TC03586

Appeal number: TC/2010/06391

FIRST-TIER TRIBUNAL
TAX CHAMBER

CGT – valuation of goodwill in accounting practice –March 1982 deemed disposal valuation - calculation by reference to "client book" or "whole practice" taking account of net assets – market valuation – valuation on sale in 2003 – consistency of approach – valuation method to be used - multiple to be applied – held – "client book" accepted as most appropriate valuation method for accountancy firms – multiples for 1982 and 2003 adjusted- appeal allowed in part.

GRAHAM MICHAEL WILDIN **Appellant**

- and -

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

TRIBUNAL: JUDGE RACHEL SHORT
MR JULIAN STAFFORD

Sitting in public at 45 Bedford Square, London WC1 on 17 - 20 February 2014

Mr Wildin representing himself as the Appellant

Ms Hui-Ling McCarthy instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents

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DECISION

This is an appeal against a capital gains tax charge of £83,701.60 on the disposal by Mr Wildin of his share of the goodwill in his accountancy practice in April 2003.

Background Facts

1. Mr Wildin acquired his practice, Wildin & Co, in July 1981 as the result of his resignation as a partner in the accounting practice of Kingscott Dix and Co. At that time £100,000 of clients were transferred to him, being the clients of the existing Lydney office of Kingscott Dix. Mr Wildin commenced trading as a sole practitioner with his new firm on 1 July 1981.

2. Mr Wildin's new firm attracted a standard mixture of clients, doing approximately 58% general accounting work, 30% audit and 12% other types of accounting work and grew on the basis of Mr Wildin's contacts in the local area. Clients were billed at the end of their accounting year, which for most of Mr Wildin's clients was April – June, which were the busy months of the year. The firm had no particular "niche" clients; its client base was and remained typical for a small local accountancy practice. At the time of the transfer of the clients of the Lydney office to Mr Wildin, all existing billable work in progress was billed to the end of June 1981.

3. Wildin & Co moved to a new building in the centre of Lydney in November 1981 which gave an additional impetus to the growth in the business. Mr Wildin estimated that this gave rise to fee increases of approximately 70%. Wildin & Co's fees earned for the year ended June 1982 amounted to £98,498. Mr Wildin's drawings for 1982 were £14,000. As at 30 June 1982 fee notes for £105,000 had been raised.

4. Mr Wildin increased the size and profitability of Wildin & Co over the years and by 2003 the firm had one other partner and approximately 30 staff members with 1,500 clients. Mr Wildin worked long hours, starting at 5am and finishing at 5pm seven days a week. Mr Wildin transferred his share of the business to Wildin & Co (Accountants and Financial Advisers) Limited on 1 April 2003. At that time the goodwill in the practice was valued at £1,650,000 of which Mr Wildin's share was 84.85% following a transfer of 15.15% to his business partner Mr Lewis shortly before the disposal to the company.

5. Mr Wildin's self assessment return for the 2002 – 2003 tax year stated that the capital gains arising as the result of his disposal of the goodwill in Wildin & Co amounted to £21,505. HMRC made an amendment to this self assessment on the basis that the correct capital gains tax charge on Mr Wildin's disposal was £230,759. A closure notice was issued by HMRC on 22 April 2010 which Mr Wildin appealed against on 26 April 2010. HMRC undertook a statutory review which confirmed their original decision and notified Mr Wildin on 9 July 2010 and Mr Wildin appealed to this Tribunal on 3 August 2010.

The issues in dispute

6. The dispute between the parties centres on the correct method for valuing the goodwill in Wildin and Co to establish its base cost under the deemed disposal rules in March 1982 and its value on actual disposal in April 2003.

7. The initial matter under appeal concerned only the 1982 valuation of the goodwill in Wildin & Co, but as a result of Mr Wildin's request to amend his grounds of appeal and pursuant to Directions issued on 12 December 2011, Mr Wildin also disputed the 2003 valuation of the goodwill in Wildin & Co and HMRC withdrew their earlier agreement to the 2003 valuation of £1.4 million.

8. It was not disputed that the goodwill of Mr Wildin's practice was an asset for capital gains tax purposes, that the deemed disposal rules applied to establish its base cost in March 1982 or that it was disposed of by Mr Wildin in April 2003 and that the burden of proof lies with Mr Wildin to demonstrate that the assessment made by HMRC is not correct.

9. The table below sets out the basis on which Mr Wildin and HMRC have calculated the capital gains tax on Mr Wildin by reference to both the value of the goodwill in Wildin & Co in March 1982 and on disposal in April 2003.

1982 valuation	Mr Wildin	HMRC		Comments
1982 GRF	£147,697	£108,774 minus net assets		
1982 multiple	3.5	1		
1982 CGT base cost (total)	£516,940	£75,000		
1982 CGT base cost	£438,624	£63,638.		Mr Wildin's 84.85% share

2003 valuation	Mr Wildin	HMRC		
2003 GRF	£1,056,540	£833,000		Weighted average fees per Appellant
2003 multiple	1.5	0.88		HMRC's "whole practice"

				valuation
2003 CGT disposal value	£1.585m	£740,000		Reflects alteration in position post December 2011 directions.

