Valuation of shares - use of auditors valuation.

NACAB JM

D /SH/43

Commissioner's File: CIS/76/1989

Region: Wales & South Western

SOCIAL SECURITY ACT 1986

APPEAL FROM DECISION OF SOCIAL SECURITY APPEAL TRIBUNAL ON A QUESTION OF LAW

DECISION OF THE SOCIAL SECURITY COMMISSIONER

1. For the reasons hereinafter appearing, the decision of the social security appeal tribunal given on 14 November 1988 is erroneous in point of law, and accordingly I set it aside. I direct that the appeal be reheard by a differently constituted tribunal who will have regard to the matters mentioned below.

2. This is an appeal by the adjudication officer, brought with the leave of the tribunal chairman, against the decision of the social security appeal tribunal of 14 November 1988.

3. The question for determination by the tribunal was whether the claimant was entitled to income support from 11 April 1988. The adjudication officer had decided that the claimant was not so entitled, because he possessed capital resources in excess of the prescribed limit of £6,000. The claimant had no savings, but had a 21% interest in the share capital of J J Hamilton and Sons Ltd, a private company in Headington, Oxford. Accordingly, whether or not the claimant's capital resources exceeded the statutory limit depended upon the value to be given to those shares. The adjudication officer had taken advice, and had been informed in a report dated 5 July 1988 (presumably prepared by the Department's accountants) that the shares were at that date to be given a value of £13,200. If that value was right, then clearly the claimant had capital resources in excess of £6,000, and there was no entitlement to income support. However, the claimant disputed the figure, contending, inter alia, that the company's own accountants (by which I presume he meant auditors) valued them at only £4,906. In the event, the tribunal allowed the appeal, and decided that the claimant was entitled to income support from 11 April 1988. They gave as the reasons for their decision the following:-

> "(A) The appellant's shareholding J J Hamilton and Sons Ltd is to be disregarded for the following reasons -
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> (a) The shares cannot be sold outside the company structure
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> (b) The difficulty in placing a realisation value on shares in a small private company
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> (B) The Presenting Officer supported the appeal and referred to head 7 of R(SB) 57/83."

4. Apparently, for supplementary purposes, the value of the shares had been disregarded. Precisely why this should have been so, I am at a loss to say. But as regards income support, there can be no question of this item being disregarded. Schedule 10 to the Income Support (General) Regulations 1987 [S.I. 1987 No.1967] provided, as at 11 April 1988, for the disregard of the value of 21 forms of capital, none of which was a shareholding in a private company. Subsequent amendments to Schedule 10 have added another 14 categories of capital to be disregarded, but none of these is such a shareholding. Accordingly, in so far as the tribunal purported to base their decision on the view that the shares in question should be disregarded, they clearly erred in point of law. However, I rather suspect that they did not mean to say that they should not be taken into account, but rather that, although they should be included in the capital resources of the claimant, in this particular instance they had a 'nil' value. Moreover, they seem to have reached this conclusion on the basis of the two reasons set out in box 4 of Form AT3 cited above. If that was their view, then they clearly erred in law on this count. Manifestly, the shares had some value. The difficulty of marketing them goes very much to their value, but it cannot be said to extinguish it altogether. Accordingly, the tribunal's decision is erroneous, and I must set it aside. I direct that the appeal be reheard by a differently constituted tribunal who will give a proper value to the shares, and in the light thereof determine whether the claimant is entitled to income support as from 11 April 1988.

5. But, before leaving this matter, I think it is necessary for me to give some guidance as to how the new tribunal should deal with the difficult matter of valuation. The starting point is "the price which a willing buyer would pay ..... to a willing seller" (see R(SB) 57/83 paragraph 7). How this matter should be approached in the case of a claimant who owned one-third of the share capital in a private company, the sale of whose shares was subject to a pre-emption rights clause contained in its articles of association, was considered in R(SB) 18/83. The Commissioner observed as follows:-

> "14. The question of the valuation of the shares themselves is a difficult one to require such a tribunal to investigate. I have to point out that the shares to be valued are the claimant's shares (one-third of the share capital of the company) and that this cannot properly be done by valuing the whole of the shares in the company and dividing by three. It usually emerges that the value of a minority holding of shares in a company is well below the appropriate fraction of the value of the whole of the capital, because the latter confers control of the company and the opportunity if it seems beneficial to do so to wind up the company and take its assets. The valuation by the accountants of the Department on which the tribunal relied was a valuation of the entire share capital which was then divided by three to arrive at the value of the claimant's holding. This was pointed out by the claimant's son's accountants in one of the letters not produced to the tribunal. It is not in my judgment the correct method of valuation of the claimant's holding, and had I not set the decision aside on other grounds, I should probably have set it aside on this ground.
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> 15. ...
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> 16. In the present case the articles of association of the company according to the accountants' letter accompanying their valuation provided that a member wishing to transfer his shares had to offer them to the existing members (selected I know not how) at the 'fair value' fixed by the auditors. In the sphere of valuation for estate duty purposes a somewhat sophisticated method of taking such a provision into account has being involved (see Lynall v. I R C [1972] AC 680). But I do not think that this should have any place in the law of supplementary benefit. It seems to me that for practical purposes a claimant would not be able to realise more on his shares than the fair value so fixed and that evidence of the value the auditors would so fix would be most material."

