Neutral Citation: [2024] UKFTT 001146 (TC)

Case Number: TC09387

FIRST-TIER TRIBUNAL
TAX CHAMBER

Video hearing

Appeal reference: TC/2020/03326

CORPORATION TAX - *Intangibles relief - related parties - market value - methods of valuation - expert evidence - whether equality of arms - no - use of comparators - amortisation period - Whether UK GAAP compliant - appeal allowed*

Heard on: 20-22 and 25-26 July 2022
Judgment date: 19 December 2024

Before

TRIBUNAL JUDGE ANNE SCOTT
MEMBER: JOHN WOODMAN

Between

CHEMIDEX GENERICS LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: David Goldberg QC and Sam Brodsky of counsel, instructed by CMS Cameron McKenna Nabarro Olswang LLP

For the Respondents: James Henderson and Edward Waldgrave of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. This appeal concerns the application of the Intangible Fixed Asset Regime ("the Intangibles Regime") in terms of Part 8, sections 711 to 906 of the Corporation Tax Act 2009 ("CTA"). There is no dispute about the interpretation of that legislation.

2. In his Opening Submissions, Mr Goldberg KC, very helpfully and accurately, said that the issue for the Tribunal was about how a company's gains (or losses) in respect of tangible or intangible fixed assets are calculated and brought into account for corporation tax purposes in accordance with those sections of the CTA.

3. In brief summary, this appeal turns on the implications of an acquisition by the appellant ("CGL") of intellectual property relating to certain out-of-patent pharmaceutical products and related assets such as marketing authorisations, which we describe as the "Product Assets". It is common ground that the Product Assets constituted chargeable intangible fixed assets and so the Intangibles Regime applies.

4. In terms of a Business Transfer Agreement ("the Transfer Agreement") dated 27 March 2013 ("the Valuation Date") with Mr Navin Engineer and Mrs Varsha Engineer (each of them "a Partner" and together "the Partnership") CGL acquired the Partnership business.

5. In terms of various "Acquisition Agreements", the Product Assets had been acquired by the Partnership from third party pharmaceutical companies in the period between 18 January 2005 and 28 January 2011. In most cases, the Partners then entered into Profit Sharing Agreements ("PSAs") with a company, Chemidex Pharma Limited ("CPL"), which was wholly owned by them, as was CGL. Those PSAs granted CPL the right to exploit the Product Assets. Essentially, CPL's role was as a licensee for manufacturing and commercialisation purposes.

6. It is common ground that CGL and the Partners were related parties within section 835 CTA. Therefore, in accordance with section 845 CTA, the transfer of the Product Assets is treated as being at market value which is "the price the asset might reasonably be expected to fetch on a sale in the open market" (section 845(5)).

7. Although the Transfer Agreement provided for the sale of the whole of the business of the Partnership as a going concern, the parties are agreed that (a) the only value in that sale is the Product Assets, and (b) the Transfer Agreement focussed on those Product Assets still retained by the Partnership as at that date and which were generating significant turnover. The PSAs were novated as part of the Transfer Agreement and trade marks were assigned.

8. The attributed value of the transaction in CGL's Financial Statements for 2013 ("the 2013 Financial Statements") was £40 million. It is common ground that there was no material difference between the value of the Partnership and the value of the Product Assets as at the Valuation Date.

9. The respondents ("HMRC"), having opened an enquiry into CGL's tax return for the accounting period ended 30 June 2013 and later enquiries into a number of subsequent accounting periods, issued Closure Notices under paragraphs 32 and 34 Schedule 18 Finance Act 1998 ("Schedule 18") on 31 July 2020.

10. In order to give effect to the conclusion stated in the Closure Notices in terms of paragraph 34(2A) Schedule 18, on 5 August 2020, HMRC also issued further Notices to make amendments to other tax returns.

11. The Closure Notices and amendments were adjustments to CGL's application of the Intangibles Regime and those are summarised in this decision under the heading "The agreed facts in relation to financial matters".

The Issues

12. The parties are agreed that the two issues in this appeal relate to valuation and accountancy and for that reason four experts were appointed. We summarise the issues as being:

(1) What was the market value of the Product Assets for the purposes of section 845 CTA at the Valuation Date (27 March 2013)?

(2) Were CGL's accounts compliant with the United Kingdom Generally Accepted Accountancy Practice ("UK GAAP") in using a period of ten years for amortising (ie writing down) the value of those Product Assets?