Tax Payable	Mr Wildin	HMRC		
	£8,602 on gain of £21,505	£83,701 on gain of £230,759		Including other available reliefs.

The Law

10. The relevant legislation relating to the capital gains tax treatment of goodwill is set out in the Taxation of Chargeable Gains Act 1992 ("TCGA"):

11. S 38 TCGA applies to determine the acquisition and disposal costs of capital assets:

> "(1) *Except as otherwise expressly provided, the sums allowable as a deduction from the consideration in the computation of the gain accruing to a person on the disposal of an asset shall be restricted to-*
>
> *(a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition or, if the asset was not acquired by him, any expenditure wholly and exclusively incurred by him in providing the asset,*
>
> *(b) the amount of any expenditure wholly and exclusively incurred on the asset by him or on his behalf for the purpose of enhancing the value of the asset, being expenditure reflected in the state or nature of the asset at the time of the disposal, and any expenditure wholly and exclusively incurred by him in establishing, preserving or defending his title to, or right over, the asset.*
>
> *I the incidental costs to him of making the disposal."*

12. S 35(2) TCGA sets out how the base cost of assets held at March 1982 and disposed of after April 1988 is calculated:

> "(2) *in computing for the purpose of this Act the gain or loss accruing on the disposal it shall be assumed that the asset was on 31st March 1982 sold by the person making the disposal, and immediately reacquired by that person, at its market value on that date"*

13. S 272 TCGA provides the meaning of market value for capital gains tax purposes:

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

This is further clarified by s 273 in respect of unquoted securities:

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

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

The Evidence

14. The Tribunal was given witness statements from Mr Wildin and Mr Smith for the taxpayer and Mr Roland and Mrs Hennessey for HMRC, all of whom also gave oral evidence and were cross examined.

15. All parties referred extensively to statements made by Jeremy Kitchin in his website publication "Accountancy Practice Mergers and Acquisitions" (APMA) including that "*goodwill represents the difference between the overall business valuation, (arrived at on an on going basis) and the aggregate book value of the individual net assets carried in the balance sheet"*.

16. HMRC and Mr Wildin provided different interpretations of a number of statements made by Mr Kitchin on this website.

17. HMRC produced a formula, on the basis of this statement which they said represented the way of establishing the value of goodwill in an accountancy practice, which had to be derived from the "whole practice value" This was set out in two ways depending on the multiple of fees that was known. M1 was the multiple to be used to calculate goodwill and M2 was the multiple to be used to calculate total practice value:

M1 x [Gross Recurring Fees] = Total Practice Value – net assets.

Total Practice Value = [Gross Recurring Fees] x M1 + net assets.

M2 Goodwill = [Gross Recurring Fees] x M2 – net assets

18. In contrast, Mr Wildin suggested that goodwill in an accountancy practice was established simply by applying a multiple to the value of the firm's "gross recurring fees", with no adjustment or reference to the net assets of the firm. This is effectively the "M1" multiple.

Mr Smith – Expert Witness.

19. Mr Smith is a senior consultant at Foulger Underwood Associates Limited, specialist brokers in professional service firms. He stated that his experience included 50 professional practice sales at Foulger Underwood and 3 partnership goodwill disputes. Mr Smith confirmed that he had been instructed to look only at the goodwill valuation of Wildin & Co.

20. As a preliminary matter in response to questions from Ms McCarthy, Mr Smith agreed to strike out two comments in his witness statement relating to the valuation of goodwill in 1982 and the multiples which were relevant to accountancy practices in 1982. Mr Smith accepted that he had no records going back to 1982.

The 1982 Valuation

21. Mr Smith gave his view of the state of the accountancy market in 1982. At this period accounting firms were generally profitable, mainly because they operated in a less regulated market than subsequently. Mr Smith confirmed that in his experience most accounting firms were valued by reference to their client book; any other assets held by the firm were often of negligible value and were generally not transferred as part of the business. If they were transferred it would be as part of a separate purchase agreement. Mr Smith said that there were key differences in valuing professional services firms and unquoted corporate entities. In response to HMRC proposed method of valuation as set out by Mrs Hennessey he said categorically "*I have been involved in accounting market transactions for more than twenty years and have never seen a valuation of goodwill done in the manner carried out by HMRC*". Mr Smith said that in the current market (2014) small professional service firms were being sold on multiples of "Gross Recurring Fees" (the client book) with multiples of 0.9 – 1.5, but in 1982 multiples of 2.0 – 3.0 were not unusual.

