially, this provides that consideration attributable in part to a land transaction and in part to another matter shall be apportioned on a just and reasonable basis. In addition, paragraph 4(3) to Schedule 4 provides that where any consideration is given for what is in substance one bargain it shall be treated as given for all the elements of the bargain.

176. Mr Farrell submitted that even if Nellsar had not drawn up GAAP-compliant accounts, its allocation of the consideration in the agreements by which it purchased the properties was just and reasonable. In support of this submission, Mr Farrell cited the decision of the House of Lords in *Leedale v Lewis* [1982] STC 835. This was a case involving the apportionment of capital gains accruing to non-resident trustees of a settlement made by a UK domiciled and resident settlor. The statutory provision provided that the amount of any gain "shall be apportioned in such manner as is just and reasonable between persons having interest in the settler property…." The issue was how an apportionment was to be undertaken between discretionary beneficiaries. Lord Wilberforce said at page 843:

> "3. The words, in sub-s (2), 'in such manner as is just and reasonable' and 'as near as may be, according to the respective values of those interests' suggest a broad rather than an actuarial approach in which all relevant considerations may be taken into account. They permit (inter alia) consideration of the settlor's letter of intent which shows, at least, that the settlement was to be regarded as for the benefit of the grandchildren, not of the settlor's two children."

177. Lord Scarman expressed his view on the manner in which the apportionment was to be made at page 847:

> "The apportionment is to be carried out on a 'just and reasonable' basis so that 'the chargeable gain is apportioned, as near as may be, according to the

> respective values of those interests'. The governing words are 'just and reasonable': they confer on the inspector and the commissioners a wide latitude in judgment. The task is to apportion the chargeable gain, as near as may be, according to respective values. The language is apt to cover a valuation of interests where factors other than the market value of a property interest have to be considered.
>
> …
>
> For the purpose of valuation, the intention of the settlor, as evidenced by the deed and its recitals, is a significant factor to which value is to be attached to the extent that is just and reasonable and in a manner which, as near as may be, reflects the respective interests under the settlement. Further, the letter of intent, though not by itself of great weight, is admissible as supporting the intention manifested in the settlement itself."

178. From these passages, Mr Farrell contended that the meaning of "just and reasonable" meant that factors other than strict market valuations of respective interests could be taken into account, including the intention of the parties. A similar approach, Mr Farrell argued, was dictated by paragraph 105(3)(b) of Schedule 29 which, where the apportionment is otherwise than in accordance with GAAP, required the apportionment to be on a just and reasonable basis. The FTT had erred in not according to Nellsar a "wide latitude in judgment", in which all relevant factors could be taken into account, as indicated by Lord Scarman. Therefore, Nellsar was entitled to use figures which it did in its SDLT return, whether or not those figures complied with GAAP. Mr Farrell also referred to the decision in *Orsman v HMRC* [2012] UKFTT 227 (TC) ("*Orsman*") as authority for the proposition that a just and reasonable apportionment could reflect factors other than market values. The FTT had erred in law in not taking a broader approach of what was just and reasonable.

179. The FTT's consideration and conclusion on the "just and reasonable" apportionment issue in relation to SDLT is summarised at paragraphs 72-76 above.

180. We agree with the FTT's view (FTT [222]) that *Leedale v Lewis* "involved a very different legal and factual context" and is of little assistance in the present case. Phrases such as "just and reasonable" derive their meaning from the purpose and context of the statutory provision in which they are found and it cannot be assumed that the same words will have identical meanings in different statutory provisions. Moreover, we agree with Mr Jones' submission that there was nothing inconsistent in the approach adopted by the FTT in *Orsman* and the FTT's decision in this case. The FTT in the present appeal considered that an apportionment based on independent market values provided a more appropriate basis for an apportionment. The FTT in deciding that the apportionment should be based on the market values of the separate assets was coming to an evaluative conclusion which we consider was well within the bounds of what it was entitled to decide and that we should be hesitant to substitute our judgment for that of the FTT.

181. Therefore, we have concluded that Nellsar's appeal on Ground 5 should be dismissed.

HMRC'S APPEAL

182. HMRC appeal against the Decision on two grounds.

HMRC appeal – Grounds 1 and 2

183. As already discussed, the FTT decided that Nellsar's corporation tax amortisation allowances in respect of goodwill should be recomputed as if Nellsar had drawn up GAAP-compliant accounts where the acquisition price for the properties was based on market value, adjusted by special assumptions: FTT [218].

