Valuation Background Paper

Wealth Tax Commission

Valuation of shareholdings in private companies

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VALUATION OF SHAREHOLDINGS IN PRIVATE COMPANIES

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1. Shares in private companies

Shares in private companies represent a bundle of rights: '...the congeries of rights and liabilities of which the share consists is a creature of the Companies Act and the memorandum and articles of the particular company'– as per Lord Macmillan in *IRC v Crossman; IRC v Mann (1936)*. The rights are usually contained in the Articles of Association, which is the contract between the company and its members (shareholders) and between the members *inter se*. The Articles are public documents which have to be filed at Companies House.

Some private companies also have Shareholders' Agreements which are personal to the named individuals who are party to them.

The rights attaching to shares can be very simple – such as the Director's ability to restrict a transfer of those shares – or they can be very complicated. The latter may be the case where the class of share is one of a number of classes and the value attaching to the class is dependent on economic returns and/or performance measures.

It is these rights for which regard must be had when valuing a shareholding for any purpose.

2. Tax valuations

Valuations are necessary for Inheritance Tax, Capital Gains Tax and Income tax.

Inheritance Tax (IHT) valuations are needed on transfers of shares on death, where someone dies within seven years of making a gift, in respect of chargeable lifetime transfers and in relation to some trusts e.g. on a ten year anniversary charge or where property is transferred out of the trust.

Valuations are needed for Capital Gains Tax (CGT) if a gift is made, or if a sale is made between ‘connected’ parties. In both cases the price is deemed to be equal to open market value (see 4.5 below). In some cases the cost of acquisition is not by reference to the actual cost but by reference to a particular date at which the asset was rebased. An asset acquired before March 1982 is usually rebased to its value at that date. Disposals of property-rich companies by non-residents are rebased to April 2019. There are also more esoteric occasions of charge under the CGT rules. For example, in relation to value shifting on transfers of share rights between shareholders. There is no actual disposal of property, but value is nevertheless shifted and CGT charges can arise.

Valuations are sometime necessary for Income tax purposes. For example where an employee shareholder is deemed to have received a benefit because he has paid less than the market value for the shares.

3. Non-tax occasions for valuation of unquoted companies/shares

Non-tax occasions for valuation of unquoted companies/shares occur:

(1) on the purchase and sale to a third party of the whole company or, less commonly, on the sale of a shareholding;

(2) on divorce or shareholder litigation; and

(3) for accounting purposes.

3.1 The purchase and sale to a third party of the whole company.

Corporate finance practitioners, investment banks and/or private equity houses may be involved as advisers for the purchase and sale to third parties of companies as a whole or the businesses within them.

It may only be the company's accountants and bankers involved if the valuation is for the purposes of what might be described as an internal event such as a management buyout.

In either case, apart from informing us about market transactions, this does not necessarily inform us with regard to the value, rather than price, of the many other businesses which are not for sale.

'Price is what someone pays for an asset; value is what he gets.'

Very often, the purchaser may not want all of the assets of the business e.g. the vendor company's office building. In this case, what is sold is not that which was held before.

In many cases, the purchaser will be able to make savings of overheads (synergistic benefits) or will receive benefits within its own business from the acquisition (complementary benefits), so enhancing the value of both businesses.

In other cases, a private equity concern acquires the business and then finances the acquisition with, sometimes, very substantial amounts of debt.

In my opinion, such sales do not necessarily provide evidence of comparable value, even for another company conducting the same business – although no two entities even in the same industry can be ever the same. An amount paid in an arms-length transaction represents the price paid for that business at that time.

At a particular point in time, Company A may be looking to acquire another business which has a contract with a customer with whom they wish to deal, or intellectual property (IP) which they wish to acquire. In order to prevent any other bids for Company B, Company A makes what it hopes is a shut-out bid. The sale goes through and the statistics from that very specific transaction is then added to the databases of multiples at which companies in that industry are bought and sold. In my opinion, that multiple is very specific to the circumstances of Company A's acquisition and not necessarily of wider relevance.

3.2 Divorce or shareholder litigation.

The valuations in these situations can be hotly contested, with experts for both sides differing widely in their views as to valuation of the entity as a whole or the particular shareholding. The reasons for this include:-

There is a wealth of case law relating to divorce valuations and those for shareholder disputes, which discusses bases of valuation for the company as a whole and the discounts appropriate to the size of shareholding and the specific matters to take into account, such as the dependence of the business on the founder or some other key individual.