22. Mr Smith explained that the profit of a particular accounting firm was not a definitive measure of its value because the same turn over could produce different profits depending how a firm was managed, including how hard each partner worked and how efficiently they used their assets.

23. When questioned by Ms McCarthy Mr Smith agreed with the internal logic of HMRC's M1 and M2 examples, but stressed that in his view the Jeremy Kitchin statements on the APMA website did not support HMRC's approach. Mr Smith accepted that HMRC's approach was *an* approach to valuing goodwill, but did not accept that it was one which was used in practice or necessarily one which gave the most accurate valuation.

24. Mr Smith did disagree with Mr Wildin's inclusion of his additional work in progress figures in coming to his goodwill valuation for 1982, which he thought did amount to double-counting. He said that the correct approach was to value work in progress by taking the difference between the opening value for goodwill and its value at the end of the previous accounting period, which he said gave a work in progress figure of £24,616 for 1982.

The 2003 Valuation

25. As far as the 2003 valuation of Wildin & Co was concerned, Mr Smith had been provided with specific information from Mr Wildin from a questionnaire which he had completed. Mr Smith confirmed that the information which he had for client figures for 2003 was for audit only clients. Mr Smith said that on the basis of this information it was clear that Wildin and Co had a normal dispersion of client types, with no special features, no high value clients but equally no negative issues.

26. Mr Smith said that the so-called "consolidators" (listed companies which were financed by external investors to acquire professional firms) were paying a multiple of between 2.5 and 3.5 of turn-over for target accountancy practices in 2003. He suggested that in order to establish Wildin & Co's goodwill valuation in 2003 the best method would be to take the weighted average of fees for the past three years and apply a multiple of between 1.00 and 2.00 to that average.

27. In Mr Smith's view Wildin & Co's goodwill should be valued by applying a multiple of 1.5 to the firm's average turn-over, reflecting the "up-surging market" in 2003, which would give a goodwill valuation of around £1,585,000 for Wildin & Co. Mr Smith cast doubt on the reliability of the publicly available information about the pricing of accountancy firms in 2003 on which HMRC relied.

Mr Roland – HMRC witness of fact.

28. Mr Roland is a team leader in HMRC's "Charities, Assets and Residence, Shares and Assets Valuation" (SAV) group. He has 20 years experience in SAV and 15 years experience in the valuation of goodwill.

29. Mr Roland said that in his experience most accountancy practices were valued in the basis of goodwill by reference to gross recurring fees. Mr Roland referred to the ACCA Technical Factsheet 87 which states that accountancy practices are valued at multiples of between 75% and 150% of gross recurring fees.

30. He explained that he is the keeper of SAV database for HMRC, but that this is not a complete database; 50% of cases considered did not have complete records. The SAV database covers the period from 1980 to 2010 comprising 621 cases, of which complete records exist for 309. He said that approximately 10 valuations were done per year but that the database was "not as comprehensive as he would like".

31. Mr Roland explained that the SAV database provided evidence from the records which were complete that for the 1982 – 2010 period the most common multiple applied in valuing goodwill was 1 – 1.5, with the dispersion for 1982 itself being very similar. The SAV database did provide evidence of some multiples of up to 2 for 1982, but no higher. Mr Roland agreed with Mr Wildin that the HMRC database was giving a potentially misleading picture since in all but 16% of cases the goodwill valuations had not been negotiated since there was no tax at stake; therefore neither party had an interest in accurately valuing the goodwill.

32. Mr Roland said that in the handful of accounting valuations he had seen, the valuation was usually based on gross recurring fees times a multiple (or by reference to turn-over) but that net asset value was not usually significant.

33. Mr Roland referred to HMRC guidance about how goodwill should be treated for tax purposes as set out in Mrs Hennessey's witness statements, which is an extract

from a book by Chris Glover which states that goodwill cannot be sold alone, but always attaches to a business.

Mrs Hennessey Evidence – Expert witness

34. Mrs Hennessey is a partner in Lane, Clark and Peacock LLP. Her experience includes valuing a wide range of businesses, and she explained that she applied common principles in valuing Wildin & Co. She believed that the approach to valuation should be the same in all cases. Under questioning from Mr Wildin, Mrs Hennessey accepted that her experience in valuing accountancy practices was limited to 1-2 accounting practices, including her own. She has also acted on deferred consideration disputes.

35. Mrs Hennessey explained her approach to valuing goodwill, namely that goodwill is more than fees but includes other intangible assets (such as brand name, staff and contracts) and everything used for attracting clients. She accepted that it is possible in theory to sell blocks of fees, but did not accept that this was the correct starting point for the valuation of an accountancy practice. Mrs Hennessey's interpretation of Jeremy Kitchin's valuation guidance on the APMA website was that it is applying a multiple of fees to determine total practice value, from which net assets need to be deducted.