184. In the next paragraph (FTT [219]) the FTT said:

> "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."

185. However, in the immediately following paragraph (FTT [220]), effectively the paragraph which causes HMRC concern, the FTT said:

> "220. In view of the agreement referred to at [10] above [i.e. as to the role of the FTT – see paragraph 70 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."

186. HMRC's concern is that if the second part of FTT [220] is taken literally as requiring a special, counterfactual, assumption that there are "no current staff, residents, contracts, permits or other accoutrements of the business" and no chattels available, then this was an error of law. HMRC did recognise, however, that this paragraph may simply be repeating the uncontentious point that what must be valued is only the "identifiable asset" i.e. the land and building, without any other asset or accoutrement, rather than mandating the counterfactual assumption that the care homes were effectively closed and there were no chattels, staff etc. If understood in this latter sense, HMRC took no issue with FTT [220].

187. If, however, the FTT in FTT [220] was laying down counterfactual assumptions for the purposes of the valuations for corporation tax purposes, then HMRC in their second ground of appeal considered that that error also affects the FTT's conclusions on SDLT.

188. If we dismiss Nellsar's grounds of appeal and conclude that the fair value of the properties should be based on "market value" pursuant to FRS 7.9(a), then Nellsar submitted that HMRC's appeal should be dismissed on both grounds.

189. Having reviewed FTT [220] carefully, we consider that the FTT was simply emphasising the point that the asset which must be valued is merely the "identifiable asset". Paragraph 9(2) of Schedule 4A to CA85, which sets out "the acquisition method of accounting", requires 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."

190. In our view, the second half of FTT [220] is governed by the words "*valuing only the "identifiable asset" in each case, i.e. assuming there to be*", which strongly indicate that the words that follow simply define the identifiable asset.

191. We have already referred to the decision of this Tribunal in *Marlborough*. That decision also summarised the case law, which we did not understand to be in dispute, concerning the way in which an appellate court should consider a judgment which is under appeal:

> "80. Before examining the disputed passages of the Decision and the transcript of the hearing before the FTT, we should record that it was common ground that the authorities established a number of propositions. First, was the proposition that the Decision had to be read fairly and as a whole, not picking upon individual passages in isolation. Secondly, the FTT was under no obligation to deal with every submission or piece of evidence – to conclude otherwise would place an intolerable burden on the fact-finding tribunal. It was necessary only to deal with relevant evidence and submissions. Moreover, the mere fact that the FTT does not refer to a piece of evidence does not mean that the evidence was overlooked or ignored. Thirdly, there was a presumption that if the FTT correctly sets out the law it can be taken to have applied it correctly. Obviously, mistakes can be made and if it can be shown that the FTT did not apply the legal test correctly that presumption can be rebutted."

192. Read in context, we are clear that the second part of FTT [220] is simply referring to the identifiable asset. Having said in FTT [219] that it was not laying down assumptions to be applied by the Lands Chamber of the Upper Tribunal, to decide that it then contradicted itself in the very next paragraph of an otherwise carefully reasoned and meticulous decision would be a strange conclusion, which of itself suggests that it cannot be correct. As the Court of Appeal said recently in *A Taxpayer v HMRC* [2025] EWCA Civ 106:

> "It is well established that reasons given for a decision can always be better expressed, but that judgments and decisions should be read on the assumption that judges and tribunals know what they are doing unless they have demonstrated the contrary. In the same way I think a decision such as that of the FTT here should be read on the assumption that the FTT intended it to be rational, coherent and consistent unless one is driven to the conclusion that it cannot be so read."

193. Accordingly, we consider that HMRC's concerns regarding FTT [220] are unfounded and that their appeal on both grounds can be dismissed on the basis we have indicated.

DISPOSITION

194. We have decided that both Nellsar's and HMRC's appeals on all grounds should be dismissed. The Decision, which contains a meticulous examination of the facts and the law, discloses no error.