However, divorce or litigation between shareholders are events to which specific individuals are a party and specific personal attributes are brought into play, e.g. on divorce, the extent to which the individual can influence board decisions, and in the case of shareholder litigation, whether or not that particular shareholder was a quasi-partner if he is a minority shareholder in a company.

Neither event is common enough and there, are too many special circumstances, for valuations to be derived from such litigation or settlements.

3.3 Accounting purposes

This may be in the context of the fair value of an entity owned by another company and so would appear not to be a useful reference point for a wealth tax for shares owned by individuals.

In addition, companies have to include a ‘cost’ in the profit and loss account of the company under Financial Reporting Standards IFRS2/FRS20 if employees have options over shares in that company. The valuation approach is prescribed by the relevant accounting standards and takes into account such personal matters as the possibility that the individual or someone in his grade of employment, will leave the business. This charge is then spread over a number of years. This basis of valuation would appear to be too specific to adopt as a valuation reference point for a wealth tax and is often different from the market value for those options agreed with HMRC.

3.4 Other

Valuations are also reported in other circumstances, such as when a venture capital house is reporting the value of a portfolio to its investors. There are International Private Equity and Venture Capital (IPEV) Valuation Guidelines for this purpose.

4. The existing background for share valuations

When considering the value of shareholdings, it is usual to arrive at the value of the particular company as a whole. Having done this, one then derives the value of the particular shareholding, which will be informed by the purpose for which one is valuing and the application or otherwise of any specific provisions in articles or a Shareholders' Agreement or any other circumstances which are to be taken into account.

In the UK there is no professional qualification required to undertake any form of valuation of companies/businesses or shareholdings.

In the US and Canada, there are bodies providing examinations and membership.

In the UK, the Institute of Chartered Accountants in England and Wales (ICAEW) has a Valuation Community which runs events for those interested in valuation, charging a membership to be part of that Community.

The Society of Share and Business Valuers was formed by volunteers some years ago but without secretarial support has not been able to develop in the same way as the Society of Trust and Estates Practitioners (STEP) who have developed exams etc. in order to provide a qualification in their specialisation to members.

The most distinctive body of valuers of unquoted shares is probably Shares and Assets Valuation (SAV), a specialist HMRC team that values shares in private companies as well as other assets such as goodwill, IP, bloodstock etc.

As noted at 3.4 above, the IPEV Valuation guidelines are used for reporting the values of investments held by private equity/venture capital entities.

The International Valuation Standards Council (IVSC), which was set up some years ago, has set out some common standards for valuation of unquoted entities.

The IVSC set out bases of valuation, including:

(a) Market value – more akin to valuations for tax purposes.

(b) Equitable value – perhaps more relevant for divorce or shareholder disputes (fair value not being referred to as this is now included in accounting standards).

(c) Investment value – relevant to the corporate finance type transactions, of actual sales and purchases.

(d) Synergistic value – again relevant to the corporate finance type transactions, of actual sales and purchases.

(e) Liquidation value – one assumes that this would not be the norm.

The IVSC then sets out approaches to valuation as follows:

- Market Approach
    - Comparable Transaction Methods

  - Guideline publicly traded comparable method
  - Other market approach considerations, e.g. valuation benchmarks
- Income Approach – Discounted Cash Flow or multiple of profits
- Cost Approach – historic replacement

The above are very similar to the guidelines given by the / British Private Equity and Venture Capital Association (BVCA). The interpretation also involves subjective judgements to be made by the valuer.[1]

For tax purposes, the basic rule was introduced in the Finance Act 1894 for estate duty. This is adopted in the IHT legislation and provides that:

> *...the value at any time of any property shall for the purposes of this Act be the price which the property might reasonably be expected to fetch if sold in the open market at that time.....* Section 160, Inheritance Tax Act (IHTA) 1984.

Certain changes arising by reason of death itself are ignored, e.g. life policies. Other matters arising as a result of death of the shareholder are taken into account such as the effect of the death of a shareholder on the future operation of the Company.

Also one cannot assume that the price is reduced if the whole of the property was put on the market at the same time.

Section 272 of the Taxation of Chargeable Gains Act (TCGA) 1992 for CGT purposes has very similar wording to that in section 160, IHTA 1984. The TCGA wording is specifically adopted for income tax purposes in the employment related securities legislation (see section 421, Income Tax (earning and pensions) Act (ITEPA) 2003).