36. For her 1982 valuation of Wildin & Co, her approach had been to apply a multiple of 1 to gross recurring fees as at June 1982, to come to a value of the whole practice and then deduct net asset value to come to a value of goodwill. In terms of HMRC's formula described as M1 and M2, Mrs Hennessey accepted that when attempting to use the M2 formula, there is no concrete evidence to find M2.

37. Mrs Hennessy explained the basis on which she had established Wildin & Co's goodwill value for 1982. She said that at that time the practice had only been established for nine months and its actual revenues were uncertain. While it had attracted new clients, in March 1982 no work would have actually been started for many of those new clients. Moreover the new firm was completely dependant on Mr Wildin and would be at significant risk if he left soon after a purchase of the business. The practice had made a loss for the year to June 1982 (or a very small profit if allowance was made for equipment leasing costs). As at June 1982 Mr Wildin's drawings were £14,091, the firm's net assets were £37,059 and the firm had fee income of £98,498 with debtors of £51,565, with no real evidence of the growth potential in its client base.

38. The valuation was required to be done on the basis of the information available as at March 1982. The firm's 1983 turn over and 1982 work in progress were irrelevant and, contrary to Mr Wildin's contentions, it is not permissible to look at future information. She looked at the June 1982 accounts figures only. In coming to her work in progress she had assumed that work in progress amounted to 3 weeks' turn over being £5,000. She did not accept that much if any value could be put on new clients at this stage; it was necessary to take account of new clients and clients at risk of not being retained.

39. Mrs Hennessey also referred to wider economic indicators of the state of the economy in 1982 including 13% interest rates, 2.7 million unemployed and a generally depressed market. On the basis of her valuation the price earnings ratio of

Wildin & Co would be 10.8, which seemed very high compared to the FTSE price earnings ratio for the same period for listed companies of only 9.7. Therefore she considered that a valuation of even £75,000 was generous.

40. For all of these reasons Mrs Hennessey had concluded that an open market value of no more than £75,000 was a reasonable valuation for the goodwill in Wildin & Co, on the assumption that Mr Wildin stayed with the firm for at least a year after it was purchased. (Derived from gross recurring fees of £108,000 plus £5,000 work in progress, minus net assets of £39,000).

The 2003 Valuation

41. As far as the valuation in 2003 was concerned, Mrs Hennessey had looked at market comparables and the publicly available pricing information from the activities of the "consolidators" at this time and had concentrated on the valuation of a practice called H&L Bloom based in Glasgow in particular, because she considered this was a very similar firm to Wildin & Co. From Mrs Hennessey's view of the market at this time a multiple of 2.5 was the maximum which anyone would be prepared to pay for an accounting practice.

42. In deriving the value for the accounting practice in 2003 Mrs Hennessey's approach entailed looking at the total price paid for whole practice, including net assets and then deducting net assets to give a value for goodwill. Mrs Hennessey accepted that the value of goodwill for the comparable market transactions which she looked at was not publicly available.

43. Her 2003 valuation was based on Wildin & Co's turn-over for the year to 30 June 2002 of £1,003,828, to which she applied a "whole practice" multiple of 0.88 giving a figure rounded to £883,000 and then deducted net assets, which she valued at £139,032, giving a 2003 goodwill valuation of £743,968 rounded to £740,000.

The Appellant's arguments

The 1982 Valuation

44. Mr Wildin's starting point was that no expert evidence existed relating to 1982 valuations for this or any other accountancy practice. He explained the attempts which he had made to obtain third party evidence about valuations and multiples going back twenty five years, including conversations with practitioners who he knew were involved in the market at that time. Nevertheless, Mr Wildin said that he had experience of valuing accounting practices, including his own and provided evidence from conversations he had had with other practitioners who had been in the market in 1982.

45. The core of Mr Wildin's case is that, contrary to what is said by HMRC, the correct basis for the valuation of the goodwill in an accountancy practice such as Wildin & Co is by reference to gross recurring fees to which a multiple is applied; buying an accounting practice is essentially buying a block of fees and cannot be compared to a standard corporate acquisition.

46. There is no basis on which net asset value should be included in the calculation of how a professional services firm should be valued. Mr Wildin was clear that it is possible to buy a "client book" (as made clear by adverts for sales of accountancy practices in 1982 to which he referred us) and indeed this is how accounting practices were then and are still sold.

47. Mr Wildin gave his interpretation of third party commentators' statements about the valuation of accounting practices and the Jeremy Kitchin statements in particular. He stressed that in his view it was not normal to deduct net assets in valuing accountancy practices. Mr Wildin disagreed with the interpretation of Jeremy Kitchin's statements which suggested that the value of goodwill differed depending whether the whole business was being bought compared with a block of fees. Mr Wildin had entered into correspondence directly with Mr Kitchin in which he had confirmed that taking a multiple of gross recurring fees is the normal method of valuation of an accountancy practice.