COSTS

195. Any application for costs in relation to this appeal must be made in writing and served on the Tribunal and the person against whom it is made within one month after the date of release of this decision as required by rule 10(5)(a) and (6) of the Tribunal Procedure (Upper Tribunal) Rules 2008.

MR JUSTICE MELLOR
JUDGE GUY BRANNAN

UPPER TRIBUNAL JUDGES

Release date: 3 June 2025

APPENDIX 1 – FINANCIAL REPORTING STANDARDS MATERIAL: EXTRACTS FROM THE FTT DECISION (USING PARAGRAPH NUMBERING FROM THE DECISION)

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 an individual company or other reporting entity combines with a business other than a subsidiary undertaking.

94. This statement provides a direct link back to the "true and fair view" requirements of the companies legislation, and also makes it clear that acquisition accounting applies to acquisitions of businesses (such as those involved in the present appeals), and not just to acquisitions of companies. In considering the terms of the FRS and associated commentary, however, it is important to remember that its primary concern (and the statutory foundation on which it builds) is to address the situation of groups of companies and their consolidated balance sheet.

95. As to the specific detail of acquisition accounting, this is set out in paragraph 20 of FRS 6:

> Under acquisition accounting, the identifiable assets and liabilities of the companies acquired should be included in the acquirer's consolidated balance sheet at their fair value at the date of acquisition… The difference between the fair value of the net identifiable assets acquired and the fair value of the purchase consideration is goodwill, positive or negative.

96. Acquisition accounting therefore proceeds on the basis of establishing "the fair value" of "the identifiable assets… acquired". For this purpose, a slightly amended definition of "identifiable assets" set out in CA85 (see [91] above, see also [101] below for the amended version) clearly applies.

97. The "fair value" concept is explored in detail in FRS 7 "Fair Values in Acquisition Accounting".

98. At this point, it is important to mention that FRS 7 (like the other FRSs under consideration) is expressly composed of several elements. There is a stated overall “Objective”, set out in paragraph 1. Some definitions are set out in paragraphs 2-3 and then paragraphs 4-31 contain the actual “Statement of Standard Accounting Practice”. There follow further paragraphs (32-85) which are said to comprise the “Explanation”. There is a hierarchy to these various sections. The core provisions are those in the Statement of Standard Accounting Practice, but those provisions are to be “read in the context of the Objective… and the definitions… and also of the Foreword to Accounting Standards and the Statement of Principles for Financial Reporting currently in issue.” The “Explanation” is to be “regarded as part of the Statement of Standard Accounting Practice insofar as it assists in interpreting that statement.”

99. The “Summary” at the start of FRS 7 (which has no particular status in the hierarchy referred to above) includes the following:

> *General*
>
> a Financial Reporting Standard 7 ‘Fair Values in Acquisition Accounting’ sets out the principles of accounting for a business combination under the acquisition method of accounting. Companies legislation requires the identifiable assets and liabilities of the acquired entity to be included in the consolidated financial statements of the acquirer at their fair values at the date of acquisition. The difference between these and the cost of acquisition is recognised as goodwill or negative goodwill…
>
> *Fair values of identifiable assets and liabilities*
>
> b The assets and liabilities recognised in the allocation of fair values should be those of the acquired entity that existed at the date of acquisition. They should be measured at fair values that reflect the conditions at the date of the acquisition.
>
> 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 nonmonetary 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.
> *f/n3[*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.*]*

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 should be determined in accordance with the acquirer's accounting policies for similar assets and liabilities.

Tangible fixed assets

9 The fair value of a tangible fixed asset should 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.

…

103. In the "Explanation" section of FRS 7, at paragraphs 42 to 44, further commentary is given, under the heading "Measurement of identifiable assets and liabilities", on the concept of "fair value":

42. Although the FRS contains specific requirements for determining fair values of different classes of assets and liabilities, the concept of fair value underlying the specific rules is the value at which the asset, or liability, could be exchanged in an arm's length transaction between informed and willing parties.

43. Where similar assets are bought and sold on a readily accessible market, the market price will represent the fair value. Where quoted market prices are not available, market prices can often be estimated, either by independent valuations, or valuation techniques such as discounting estimated future cash flows to their present values. In some cases, where quoted market prices are

not available, subsequent sales of acquired assets may provide the most reliable evidence of fair value at the time of the acquisition.