The way in which the valuation statute is to be interpreted has been the subject of case law, dated from the late 19th century and continues to be discussed in current cases.

One of the fundamental differences between valuations for tax and other purposes is that, for tax, we assume that the parties to the transaction are hypothetical and that they acquire the shares to be valued but no more, e.g. they do not occupy the position of the actual owner, acquirer or disponor, as a director or employee or member of the family which owns the company.

The existence of the hypothetical purchaser for the purposes of valuation for UK tax purposes has applied since the 19th century and has been reaffirmed in case law this century, in *Grays Timber Products Ltd v HM Revenue & Customs* [2010] UKSC 4.

There is a second section of statute for tax valuations (in section 168 IHTA 1984 and section 273 TCGA 1992) which introduces an 'information standard' following the case of Lynall, which was heard in the House of Lords in 1972.

This legislation states that the information available to the hypothetical prudent purchaser is that which he could 'reasonably require'. In most commercial situations the information required is that of as much as possible but for tax purposes is assumed to be limited by reference

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[1] For further information about valuing businesses as a whole see Ryan, D. (2020), 'Valuation of businesses and intellectual property assets', *Wealth Tax Commission Background Paper*

to the size of shareholding and the weight of money, i.e. the holdings' likely value. The information standard is sometimes one of the areas of dispute with SAV. Sometimes they seek to interpret the words, "reasonably require", as a form of limitation but, in other cases, seek information such as that about the sale of a company which is information to which the purchaser of a small minority of shares in the real world might not be privy.[2]

However the statute is silent on the approaches to valuation, such as whether net assets, multiples of earnings or discounted cash flows should be adopted as the approach to valuation. This is something which has developed by way of experience amongst those who deal with valuation for tax purposes on a regular basis. It is influenced by the type of business but also by the preference of the practitioner. There are certain businesses such as property investment for which one would always have regard to the net assets basis of valuation but then might have more regard to a dividend yield basis of valuation to value small minority holdings of shares in such companies.[3]

[2] See Pentelow, L. (2020), UK tax valuation and potential wealth tax, *Wealth Tax Commission Background Paper*, 146.
[3] See Pentelow (2020).

5. Brief overview of the issues arising in the valuation of an unquoted company and its shares for tax purposes[4]

5.1 Trading companies/businesses

Many unquoted companies do not have budgets for, say, more than one year, if at all. It is therefore almost impossible to undertake a valuation based on discounted cash flows which require some form of projection into the future.

However, if one bases the valuation of the entity as a whole on a multiple of profits, one has to take a view as to the future trend of those profits to determine the multiple to be applied to them. This is a subjective judgement and is the major issue particularly when valuing growth shares (see 8.1 below) where the value attaching to such instruments is dependent on a view of the future.

There are also choices as to which measure of profit to adopt – should this be EBITDA (earnings before interest, tax, depreciation and amortisation), EBIT (earnings before interest and tax), profits before tax or profits after tax. The profits might also be those achieved historically, current or prospective.

In many cases, the profits of the owner-managed business may not reflect an investor's return. There may not be a full commercial charge for the owner manager's services because he or she chooses to draw dividends (paid out of post-tax profits) rather than a salary (paid out of profits before tax). This might be one reason why a formulaic approach to valuation which adopts the profits reported in accounts would be inappropriate. In addition, the profits shown by the accounts of an unincorporated entity, be it a sole trader or a partnership, do not include any costs for the proprietor or partners' time engaged in making those profits. There may be other exceptional income or profits in some years, but the effects of this may be neutralised by a formula which included the average of a number of years' profits.

And what if a company is making losses? A formula based on a multiple of profits (to be defined), would imply a zero value.

In many of the valuations challenged or looked at by SAV, agreement is reached as a result of 'horse-trading' by which the case is settled to the 'dissatisfaction' of both parties.

5.2 Property investment companies

If the company is that of property investment or otherwise asset based, one usually has regard to the underlying net assets, including the investments at market value.