48. In Mr Wildin's view, the best starting point for estimating the 1982 value of his client book was the June 1983 accounts of Wildin & Co, because these most accurately reflected work which was still to be billed at March 1982 and which would have made up the gross recurring fees for 1982, including for example the work billed for a significant new client, Gullivers, for whom work had only just commenced in March 1982.

49. Mr Wildin also explained that work in progress needed to be included as an addition to 1982 figures. This was not double counting and reflected clients as at March 1982 (amounting to £74,000).

50. As regards the appropriate multiple which should be applied to this gross recurring fee figure, Mr Wildin's view was that the multiple should be 3 (plus 0.5 for work in progress), on the basis of the booming market in 1982, adverts from selling brokers in 1982 and his letters to Lloyds bank at that time. Mr Wildin produced copies of a number of brokers' adverts from the accountancy press in March 1982 which referred to "clients looking for up to three times gross recurring fees" and to letters which he had written to Lloyds bank seeking a loan in October 1981 and October 1983 in which he valued the firm's clients at "the very least £500,000". He also referred to the multiple which had been applied by his old firm, Kingscott Dix, when they acquired a small block of fees in 1979, which was a multiple of 3.

51. In relation to the multiples suggested by HMRC relying on the SAV database, Mr Wildin pointed out that these were skewed because they covered a large number of cases in which no tax was actually payable and therefore the accuracy of the goodwill valuation was not important.

The 2003 Valuation.

52. In Mr Wildin's view any valuation method which was used in 2003 should be consistent with the method used in 1982. That method should be based on the value of the current book of client fees which is the equivalent of the value of the good will in the practice.

53. In finding that valuation for 2003, HMRC should take the valuation of the goodwill reflected by a proposed fee transfer agreement of 2003, in which 20% of

Wildin & Co's fees were to be sold for £240,000, giving a total valuation of £1.65 million although this fee transfer did not ultimately take place. Mr Wildin cast doubt on whether the comparative deals relied on by Mrs Hennessy, particularly the H&L Bloom disposal was sufficiently similar to his firm to provide a proper market comparison; Wildin & Co was not sold for cash or in a "consolidator" type deal.

54. In Mr Wildin's view the correct multiple for 2003 was 1.5 on the basis of his market knowledge and the fact that Wildin & Co was a firm with no historic issues and which would have been attractive to a purchaser in the up-surging market in 2003.

55. In response to HMRC's witness evidence Mr Wildin cast doubt on Mrs Hennessey's expertise in valuing accountancy practices, as opposed to other company valuations and also objected to HMRC withdrawing their previous agreement that the correct 2003 goodwill valuation was £1.4 million for Mr Wildin's 84.85% share of the goodwill.

HMRC's arguments.

56. For HMRC Ms McCarthy argued that goodwill should be valued by taking Wildin & Co's gross recurring fees x a multiple minus net assets. This is a "whole practice" valuation. The valuation must be done only by reference to information available at the time and making realistic assumptions about the approach of the seller and purchaser as made clear in *IRC v Gray* "*one assumes that the hypothetical vendor and purchaser did whatever reasonable people buying and selling such property would be likely to have done in real life*" ([1994] STC 360)

57. In ascertaining the "whole practice" valuation, net assets have to be taken account of. If the practice multiple is known (the M2 formula), in order to ascertain goodwill, net assets have to be deducted. If the goodwill multiple is known (the M1formula), in order to ascertain the whole practice value net assets need to be added to M1. All of the secondary sources cited (including Jeremy Kitchin) are referring to multiples which are being applied to M2, not M1 and are attempting to derive the "whole practice" valuation, therefore the value of net assets needs to be deducted after this multiple has been applied. The value of net assets does have an impact on the value of a firm's goodwill, according to HMRC "*all other things being equal, a business with larger net assets will have a lower value of goodwill than a business with a smaller value for net assets*".

1982 Valuation

58. In HMRC's view, the correct multiple to be applied to the gross recurring fees of the Wildin practice in 1982 was a multiple of 1, taking account of the nature of the practice and the state of the wider UK economy at that time, as explained by Mrs Hennessey. Moreover that multiple should be applied to Wildin & Co's June 1982 fees, that being the best available evidence at the time. There was no basis on which it was possible to use later information in coming to this valuation, particularly the 1983 figures as suggested by Mr Wildin. HMRC said that in 1982, when Wildin & Co was a relatively new firm, there was no evidence that fees would increase as suggested by Mr Wildin as the fee levels in 1982 could have been a "bubble" which was not

sustained. That fee level was in part a result of the long hours worked by Mr Wildin, which would not necessarily be replicated by a purchaser.

59. HMRC pointed out that there was no third party evidence for a multiple of 3 in 1982. The only evidence of this was either from brokers in the market who had an incentive to inflate sales multiples and Mr Wildin's own correspondence with his bank. A multiple of 3 was unjustifiably high, giving a valuation of the practice of £516,940, equal to 37 times Mr Wildin's drawings of £14,000. This was not credible during a period of recession such as 1982. In their view a more appropriate multiple is in the range of 1 – 1.25, as suggested by Mrs Hennessey. A multiple of 1 was a ballpark figure for the early 1980s and there were no special features of Wildin & Co at this stage in particular to support a premium above that multiple.