13. CGL compiled its accounts on the basis that the Product Assets had a market value of £40 million which was to be amortised over ten years. In their Skeleton Argument, it was argued by Messrs Goldberg and Brodsky that the £40 million that was originally taken as market value was conservative and, in the event, too low. The expert evidence that was later obtained suggested that it should have been in the range £45 million to £60 million. That had been foreshadowed as long ago as 10 November 2015, when King & King, the appellant's accountants, wrote to HMRC pointing out that the Partners had forecast that the profits derived from the Product Assets would rise between 5% to 10% per annum and a conservative assumption of 5% had been used. However, the actual sales figures were much higher than 5% so the figure of 10% should have been used giving a valuation of in excess of £45 million.

14. HMRC rejected that argument. Their original valuation had been £10.5 million. By contrast, their expert evidence was that the market value was £9 million which should have been amortised over 20 years. However, in oral evidence Ms Brotherston for HMRC amended that to "something nearer to 15 years" if there was a perceived risk of the pricing being either capped or reduced.

15. At paragraph 52 of HMRC's Skeleton Argument it was suggested that the decision of the Tribunal should be in principle only because the parties were likely to agree the quantum of the relevant Closure Notices and amendments once the issues before the Tribunal were determined. We agree. In the event that the quantum and amendments cannot be agreed then those issues will revert to the Tribunal.

The hearing and the evidence

16. With the consent of the parties, the hearing was conducted by video link using the Tribunal's video hearing system. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

17. The documents to which we were referred comprised five bundles being a Hearing bundle extending to 2,176 pages, an Accountancy Experts Bundle extending to 1,878 pages, a Valuation Experts bundle extending to 6,877 pages, a contested Supplemental Bundle extending to 48 pages and an Authorities Bundle, which included the two Skeleton Arguments. That last Bundle initially extended to 321 pages but it was updated on 21 July 2022 with the addition of the second witness statement of Mr Engineer, three new authorities and correspondence relevant to the Preliminary Applications. It then extended to 517 pages.

18. We had a reading day on 19 July 2022.

19. The valuation experts were Mr Palmer and Mr Mitchell and the accountancy experts were Mr Chidgey and Ms Brotherston for CGL and HMRC respectively.

20. We heard evidence from one witness of fact, namely, Mr Engineer. Ultimately, we had three witness statements from him.

21. We had the benefit of transcripts. We had Skeleton Arguments for both parties, a Statement of Agreed Facts and a Statement of Facts that were not agreed. The latter was resolved in the course of the hearing.

22. We had raised a number of queries about the Statement of Agreed Facts and other issues on 25 and 27 July 2022 and, on 28 July 2022, the parties lodged an Agreed Response ("the Response") modifying and expanding on the evidence that had previously been lodged. Not all of our queries were resolved by that, for example, the roles of Mr and Mrs Engineer as partners or directors.

23. In their Skeleton Argument, HMRC stated that they would lodge a Note on the Evidence following the factual and expert witness evidence which they did on the final day. On that morning Mr Goldberg lodged two papers, one of which addressed the facts that the Tribunal was invited to find and the other of which made Submissions.

24. On the third day of the Hearing HMRC had produced (the night before to the appellant and that day to the Tribunal) an article from the Daily Mail Online dated 18 July 2010. After debate, whilst not formally admitted, with the consent of Mr Goldberg and the Tribunal, the article was put to the two expert valuation witnesses.

25. At the close of the third day, after brief submissions, we directed that if HMRC wished that article to be admitted formally and if, as they had intimated, they wished Mr Engineer to be recalled, then they should submit a formal application specifically addressing the issue as to the relevance of the article and in consequence why they wished Mr Engineer to be recalled.

26. On 24 July 2022, CGL lodged an application to admit a third witness statement of Mr Engineer.

27. Those applications were duly received and addressed at the outset of the fourth hearing day.

28. We granted both.

Preliminary issues

29. On 7 July 2022, HMRC had lodged an application to admit further documents in the form of the Supplemental Bundle. I had granted permission for the inclusion of those documents on the assumption, given the correspondence, that these were merely accidental omissions. On 8 July 2022, CGL's agents emailed the Tribunal and HMRC stating that whilst there was no objection to the inclusion of the Supplemental Bundle, it was argued that the relevance was less than clear and HMRC's application had not indicated the relevance. CGL intimated that they intended to lodge a further witness statement in response.

30. On 11 July 2022, I requested that the Tribunal write to the parties indicating that the Supplemental Bundle would be deemed to have been lodged on a *de bene esse* basis and if a further witness statement were to be lodged, then it too would be deemed to be lodged on a *de bene esse* basis. The respective applications would then be considered as a preliminary issue at the substantive hearing.