Under the current accounting standard, FRS 102, which affects all but micro entities, a provision now has to be included in the annual accounts for the full charge to corporation tax on the chargeable gain which would arise on the sale at market value of the property. The market value is also included in the accounts. That tax liability may not arise for many years. SAV tend to take account of this by suggesting that all but a small percentage, say, 10% of the liability to tax,

4 See Wealth Tax Commission Background Papers on Valuation for tax purposes and for non-tax purposes

should be added back to the net assets. There is inconsistency of treatment in this regard as some taxpayers 'get away' with having the value of their shares based on the net assets after a full deduction of the tax, i.e. those as shown in the accounts, whereas others are challenged.

6. Valuation of shareholdings in unquoted companies

For tax purposes, in particular, but also in a number of actual purchases and sales of shareholdings, the value of a shareholding will be arrived at after the application of a discount applied to the underlying pro rata value of the share.

The pro rata value is calculated as a share of the value of the whole, e.g. the value of the whole is £1 million there are 1,000 shares in issue so the pro rata value per share is £1,000 (£1 million ÷ 1,000).

Where there are a number of classes of shares in issue, the sums may be more complicated to arrive at the pro rata value of the particular class of share.

In the case of majority holdings, the discounts which are accepted as a matter of practice for tax purposes are as follows:

% Holding	Discount from pro-rata value per share
90% +	0 - 5%
75% to 90%	0 - 5%
50% plus	5% - 15%

These take account of the theoretical nuisance factor of the existence of the other shareholdings.

However, in any commercial situation, where the value of a majority holding is in issue, it is more likely that the holder will seek to attach a premium rather than a discount to the holding.

In the case of the valuation of a minority shareholding, the discounts reflect the lack of control and marketability of it. The latter reflects the extent to which it can be expected to be transferable or saleable.

Some valuation specialists specifically apply two discounts, one for lack of control (DLOC) and one for lack of marketability (DLOM). This practice is informed by studies which have been carried out in the US. However, I understand that these have been undertaken having regard to surveys covering the values of restricted stock which are not the same as minority shareholdings in unquoted companies.

Most practitioners apply one discount for both the lack of control and marketability. For a shareholding of, say, up to 15% in an unquoted company, the discount might be anywhere between 70% and 80% or sometimes more, depending on the circumstances. Such levels of discount, however, assume that returns in the form of dividends or capital are not foreseeable. If a sale is in prospect, the discount may be minimal.

The discount will be less if dividends are received, in which case the value would be arrived at using a dividend yield. Since private companies are not subject to the factors which govern quoted company yields, one has to consider the yield by reference to the facts relating to the actual company. It would be impossible to prescribe a formula for the yield, which is a function of many things such as the cover for the dividend, the risk attaching to its payment. A dividend yield is not an appropriate approach for the valuation of a majority holding. It is also not appropriate where a dividend is paid to the shareholder, not as an investor return, but in lieu of remuneration.

Although tables of discounts are published from time to time by various authors, one cannot adopt those discounts without considering the circumstances of the particular company and its shares and the purpose of the valuation.

7. Example: The effect of the minority holding discount

Company A is worth £1 million and has 10,000 shares in issue. The underlying, or pro rata, value per share is £100 (£1 million ÷ 10,000 shares).

Mr A owns all the shares. His shareholding of 100 shares is therefore worth £1 million.

Mr A gives shares to his wife – exempt to charge for IHT and CGT – although, assuming that Company A is a trading company which qualifies for Business Property Relief (BPR), Mrs A would lose this relief until she had held the shares for two years. Mr A also gives shares to trusts and his children. There may be tax consequences arising from those transfers.

The shares after the gifts are held as follows and each shareholding as a minority is worth the following:

	After gifts holding	Discount to value per share of £100 %	Value of holding as a minority £
Mr A	2,500	50%	125,000
Mrs A	2,000	60%	80,000
Trust 1	1,500	70%	45,000
Trust 2	1,500	70%	45,000
Child 1	1,250	70%	37,500
Child 2	1,250	70%	37,500
	10,000		£370,000

Effectively the family holdings now have a value of £370,000, held individually as minority holdings, although the family wealth might be suggested to be the value of the whole company, i.e. £1 million.

For IHT purposes, the value of Mr and Mrs A would be treated as related property and both valued as part of a 45% shareholding. If that is taken into account, the discount would reduce to, say, 20%, resulting in additional value to that in the table above of £110,000. This increases the 'family value' to £480,000 (£370,000 + £110,000).