60. In HMRC's view the best evidence for the correct multiple for 1982 can be derived from the SAV database referred to by Mr Roland and an article of August 1982 in the Accountants' Magazine by R A Scott which supported a multiple of 1. Equally the APMA website referred to a thirty year period of valuations none of which supported a valuation based on a multiple higher than 1. HMRC had also entered into correspondence with Mr Kitchin in October 2007 in which he had confirmed his view that a valuation based on a multiple of 1 – 1.25 was a reasonable multiple for this period.

61. The multiple should be applied to Wildin and Co's turn-over as recorded in the year end accounts for June 1982, which was £108,774 and which was the best contemporaneous evidence which could be used to ascertain the correct level of turn over. HMRC said that they were no longer bound by their statement to Mr Wildin in their letter of 5 January 2006 in which they had accepted a gross recurring fee figure of £147,697 for 1982, since this agreement had been withdrawn by their letter of 27 July 2007.

62. The best 1982 valuation for the goodwill in Wildin & Co was £75,000, taking £108,000 as the firm's gross recurring fees, adding work in progress, applying a multiple of 1 and then deducting net assets of £37,000.

2003 Valuation

63. HMRC explained their position about their withdrawal of their proposed settlement of Mr Wildin's 2003 valuation figures and referred to their letter of 27 July 2007. They viewed the offer which had previously been made to Mr Wildin as predicated on the basis that all other aspects of the dispute were agreed. Since this was not the case, their letter of 27 July 2007 overrode any previous agreements about the 2003 goodwill value, which had effectively been a conditional offer whose conditions had not been met.

64. HMRC stated that a similar approach to valuation should be taken in 2003 as for 1982 and that the valuation starting point was the "whole practice" to which a multiple of 0.88 should be applied. That multiple was derived from the evidence of valuations in the market provided by Mrs Hennessey and the activities of the so called consolidators in particular. The H&L Bloom consolidator sale was a close comparison for Mr Wildin's business and was aligned with other third party evidence including the ACCA Technical Factsheet 87 referred to by Mr Roland and the APMA website.

Discussion

Findings of Fact

65. On the basis of the oral and written evidence provided to the Tribunal we make the following findings of fact;

66. It was common practice to value accountancy firms by reference to a multiple of fees or by reference to their "client book" both in 1982 and 2003, although other methods of valuing businesses prevailed elsewhere.

67. Mr Wildin's accountancy practice was a standard small local practice with no niche clients or other special features. The success of the firm was dependent on Mr Wildin's own local contacts and his work ethic.

68. While the accountancy market was relatively healthy in 1982, the UK economy was in recession.

Goodwill in accountancy practices.

69. There is no specific definition of goodwill in the capital gains tax legislation and case authorities make it clear that goodwill cannot be defined the same way for all types of businesses: it is not "one size fits all", as was stated by McNaughten in the *Muller* decision (*IRC v Muller & Co Margarine Ltd* [1901] AC 217) "*it differs in its composition in different trades and in different businesses in the same trade*", which is an approach reflected in 2006 in the *Balloon* decision which was cited to us (*Balloon Promotions Limited v Wilson* [2006] STC (SCD) 167). HMRC stressed that goodwill must be attached to a business and that is clearly a correct statement, and is derived from HMRC's own guidance coming itself from the work by Chris Glover. However the Tribunal considers that this is more a statement of the legal and commercial aspects of goodwill and not necessarily an indication of how it should always be valued.

70. The Tribunal has approached this question of valuation on the basis that it is an art not a science; the Tribunal's job is to ascertain the best method for valuing goodwill for this taxpayer on these facts and on the basis that no method will provide a perfect answer. The evidence from Mrs Hennessey, Mr Roland and Mr Smith made clear to us that there were a number of different methods for valuing goodwill and that the critical question was, of those methods, which gives the most accurate valuation of a business like Mr Wildin's.

71. We took from the oral evidence provided to us from Mr Wildin, Mr Smith and Mrs Hennessey and the secondary sources to which they referred that while there is a general commercial approach to valuing goodwill for standard businesses, there is a different approach which is usually applied to professional services firms. Our conclusions from this evidence, including in particular the approach of Jeremy Kitchin in the APMA website referred to, is that in practice goodwill is ascertained in

a particular way for professional services firms, reflecting the different value structure of these businesses. For these businesses goodwill is not "everything else which is not net assets", it is the business. To quote from the Kitchin website "*In the case of professional partnerships in general, and accounting practices in particular, a different valuation convention can generally be adopted. A methodology involving a multiple of turn over is normally adopted which, in so far as it is not expressed as a multiple of profit, appears initially to be quite distinct from that used in commercial businesses....*"

72. On that basis we considered the two formulae suggested by HMRC and their assertion that it is necessary to derive goodwill from a "whole practice valuation" – the so called M2 approach, taking fee income times a multiple then deducting net assets and the so called M1 approach which starts from a multiple of gross recurring fees and adds the value of net assets to find the value of the whole practice. The question for the Tribunal is whether this "whole practice" approach to goodwill valuation is a better approach than the approach suggested by Mr Wildin which equates goodwill with a straightforward multiple of gross recurring fees.