44. Where a fair value is based on a market price, it is important to ensure that such price is appropriate to the circumstances of the acquired business. For example, it may be possible to obtain a price for secondhand plant and machinery of the type used in the business, but the secondhand market may deal in very small volumes; or the items may not be identical in terms of the ability to obtain maintenance or technical support from the manufacturer or for the machinery to be customised to the requirements of the business. In general, unless the acquired business is genuinely able to consider the purchase of second-hand equipment as a viable alternative to purchasing direct from the manufacturer, the fair value of plant and machinery is more appropriately determined from the replacement cost of an equivalent new asset, depreciated where appropriate to reflect its age and condition.

104. Later in the same "Explanation" section, at paragraph 50 under the heading "Tangible fixed assets", the following further commentary appears:

50. Where reliable market values are obtainable – for example, for quoted investments and certain types of property – fair value would be based on current market values of similar assets. As explained in paragraph 44 above, for many types of fixed assets – for example most plant and machinery, and specialised properties *[f/n4]* specific to the business – fair value is represented by gross replacement cost reduced by depreciation to take account of the age and condition of the asset…

[f/n4] Whilst no definition of the phrase "specialised properties" appears in FRS7, FRS15 "Tangible fixed assets" imports the definition of that phrase from the RICS "Appraisal and Valuation Manual". The parties are agreed that nursing homes are not "specialized properties" within the meaning of that definition. It will be noted that the RICS guidance generally uses different spelling ("specialized") but we consider that nothing hangs on the difference. Where that guidance is quoted in this decision, the spelling follows the original.

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.

<u>APPENDIX 2</u> - RICS MATERIAL – EXTRACTS FROM THE FTT DECISION (USING PARAGRAPH NUMBERING FROM THE DECISION)

RICS Appraisal and Valuation Manual

116. Apart from the definitions referred to at [108] above, there was some other material contained in the RICS Appraisal and Valuation Manual (5th edition, issued 2003), colloquially referred to as "the Red Book", to which we were referred.

117. By way of introduction, it was explained to us that the Red Book consisted of two main elements, Practice Statements (compliance with which is mandatory for RICS members carrying out formal professional valuations) and Guidance Notes. The status of the Guidance Notes was set out in Part 1, Section 6, paragraph 6.9 of the Red Book as follows:

> The Guidance Notes explain how the Practice Statements should be applied to certain types of property, or in particular situations, by highlighting issues that are peculiar to the subject of the Guidance Notes, and discussing these in the context of the Statements. The Guidance Notes do not carry the same mandatory status as the Practice Statements. They describe the standard of work that is expected of a reasonable, competent surveyor experienced in the subject to which the Guidance Notes relate. They are provided as guidance to help the valuer.

118. In addition, it was specifically recognised that "there are situations and circumstances where valuers, exercising their proper professional skill and judgment, will not necessarily follow the Guidance Notes."

119. Thus a chartered surveyor would be constrained by the terms of the Red Book in carrying out a valuation, whether or not the valuation was for the purposes of a company's accounts. He or she would be required to comply with any relevant Practice Statements in the Red Book, but would be permitted to disregard any Guidance Notes to the extent that the exercise of proper professional skill and judgment allowed.

120. The parties were agreed that there is no specific guidance within the Red Book on undertaking valuations in accordance with FRS 7 in the context of business acquisitions. There was however a Practice Statement PS1 addressing "Valuations for Financial Statements". This provided (at PS1.1) as follows:

> **The bases of valuation**
>
> Valuations for inclusion in Financial Statements prepared in accordance with UK Generally Accepted Accounting Principles (UKGAAP) shall be on the basis of either:
>
> (a) **properties other than Specialized Properties:**
>
> Existing Use Value (EUV), as defined in UKPS1.3, for properties that are owner occupied for the purposes of the entity's business; or Market Value (MV), as defined in PS 3.2, for property that is either surplus to an entity's requirements or held as an investment;
>
> (b) **for Specialized Properties:**
>
> Depreciated Replacement Cost (DRC), as defined in PS3.3.

121. In the associated commentary, reference was made to FRS15 (and an earlier SSAP19 in relation to Investment Properties), and the equivalence of "Market Value" to the previous obsolete term "Open Market Value" as used in FRS15.