There are tax and commercial consequences of giving away shares. For tax purposes, under current rules for CGT, there may be some aggregation of the number of shares given away. Mr A may not wish to lose voting control. He could do this by appointing himself as a trustee of the two settlements. If he did this, subject to the agreement of the other trustees, he effectively still controls 55% of the voting rights.

Under the current law, trustees are taxed as a separate body of persons and there is no aggregation for tax purposes of the holdings of an individual with those in a trust or trusts of which he or she is a trustee.

It may also be the case that the shareholdings in the table at 7.3.1 above have been held in that way for many years. There might need to be a differentiation in treatment between the circumstances of one where the shareholdings were ‘arranged’ as suggested above, perhaps on incorporation of a new company or by way of gift, and where the same shareholdings were held as a result of historical circumstances.

The application of discounts to arrive at the value of minority holdings of shares is a common practice for tax valuations. They are also often applied to the commercial sale and purchase of individual holdings of shares in unquoted companies.

It might be considered that, if there has been a transaction in the shares of a company, this should inform the value of other shareholdings. However, the price which is attached to shares can vary significantly depending on the circumstances of, and who are, the actual parties to the sale.

It is also the case that an agreed value with SAV for tax purposes at or near the time of another charge to tax is not binding on the second tax payer nor on SAV although it would be odd if SAV did not agree something similar for similar sizes of holdings of shares, unless circumstances had changed significantly between the two dates.

In the corporate finance and private equity environment, the value of shareholdings is usually referred to without the application of a discount for the size of holding. The approach is that of buying and selling companies/businesses as a whole and/or raising funds for investment at a subscription price which is not discounted.

8. Ways of altering value

As noted at 1 above, a share is a bundle of rights and liabilities.

Value can be transferred or removed by creating different classes of share. There may be a tax charge on transferring the rights but this is not necessarily always the case and can be difficult to quantify.

Deferred shares: A class of share might be created/exist which becomes entitled to all the votes and the economic entitlement in, say, 10 years' time (often called deferred shares). If we assume that the company owns a farm, it would appear that the ability to obtain the right to those assets has a value, and possibly a significant one, even ten years before the economic entitlement resides in the deferred shares, as a farm may be less likely to go into liquidation than many other types of business.

If the other class of share, say, ordinary shares, has an entitlement to all the votes and rights to dividends in the intervening ten years but cannot liquidate the company, it would appear that the deferred shares will have a value in ten years' time. There must be a current value attaching to them, although this would be discounted for time and some risk. However, if the ordinary shares can, in the intervening period, realise the property and pay out the proceeds as dividends, what would be left for the deferred shares?

This may not be the action which the family would actually take but, based on the case law for tax purposes, which assumes that the parties to the transaction are hypothetical, it could be argued that the hypothetical prudent purchaser would assume that he would never receive value in his deferred shares. He would assume that the actual holders of the ordinary shares would sell the properties and pay out the profits as dividends in order to maximise their returns before the period begins when the value resides in the deferred shares which he, as the outsider, is now deemed to own. In reality it would be said that the deferred shares have value but because we have to assume a hypothetical purchaser, it can be argued that they do not.

8.1 Growth shares

As a result of the introduction in 2003 of the amended statute relating to shares awarded to employees, what are commonly known as 'growth' shares are often made available to employees. They are so named as the share becomes entitled to value, for instance, when the company has increased in value or another class of share has achieved a certain return. The growth shares will be dependent on the future prospects of the particular company. Often, value does not accrue to the growth shares until a 'hurdle' value in excess of the current value of the company has been achieved, which might be defined by an absolute amount or percentage growth.

Many advisers were of the view that, at the time of the creation of growth shares, all the value attaches to the existing shares. The growth shares must therefore have no value at the date of issue to the employee. This may in fact be the case because of the risks attaching to the business.

There is no accepted way to value these shares which must be dependent on one's view of what will happen in the future. Some consider that the shares are in the nature of options but the only traded options, which might be said to be similar, are in the quoted market and the formulae used to attribute value are based on much shorter time periods than that for which an unquoted share is usually held. In addition, there is a fundamental difference between an asset, the quoted instrument, which is freely marketable, and the unquoted shareholding, which is not marketable.

Currently there are significant differences of opinion about and approaches to the value of growth shares between SAV and practitioners.

9. A formula for valuation

A formula may seem to be attractive but there will always be circumstances where this is inappropriate.