73. Mr Smith said, when pushed by Ms McCarthy that HMRC's "whole practice method" was "a method" but that is not to say that it is the best approximation of goodwill for this market. Mr Roland said that from his experience the normal practice was to value goodwill on the basis of gross recurring fees or turn-over. Mrs Hennessey agreed that in using the M2 method it was necessary to rely on an unknown element to determine the value of the goodwill itself.

74. The Tribunal has concluded that it cannot be correct that the value of a professional firm's net assets should affect its overall goodwill value. The Tribunal disagrees with HMRC's assertion that there is any necessary link between the net assets of a professional firm and the value of its goodwill. Indeed it is clear that deducting net assets to find the goodwill value can result in anomalies, particularly where freehold properties are involved or where practices have different approaches to profit retention. Taking "client book" as proxy for value of goodwill is a reasonable method of arriving at a goodwill valuation for capital gains tax purposes for professional firms. This is in our view supported by the Jeremy Kitchin APMA information and by Mr Roland's evidence about what was commonly done in practice.

75. For these reasons we have concluded that valuing goodwill on the basis of a multiple of gross recurring fees is a more accurate method of valuing professional firms including small accountancy practices like Wildin & Co and that this is the method which should be adopted for tax purposes for Wildin & Co's goodwill valuation in 1982 and 2003.

1982 Valuation – the Multiple

76. Having concluded that a multiple of gross recurring fees gives the most accurate approach to the valuation of Wildin & Co's goodwill, the next question is what multiple should be applied to the "client book". The multiple as applied here is an approximation of market value. In estimating open market value the capital gains tax legislation and authorities direct us to make certain assumptions and to assume

reasonable people operating in a real market, who would have done due diligence and understand the local market (and Wildin & Co's place in it). On this basis, a willing buyer would have been aware of both the positive and negative aspects of the Wildin practice, including its reliance on Mr Wildin as the main source of new clients and the current state of the accountancy market.

77. We were provided with detailed evidence of the market at this time from Mr Smith, Mr Wildin and Mrs Hennessey, but on this point we agree with HMRC that we were not given any independent third party evidence that a multiple of 3 was reasonable for Mr Wildin's practice at this time. We were provided with some evidence (including HMRC's SAV database) for multiples up to 2 and that the average multiple for 1982 was 1 – 1.5. Over and above this, we cannot see any reason why Wildin & Co should attract a particular premium. The evidence, including Mr Wildin's own statements, suggested this was a fairly normal accounting practice. If it did attract a premium, that was as a result of Mr Wildin himself and his personal contacts, which as Mrs Hennessey pointed out, might not be an asset which the business retained for very long if it was sold.

78. The Tribunal has taken the relatively limited evidence available from 1982 and placed reliance in particular on the information from the SAV database, as the best available independent evidence, to determine a reasonable range for the multiple to be applied to Wildin & Co's goodwill in 1982. We have assumed that while Mr Wildin's practice was successful, and so might have commanded a multiple at the top of the SAV database range, there were nevertheless some risks in his business, including the retention of some newly acquired clients. For these reasons the Tribunal has concluded that a reasonable multiple for Mr Wildin's practice in 1982 is in the range of 1.5 – 1.75.

79. Having established a range for the multiple to be applied, we need to clarify the correct fee figure for applying that multiple for 1982. We take HMRC's point that the 1982 valuation has to be based on the best available contemporary evidence. In deciding what this best available evidence is we have taken account of (i) the fact that all pre-July 1981 work in progress was excluded prior to the sale to Mr Wildin (ii) that Mr Wildin's clients were billed annually with a peak from April to June (iii) that Mr Wildin took in new clients during quarter 3 and 4 of 1981 who had had work done but not billed until quarter 3 of 1982 (e.g. their new client, Gullivers). Mrs Hennessey for HMRC did accept that one could take account of new clients at this stage if there was some evidence that they would remain with the firm.

80. Therefore we agree with Mr Wildin that the 1983 year end numbers give the best available estimate of 1982 turn over and we do take notice that HMRC did also at one point accept this as a reasonable starting point. However on this basis we do not think that it is correct to include, as Mr Wildin attempted to persuade us, any additional work in progress for 1982. (Represented by Mr Wildin's 0.5 additional multiple). Our conclusion at this point on the calculation of the base cost of Wildin & Co's goodwill in March 1982 is that it is in the range of £147,697 x 1.5 and £147,697 x 1.75.