122. Existing Use Value was defined and commented on in PS1.3, which provided as follows:

> **Existing Use Value (EUV)**
>
> Valuations based on Existing Use Value (EUV) shall adopt the definition settled by the RICS. Existing Use Value is to be used only for valuing property that is owner-occupied by a business, or other entity, for inclusion in Financial Statements.
>
> Definition
>
> 'The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction, after proper marketing wherein the parties had acted

> knowledgeably, prudently and without compulsion, assuming that the buyer is granted vacant possession of all parts of the property required by the business and disregarding potential alternative uses and any other characteristics of the property that would cause its Market Value to differ from that needed to replace the remaining service potential at least cost.'

123. The definition [ ], differs somewhat from the earlier RICS definition which had been imported into FRS15, though neither party argued the differences were material for present purposes.

124. Paragraph 5.2 of the commentary under PS 1.3 said this:

> Any value attributable to goodwill should normally be ignored, with the exception of trade-related property (see GN1), where the element of goodwill that is reflected in the trading potential (that which is inseparable from the interest in the property) should be included in the EUV.

125. Section PS3 of the Red Book was headed "Valuation bases and applications". PS3.1 provided as follows:

> **Use of appropriate basis**
>
> The member must use a Basis of Valuation recognised by these Standards as being appropriate for the purpose of the valuation.
>
> **Commentary**
>
> This statement reinforces the mandatory nature of the Practice Statements and the mandatory use of the various bases of valuation.

126. PS3.2, headed "Market Value", provided that "Valuations based on Market Value (MV) shall adopt the definition, and the interpretive commentary, settled by the International Valuation Standards Committee." After that definition and interpretive commentary were set out, some additional commentary was added, which included the following at paragraph 6:

> There are certain categories of property designed or adapted for particular uses which change hands in the open market as fully operational business units for a strictly limited use at prices based directly on trading potential. The price will include trade fixtures, fittings, furniture, furnishings and equipment. This type of property includes: hotels, bars, some restaurants, movie theatres or cinemas, gasoline or petrol stations. In these cases the valuer will need to supplement Market Value with additional words clarifying whether the valuation assumes that the property changes hands as a fully-equipped, trading entity, or on some other Assumption or Special Assumption (see Appendix 2.2 and Appendix 2.3*[f/n7]*). Further information on this type of trade-related valuation is also contained within GN1.
>
> *f/n7 These Appendices were not included in the copy of Practice Note 3 included in our bundle.*

127. Guidance Note GN1, entitled "Trade-related valuations and goodwill", went through a number of versions over the relevant period. We were provided with versions from May 2003, September 2003, January 2006 and unknown dates in 2007 and 2008. In the 2006 version, its title was changed to "Specialized Trading Property valuations and goodwill", and for the 2007 and 2008 versions its name was changed again to "Trade related property valuations".

128. The introduction to GN1 remained largely the same throughout these versions. The following text shows the original version from 2003, with alterations made in the 2007 version (and carried through to the 2008 version) noted in italics:

1. Introduction

> 1.1 The commentary to PS3.2 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, movie theatres *[movie theatres replaced by "theatres" in 2007 version]* or cinemas, gasoline or petrol stations *["gasoline or petrol stations" replaced by "fuel stations" in 2007 version] [", and care homes" added in 2007 version]*. 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" added in 2007 version]* considers the additional criteria that need to be considered by the valuer in these cases. It *[". It" replaced by ", but" in 2007 version]* does not concern itself with methodology *["methodology" replaced by "methods of valuation" in 2007 version]*, which will vary depending upon the trading *["trading" deleted in 2007 version]* property to be valued.

129. There was fairly substantial revision of GN1 in its 2006 version compared to previous versions, and again in the 2007 version. The 2008 version appears unchanged from the 2007 version in all material respects. During the course of argument, we were referred by the parties to extracts from a number of the different versions for different purposes. Since the issues before us arose in relation to acquisitions which would have first been accounted for in accounts for the years ended 31 October 2004, 2005, 2006 and 2007, and since the various versions of GN1 show an evolution and development of the original guidance rather than any fundamental changes to it, we consider it appropriate to have regard to all of them. The only qualification we would add is that the concept of the "reasonably efficient operator" in valuing "Specialized Trading Properties" only became fully explicit and well-developed in the 2006 version of GN1, however we are satisfied that references in the earlier versions to "an average competent operator" were effectively intended to refer to the same underlying concept.