When drafting provisions in articles or Shareholders' Agreements relating to the valuation of shares, e.g. when an individual leaves the employment of the company or offers his shares under the pre-emption provisions, advisers sometimes suggest a formula to arrive at the value of the company as a whole. However, invariably, whatever formula is deemed to be appropriate at the time of its creation becomes inappropriate as the life of the company evolves.

A formula adopted in Switzerland provides that, for the purposes of Swiss Wealth tax, the valuation of an unlisted company can be arrived at using two methods.

The first method is by reference to the net asset value.

The alternative formula for the valuation of shares in unlisted Swiss holding companies states that the company's value results from the sum of:

a) the net asset value

b) the double-counted capitalised earnings value

c) the sum of a) and b) then being divided by 3.

The shareholding would then be found by reference to the value of the whole company and discounted as described above.

By way of illustration, there are 4 scenarios below:

Property investment company:

Conventionally the value of property investment companies are arrived at by reference to the net assets. This would therefore fall within the first method above and the alternative formula would be inappropriate. If the accounts do not include the current market values of the properties or other investment assets, there will need to be an adjustment to the net assets per the balance sheet.

Trading company A:

This company has net assets of about £2 million and makes low returns on its capital employed, of say, £80,000 post tax profits.

Under the alternative formula above, the net assets are £2 million (as per (a) above). However if there is a value for goodwill included in the net assets, this should be deducted as it reflects an historic rather than current value.

The capitalisation of the earnings might result in a value of no more than £500,000 (about six times the post-tax profits of £80,000). This is double counted to result in the input at (b) above being £1 million, i.e. double counting of £500,000.

The sum of £2 million (assuming there is no goodwill) plus £1 million is £3 million, which is divided by 3 (see (c) above), to give a value for the company as a whole of £1 million. This may arrive at a value which is lower than that which one might arrive at without adopting a formula.

The application of the formula takes no account of the fact that the net assets might include some which are surplus to the requirements of the trade.

Trading Company B:

There are net assets of £500,000 and the profits after tax are £1 million per annum.

Under the formula above, the net assets are £500,000 (as per (a) above).

The capitalisation of the earnings might result in a value of, say, £8 million (8 × the post-tax profits of £1 million). This is double counted to result in the input at (b) above being £16 million, i.e. double counting of £8 million.

The sum of £500,000 plus £16 million is £16.5 million, which is divided by 3 (see (c) above), to give a value for the company as a whole of £5.5 million.

Again, the value may be lower than that which one might otherwise attribute to Company B.

Trading Company C:

This company has not yet started to make profits. It has recently raised funds from High net worth individuals of £10 million for 30% of the shares of Company C..

As a result of the investment, Company C now has net assets of the order of £10 million (as per (a) above).

It has no profits so there is no value by reference to the application of the capitalisation of profits (see (b) above).

The value might therefore be £10 million under the first method above, the net asset value, or £3.33 million if the formula at (c) applied.

The reporting to investors after the investment of £10 million would probably refer to a value for Company C as £33 million, on the basis that 30% of its shares have just been acquired for £10 million (£10 million ÷ 30%).

Would the formula be overruled by or overrule the implied value in the report which the investor receives from the nominee? The report to investors also does not include any discount for minority holdings.

10. Agreements of, and challenges with regard to, values for tax purposes

For tax purposes, valuations are referred direct to SAV by taxpayers or their representatives or may be referred from elsewhere in HMRC as follows:

For CGT: by HMT (Inspector of Taxes)

For IHT: by IHT department

For ERS: if for 'favoured' purposes (Enterprise Management Incentives or Company Share Option Plans) and valuation requested in advance of the transaction, most valuations are accepted, subject to caveats, on the basis that 80% to 90% of the options are never exercised and therefore the risk levels are low. This rate of acceptance cannot be extrapolated to valuations for employment related securities (ERS) which have already occurred but no value has been agreed.

In all cases, as I understand it, a risk assessment is carried out to decide which cases to refer to SAV by other parts of HMRC and, within SAV, in order to decide on the cases to be challenged.

The main areas of challenge by SAV currently relate to circumstances where tax will be payable. The main circumstances for holdings of private company shares include the following:

(a) For IHT where business property relief is not available, e.g. for shares in a property investment company, or there are excepted assets, such as cash not used for the trading activity, about which there can be some dispute.

(b) For CGT if the price paid was not at arm's length and market value has to be agreed.