31. On 14 July 2022, CGL's agents lodged an application to admit a second witness statement of Mr Engineer, which was enclosed.

32. On 15 July 2022, HMRC objected to that application and outlined their concerns.

33. At the outset of the Hearing, Mr Henderson argued that the documents in the Supplemental Bundle were "potentially very important because they go to the way in which the Chemidex entities were making their money". He argued that both the witness statement and the Supplemental Bundle should be admitted and Mr Goldberg, KC agreed.

34. Therefore, of consent, both applications were granted and the Supplemental Bundle and second witness statement admitted.

The Product Assets

35. The Statement of Agreed Facts narrated that the following Product Assets were acquired by the Partnership on the terms of the Acquisition Agreements.

Product(s)	***Acquisition Agreement***	***Counterparty***	***Terms*** ***(NB – This list is non-exhaustive and inclusion of a term is not a statement as to its effect)***	***Date of PSA***
Ampicillin	18 January 2005	Beecham Group plc, Glaxo Group Limited, Glaxosmithkline UK Limited	Assets acquired: Goodwill, Packaging Rights, Records, Manufacturing Know-How, Registration Information, Marketing Authorisations and the seller's stock of the product. Ancillary documents: assignment of Goodwill; Trade Mark Licence and Trade mark Assignment (PENBRITIN).	19 January 2005
Chloramphenicol, Co-Trimoxazole, Paracetamol, Quinine Sulphate, Sulphadimidine and Phenylbutazone	9 February 2005	Sussex Pharmaceutical Limited (in Administration)	Assets acquired: Marketing Authorisations, Trade Mark (PARACETS), Manufacturing Know-How, Packaging Rights, Customer Lists and Registration Information.	Co-Trimoxazole 9 February 2005 Chloramphenicol and Phenylbutazone 10 Feb 2005
Mebeverine	26 July 2005	Solvay Healthcare Limited	Assets acquired: Goodwill, Records, Manufacturing Know-How, Registration Information and	27 July 2005

			the Marketing Authorisations.	
Ethosuximide	22 November 2005	Laboratories for Applied Biology Limited	Assets acquired: Goodwill, Trade Mark (EMESIDE), Packaging Rights, Records, Manufacturing Know-How, Registration Information, Marketing Authorisations and Lab Stock.	23 November 2005
Predenema, Carbalax Suppositories, Anigate Tablets, Isosorbate Dinitrate Tablets, Sustac Tablets, EP Tablets, Fletcher's Enemette	15 January 2008	Forest Laboratories UK Limited	Assets acquired: Goodwill, Trade Marks (PREDENEMA, CARBALAX, SUSTAC and ENEMETTE), Registration Information, Marketing Authorisations, right to use Manufacturing Information, Packaging Rights.	Isosorbide Dinitrate 17 January 2008
Mucogel Suspension, Superdrug Indigestion Relief Liquid, Fletcher's Phosphate Enema, Fletcher's Arachis Oil Retention Enema, Haymine Tablets	18 February 2008	Forest Laboratories UK Limited	Assets acquired: Goodwill, Trade Marks (FLETCHERS' PHARMAX HAYMINE and MUCOGEL), Registration Information, Marketing Authorisations, Right to use Manufacturing Information, Packaging Rights.	Agreements in respect of Mucogel Suspension, Fletcher's Phosphate Enema, Fletcher's Arachis Oil Retention Enema, Haymine Tablets 18 February 2008
Bumetanide	30 April 2008	LEO Laboratories Limited	Assets acquired: Marketing Authorisation, Manufacturing Information, Safety Date, Supply of Active Pharmaceutical Ingredients, Information.	Bumetanide 28 April 2008 Burinex A Tablets 24 October 2008

Clinoril, Decadron, Dolobid and Moducren	20 March 2009	Merck Sharp & Dohme Limited	Assignment of Marketing Authorisation, right to use know-How; also Trade mark Assignment Agreement (CLINORIL, DECADRON, DOLOBID and MODUCREN).	Decadron/ Dexamethasone 20 March 2009 Sulinac (Clinoril) 20 March 2009
Propaderm	15 September 2010	Glaxo Group Limited	Acquisition of Assets including: Goodwill, Trade Mark (PROPADERM), the Dossiers, the Marketing Authorisations, right to use Manufacturing Information, Packaging Rights.	15 September 2010
Predfoam/ Prednisolone	28 January 2011	Forest Laboratories UK Limited	Assets acquired: Goodwill, Trade Marks (PREDFOAM), Registration Information, Marketing Authorisations, Right to use Manufacturing Information, Packaging Rights.	1 February 2011

36. Although the table suggests that there was an Acquisition Agreement, the purchase of Clinoril, Decadron, Dolobid and Moducren in March 2009 was not achieved by an Acquisition Agreement. We explain Decadron later and the other three products were sold in 2010 and so are not relevant to this decision.