81. HMRC suggested that if the Tribunal concluded that the correct multiple was in a range which resulted in a range of valuations which did not include either the Taxpayer's or HMRC's suggested valuations, the Tribunal should take the mid-point

of their suggested range as the most reasonable valuation to apply. On that basis we are applying a multiple of 1.625 for the purposes of the 1983 goodwill valuation.

2003 Valuation

82. We have accepted that as a result of the Directions issued by this Tribunal in December 2011 and HMRC's statements before this Tribunal the 2003 valuation of the goodwill in Mr Wildin's practice is in dispute. We can see no reason for adopting an approach to goodwill valuation in 2003 which is different from the approach which we have set out above for the 1982 valuation. This means that for 2003 we have concluded that the gross recurring fees of Wildin & Co should be the starting point for the 2003 valuation as for 1982, to which the relevant multiple should be applied. As a result of accounting rule changes between 1982 and 2003, there is no longer any question of whether work in progress needs to be added to these figures since accounting rules require it to be included in Wildin & Co's turn-over for tax purposes.

83. In applying this approach to Wildin & Co's gross recurring fees in 2003 it is necessary to establish what the correct multiple is by this date. Mr Wildin relied on the valuation from a proposed sale of a block of fees to a third party to suggest a multiple of 1.5 which HMRC considered to be high, but HMRC had previously accepted £1.4 million (implying a multiple of 1.5) as a reasonable 2003 valuation. Mr Smith referred to his firm's experience of private sales, the buoyancy in the market in 2003 and the impact of the "consolidators" to suggest that a range of 1 – 2 was a reasonable multiple for this time.

84. HMRC's alternative multiples came from Mrs Hennessey's information from the "consolidators" (and the sale of the H&L Bloom practice in Glasgow in particular). Mr Smith suggested that this was a "partial" view of the market, with the consolidators not being representative of the prices which were being applied elsewhere. Relying on these figures HMRC suggested that a multiple of 0.88 should be applied to the "whole practice" in 2003. Mrs Hennessey accepted that she would apply a different multiple if considering client book only.

85. We have concluded from the evidence provided to us in respect of 2003 that it is not clear that Mrs Hennessey's comparison with the consolidator market price and the H&L Bloom sale is necessarily an accurate way of pricing Wildin & Co and that Mr Smith's evidence concerning the wider accounting market in 2003 is to be preferred. Taking Mr Smith's suggestion of a range of 1 -2 as a multiple for this period, we have concluded that 1.5 is a reasonable multiple to apply to the Wildin & Co practice. This is also in line with the information from the SAV database and the figure previously accepted by HMRC for the 2003 valuation.

86. There is one further point to clarify in coming to the 2003 valuation which is the correct turn-over for applying the multiple in 2003. Mrs Hennessey's starting point was Wildin & Co's turn over for the previous year (£1,003,828). Mr Smith took a three-year average of Wildin & Co's turn-over, giving him £1,056,540.

87. As between Mr Smith and Mrs Hennessey we have concluded that Mr Smith's approach of taking a three year average turn over provides the best approximation for the 2003 fee valuation and we have therefore concluded that a multiple of 1.5 should be applied to this £1,056,540 valuation to give a valuation of Wildin & Co's goodwill at the time of disposal in April 2003.

Conclusion:

88. For the reasons set out above the Tribunal has concluded that the base cost for capital gains tax purposes of Mr Wildin's share in the goodwill of Wildin & Co at March 1982 should be calculated by applying a multiple of 1.625 to Wildin & Co's gross recurring fees as at June 1983 of £147,697, giving a base cost of £240,008.

89. The disposal value of Mr Wildin's share of the goodwill of Wildin & Co in 2003 should be valued on the same basis, applying a multiple of 1.5 to the gross recurring fees of £1,056,540 in 2003 giving a disposal value of £1,584,810 and a resulting gain of £1,344,802 chargeable to capital gains tax, of which £1,141,064 represents Mr Wildin's 84.85% share in the business, subject to any available reliefs.

90. Mr Wildin's original appeal to this Tribunal included an application to strike out HMRC's case under Rule 8 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the Tribunal Rules). Mr Wildin confirmed to the Tribunal at the end of the hearing that he was withdrawing this strike out application.

Costs

91. Both parties reserved the right to make applications for costs in the proceedings depending on the outcome of the case. This case was categorised as a standard case and therefore costs can only be awarded under Rule 10 of the Tribunal Rules if a party has acted unreasonably in bringing, defending or conducting the proceedings. In the light of this decision, the Tribunal does not consider that either party has grounds for making a claim for costs.

92. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First– tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

RACHEL SHORT
TRIBUNAL JUDGE

RELEASE DATE: 14 May 2014