(c) Shares issued to employees where SAV are of the view that the amount paid was less than the market value

For IHT purposes, trading companies usually receive favourable treatment from business property relief and are therefore not subject to any charge to IHT.

The areas of dispute for IHT and CGT purposes relating to property investment companies include the following:

(a) disputes about the value of the properties, which are referred by SAV to the VOA (Valuations Office Agency)

(b) the percentage deduction of the liability to tax on the disposal of the properties (see 5.2 above)

(c) the discounts for minority holdings applicable to the size of shareholding

(d) if dividends are paid, the dividend yield applied.

The value of trading companies is often the subject of challenge by SAV in the following situations:

(a) the incorporation of a trading activity

(b) the award of employee shares. Any benefit arising from the latter is often taxable at the higher rate of income tax and therefore can be expected to be challenged, particularly in the case of growth shares where there cannot be a 'correct' answer.

The challenges include:

(a) The profits and adjustments to be made to these, e.g. of a commercial charge for directors' remuneration.

(b) The multiple applicable to the profit.

(c) The assumptions underlying the future potential of the business. This is particularly relevant in arriving at the value of growth shares, which is entirely dependent on future outcomes. The opinions as to the level of risk attaching to businesses, which have not yet proved their model or are subject to competition etc., can vary significantly between the taxpayer and HMRC. In addition, the discount, if any, applied to the holding may be challenged.

The time taken to agree valuations with SAV can be years if there are entrenched positions or there is a point of principle which HMRC wish to uphold. This may reflect differences of opinion of methodology, inputs to the methodologies, the discount, the meaning of the rights attaching to the shares etc. The case may also depend on the amount of tax which might be at stake.

Settlement of cases with HMRC: It would probably be true to say that at least 90% of the valuations currently referred to SAV are agreed or settled within perhaps six months. However that reflects the current profile of cases submitted and the reliefs available to many of them. Even though business property relief is available for trading companies for IHT purposes, a valuation has to be submitted and the relief claimed. If this is included within the statistics of agreed valuations, this would be misleading for the purposes of a wealth tax which might have no reliefs against value.

Extract from the Fiscal Valuation Forum Minutes of 8 October 2018 (no meeting held since then):

> *Year ending March 2018: 12,212 valuations received, 12,335 settled.*
>
> *Achieved yield of £230m (£190m in 2016/17) and a cost/yield ratio 74:1.*
>
> *Post - 15 day 80.07% target, 80% met; 40 day 98% target 90% met.*
>
> *6 months to end September 2018 - 6,348 valuations received, 6,503 settled.*
>
> *Yield of £331m cost/yield ratio of 204.1.*
>
> *Post - 15 day 89.8% target 80%; 40 day 97.5% target 90%.*

Of the approximately 12,000 valuations received in the year ended 31 March 2018, about 6,000 of these were for EMI purposes (Enterprise Management Incentive schemes, which are favoured schemes for providing shares to employees in the companies in which they work). EMI valuations can be submitted to SAV prior to the options being granted under the EMI schemes. The valuations tend to be agreed quickly and easily but I believe that this is because it is considered that up to 80% or 90% of those options are never exercised so it is not efficient to spend time arguing about the values. SAV may be less ready to agree the value of small minority holdings of shares when an EMI valuation is submitted for approval after the option has been exercised. This may be an infrequent occurrence but does arise from time to time.

There is always a delay between the submission of a value to HMRC for IHT or CGT purposes and receipt of any enquiry which might be made by SAV. HMRC may take up to 12 months from the date of the submission of the return before making a CGT enquiry. In the case of IHT, the referral of cases to SAV seems to be rather slow, a time period of at least six months.

As noted above, at present, SAV manage about 12,000 valuations a year, not all of which are given detailed attention, having gone through a risk assessment process. Of these, approximately half, i.e. 6,000 cases, are for an event which may not occur, i.e. the options granted under an EMI scheme are never exercised.

There were 4.3 million companies recorded as registered at Companies House in March 2020, of which less than 2,000 are those quoted on the Stock Exchange. There are 850 companies listed on AIM.

Some of the 4.3 million companies may be no more than a shell.

However, even if half of them, say, 2 million companies, have some value and there is more than one shareholder in each company (and many companies have many shareholders and different classes of share), there may be many thousands of valuations which would have to be considered on a single date for a tax such as a wealth tax.