130. The introduction of the phrase "specialized trading properties" in both the title and content of the 2006 version of GN1 potentially caused confusion, which we infer was the reason for the phrase being dropped again in later versions. It will be recalled (see [108] above) that as early as 1999 (the date of adoption of FRS15), the Red Book had contained a separate definition of "specialised properties" which was adopted for the purposes of FRS15, and only 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 nontrading 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**
>
> 1.1Certain 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.
>
> 1.2This guidance note is of global application.

> 1.3This 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.
>
> 1.4Certain 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.
>
> 6.2The 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.

APPENDIX 3 - GN1 (2003) TRADE-RELATED VALUATIONS AND GOODWILL (RELEVANT EXTRACTS)

1. *Introduction*

1.1 The commentary to PS3.2 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, movie theatres or cinemas, gasoline or petrol stations. 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 considers the additional criteria that need to be considered by the valuer in these cases. It does not concern itself with methodology, which will vary depending upon the trading property to be valued.

2. *Identifying the operational entity*

2.1 The operational entity will usually comprise:

● the legal interest in the land and buildings;

● the Plant & Machinery, trade fixtures, fittings, furniture, furnishings and equipment;

● the trading potential, excluding personal goodwill, together with an assumed ability to renew existing licences, consents, certificates and permits;

● the benefit of any transferable licences, consents, certificates and permits.

2.2 *Consumables and stock in trade are normally excluded.*

2.3 The valuation of an operational entity necessarily assumes that the transaction will be of the property interest, together with all the equipment required to continue operating the business (it is assumed to be 'fully equipped'). In this context equipment includes Plant & Machinery, 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 will therefore not form part of the interest being valued. When valuing for Financial Statements the valuer must be clear whether equipment is classified as fixed assets or as consumables. 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.

2.4 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.

3. *Application of Market Value*

3.1 The valuer should distinguish 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. While the present operator will be one potential bidder in the market, to come to an opinion of value the valuer will need to understand the requirements and the achievable profits of all other potential bidders, and the dynamics of the open market.

3.2 It is necessary to qualify Market Value in order to make clear what is included in the valuation, and the Assumptions that have been made as to the property's trading status.

3.3 Where the property is trading the correct basis would be:

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

3.4 However, if the property is vacant following a cessation of trade, or if it is a new property with no existing trade to transfer, other variations may be required to describe this. For example, a vacant property is likely to have been stripped of all or much of its trade equipment, but could still be valued having regard to its trading potential. The correct basis here would be:

'Market Value of the empty property having regard to trading potential'.

3.5 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. Examples of Special Assumptions are given in Appendix 2.3.

4. *Trade-related potential and goodwill*

4.1 The trading potential that is attached to a property is sometimes referred to as ‘goodwill’. However, a valuation on the basis of Market Value should exclude any personal goodwill to the present owner or operator which would not be passed to a purchaser of the property.

4.2 The task of the valuer is to assess the fair maintainable level of trade and future profitability that could be achieved by an operator of the business upon which a potential purchaser would be likely to base an offer. 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 the existing owner or management. However, in contrast, the valuer should include any additional trading potential which might be realized under the management of an average competent operator taking over the existing business at the date of valuation.

4.3 Problems can sometimes be encountered in understanding and defining the goodwill attached to the land and buildings of a property by virtue of its circumstances, such as its location, design, planning rights, licence and occupation. This ‘inherent goodwill’ should be carefully differentiated from personal goodwill.

4.4 It is particularly important to be able to identify the type of person or entity that constitutes a potential purchaser of such a property (excluding a ‘special purchaser’). Generalizations can be dangerous and misleading. Consequently, it is essential for the valuer to have detailed knowledge of purchasers’ requirements in the relevant market and to have an in-depth appreciation of the market.

4.5 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.

4.6 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 of the underlying Assumptions supplied, the valuer should recommend verification.

4.7 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.

4.8 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 impact it might have on profitability and value.

4.9 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 by reference to trading potential.

4.10 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.

…