Some of the further difficulties involved in valuation in practice are vividly brought out in the starred Decision CSB/488/1982 at paragraph 12(d):-

> ".... I agree with the Commissioner's view at paragraph 16 of R(SB) 18/83 that the somewhat sophisticated method of valuation for Revenue purposes should have no place in the sphere of supplementary benefit. However, the owner of under 25% of the share holding cannot block a special resolution. The owner of a controlling holding of 75% of the share or more can normally wind up the Company and secure the relevant proportion of the net assets subject to costs and expenses. The valuation of a block of shares (and whether a minority, equal or controlling holding) makes some measure of complexity inevitable. I would also draw attention to the position where the shares in a limited liability company are held equally but one of the shareholders is chairman of the company and has under the articles of association a casting vote. In such a case the chairman's casting vote would reflect a higher value for his shareholding. Further the share structure of a particular company may involve preferred ordinary or deferred shares with their different rights. In any event it is essential that the appeal tribunal consider the memorandum and articles of the company, the shares in which they are valuing, as the memorandum and articles of association will deal either expressly or by reference to the relevant Companies Acts with the rights in respect of shareholdings".

7. In the present case, the articles of association provided that, in the event of anyone wishing to transfer a share, he had first to offer it (where the proposed transferee was other than a 'child or other issue, wife or husband' of the proposed transferor) to the other shareholders at the 'fair' value, such 'fair value' "in case any difference arises between the proposing transferor or and the purchaser" to be determined by the auditors. The shares sought to be transferred were to be offered to the existing members "as nearly as may be in proportion to the existing shares held by them respectively". I am not sure to what extent the auditors have been consulted as to the value of the shares - the claimant attributes to them a valuation of only £4,906 - but clearly such opinion, if it could be ascertained, would be of considerable significance. On no footing would I consider that the shares should have a higher value than that assessed by the auditors. Moreover, it may well be that for the purposes of income support - incidentally, although the passages from the Commissioners' decisions cited above relate to supplementary benefit, I consider that they are equally applicable to claims under the income support legislation - the value of the shares should be less than that assessed by the auditors. At the end of the day, the criterion is the price which a willing buyer would pay to a willing seller. In the context of income support, the claimant, who is in need of realised resources at once will necessarily be a willing seller, the determining factor in calculating the value of the shares will be the amount payable by a willing purchaser. In my judgment, in the context of income support the value must be determined on the basis of a very quick sale, and this will put the seller at a disadvantage and the purchaser at a corresponding advantage. Admittedly if a member of the company wishes to purchase the claimant's shares he must pay "the fair value", as assessed by the auditors. However if no member wishes to buy them within 28 days the proposed transferor may within 3 months offer them to anyone at whatever price he can get them for them. However, presumably the price will be prevented from going through the floor by the fact that one or more of the existing members would be loath to see someone purchase at a ridiculously low price, and would probably be willing to outbid him. Moreover, it could be the case that a particular shareholder wished to acquire the claimant's shares in order to give himself majority control (or for that matter 75% control) or just to enlarge his interest in the business. In this event, he would only be too pleased to pay the "fair value". However, in the absence of any special situation such as that just envisaged, there may well be a reluctance on the part of the other members to take up the shares, and in this event the shares might be sold at considerably less than the "fair value".

8. I am aware that the adjudication officer has received a careful and sophisticated valuation suggesting that they are worth £13,200. However, in my judgment, this valuation

accords more with that applied by the Inland Revenue, and fails to give sufficient weight to the special circumstances applicable to income support cases.

9. The task of the new tribunal will be difficult. However, they will have to reach a conclusion on whatever evidence they have before them, applying the principles stated above. Nevertheless, I would point out that the adjudication officer has put forward a figure, backed up with some sophisticated reasoning, and although, as stated above, I consider that in the context of income support legislation, it is open to challenge, it will not be enough for the claimant simply to say that the shares have no value or to attribute to them a figure which is solely arbitrary. It is a matter entirely for him, but he may well find the assistance of the auditors crucial to his case.

10. I allow this appeal.

(Signed) D.G. Rice

Commissioner

Date: 31 October 1989