37. However, as we point out in the discussion of Decadron, it was one of the instances where on the face of it, it seemed that CPL made the purchase rather than the Partnership. It transpires that although it was nominally a party to the transaction it was acting as agent for the Partnership. The Partnership funded the purchase.

Overview of the pricing structure for drugs in the NHS

38. After a drug is granted marketing approval by either the Medicines and Healthcare products Regulatory Agency ("MHRA") or the European Medicines Agency, the MHRA classifies drugs into one of three categories, namely prescription-only medicines, pharmacy-only medicine and pharmaceuticals on a general sale list. Certain medicines are assessed by NICE for cost effectiveness and drugs that are approved are eligible for reimbursement. Those drugs are subject to price control. The NHS negotiates the price of pharmaceutical drugs through the Pharmaceutical Pricing Regulation Scheme ("PPRS") which is a five-year

renewable agreement. It does not apply to unbranded generics (ie drugs that are off-patent) or over-the-counter products or drugs sold outside the NHS. In 2013 in the UK, unbranded generics were not directly subject to price controls so unbranded generic prices were generally set by reference to market prices.

39. The pricing model in the NHS for approximately 30 or 40 years had worked on the basis that:-

(a) The pharmacy dispenses the drug to the patient for a fixed fee paid by the patient. Where the cost to the pharmacy of acquiring the drug exceeds the fixed fee the amount of this discrepancy is reimbursed to the pharmacy by the Department of Health.

(b) This system of reimbursement operates differently depending on whether the drug is

(i) a patented or branded drug, or

(ii) an out of patent or unbranded generic drug.

(c) Where a drug is patented it is known as a Category C drug. The price of Category C drugs is fixed by the Department of Health in consultation with the pharmaceutical company that had produced it (ie the PPRS).

(d) Where a drug is off-patent, and thus technically generic, if it is sold as a branded drug by a single supplier then it too would be in Category C. An example of that is Decadron which the Partnership purchased from Merck. It was off-patent but branded.

(e) For other generic drugs which are readily available there is no price control and those are referred to as either Category A or Category M drugs.

(f) Category A drugs are non-branded drugs where there is only one manufacturer and the drug must have a generic name approved by the MHRA.

(g) Category M drugs are readily available generic drugs where there is more than one manufacturer. They have a market value but that was not explored in any detail in the hearing or in the expert reports. The move into Category M drugs is a matter for the Department of Health to decide whether the drug is readily available.

(h) Although there is no price control mechanism for Category A drugs, the supplier of the drugs has to publish the prices and inform the Department of Health. Effectively the price is fixed by the market because the only alternative is what are called "Specials".

(i) On a named patient basis, in a situation where there is no marketing authorisation, the NHS can also source drugs that are known as "Specials". There is no published price and no restriction on pricing.

(j) In summary, Specials are the most expensive generic drugs. Category A drugs can be very expensive, but less so than Specials, because of the lack of competition and Category M drugs are less expensive because of the competition.

In summary there are varying levels of price controls on drugs leading to varying margin levels. This is highlighted, for example, from the history of Decadron/Dexamethasone, Decadron was at all times Category C because it was branded and it was therefore subject to price controls. Initially Dexamethasone was moved into Category A since CPL was the only manufacturer. The litigation relating to Decadron, to which we refer later, identified the fact that there was a shortage of Dexamethasone in 2009 so the NHS had to source supplies by parallel importing which is the import of non-UK licensed versions from the EU and other international markets. When others entered the market, Dexamethasone became a Category M drug.

The key individuals and entities and a pen picture of their activities

A. ***The Partners, the Partnership and the Business Model***

40. The Partners formed the Partnership in 1981. Mr and Mrs Engineer are, and were at all material times, husband and wife. They traded as "Chemidex".

41. The Partnership carried on a business including from:

(a) 1981 until 1999, operating retail pharmacies;

(b) 1993 until 2013, wholesale pharmaceutical sales;

(c) 2005 until 2013, the acquisition of the Product Assets and facilitating the exploitation of those by entering into the PSAs with CPL.

42. The Partnership had one employee who was both the bookkeeper and Mr Engineer's personal assistant. As at the date of the hearing she still worked for Mr Engineer.

43. In his first and second witness statements, Mr Engineer stated that the Partnership focussed on niche products owned by large pharmaceutical companies which those companies did not wish to actively market since the sales were low volume and, in some cases, the sales had already been discontinued. However, they were still being prescribed. In oral evidence he said that 95% of the Product Assets were going to be discontinued by the companies in question. The relevance of that is that if the drug in question was discontinued or otherwise not available then the NHS would have to have recourse to either parallel importing or purchasing Specials both of which would be at a greater cost.

44. The Partners tried to identify products that were neither marketed by many others nor likely to be so. They were tried and tested products which were off-patent.

45. A case in point is Propaderm which had not been marketed or manufactured since around July 2006. In the year before it was purchased by the Partnership in September 2010 there had been no sales of it. King & King reported that the turnover went from nil in 2010 to £63,282 in the following calendar year, rising to £161,583 in 2013.

46. The Partnership also looked for products that might be difficult to manufacture or reverse engineer without the intellectual property. They were aware that since they were off-patent other manufacturers could seek a licence (Market Authorisation) to supply them but that is a costly process. Typically, it would take two or three years to get a licence from the MRHA. It would involve clinical trials, and analytical and formulation work and thus a considerable investment.

47. The Partnership tried to identify products which Mr Engineer believed had "unique" qualities that could be exploited. In particular, Mr Engineer sought to identify products that were difficult to manufacture possibly because of their APIs (active pharmaceutical ingredients) which might be difficult to source.

48. The Partnership carried out extensive market research and consulted their industry contacts to identify those individual off-patent products. There are no records of that research. Effectively they relied on Mr Engineer's specialist knowledge and contacts built up over many years.

49. The Partners believed that those products were under-valued by the pharmaceutical companies in question and that there was a significant potential for future earnings. As far as the pharmaceutical companies were concerned, the relevant overheads in respect of low volume sales would have been disproportionate to the sales but that was not the case for the Partnership.

50. As part of the acquisition process, the Partnership formed a view on the optimal re-launch strategy and pricing level.

51. The Partnership negotiated with the pharmaceutical companies which, as can be seen, were usually large companies, and, where negotiations were successful, they acquired the intellectual property, occasionally any remaining stock and, on at least one occasion, a quantity of the API.

52. Some of the acquisitions involved what Mr Engineer described as a purchase of a basket of drugs. An example is the purchase from Sussex Pharmaceutical Ltd on 9 February 2005 where one of the drugs was paracetamol in which the Partnership had no interest because it was a commodity line and widely available. However, the seller insisted that it was included with the drugs that the Partnership wished to purchase.

53. Not all of the Product Assets were exploited immediately because of limited capacity. In Mr Engineer's words some were put "on the back burner to be marketed" later. He said that it was "the nature of the business" that some of the Product Assets were very successful and some much less so. Sales can decline if new drugs come on to the market that can be used to treat the same conditions and are found to be more effective or have fewer side effects; equally sales can rapidly increase if a new or unexpected use of an older drug is discovered which is what happened in the cases of dexamethasone and ethosuximide. The latter drug had been used, and still is used, for epilepsy but a new use has been found for it in chemotherapy.

54. Although, ultimately, we were provided with ten Acquisition Agreements, there is no dispute about their content and there is no need to narrate the detail of their provisions.

55. In general, given that they are very similar in most cases, in terms of the Acquisition Agreements with those companies, the Partnership acquired, in addition to stock where appropriate, some or all of the following:-

(a) Trade marks, if for sale;

(b) Packaging rights;

(c) Records which include customer lists and the financial records including details of sales, profit and loss;

(d) Manufacturing know-how which was loosely described as "recipes" or manufacturing information for particular formulations of drugs;

(e) Registration information;

(f) Non-exclusive Marketing Authorisations ("MAs") in the UK and on occasion also Additional MAs ("AMAs"). MAs relate to a particular formulation of a drug but it is not just the recipe but also the analysis (high performance liquid chromatography (HLPC)) and other information. It is a licence (see also paragraph 46 above).

(g) Goodwill.

56. The packaging rights, and the intellectual property rights subsisting within them are a distinct asset. The MHRA is responsible for regulating all medicines and medical devices in the UK. It must pre-authorise the MA's and all packaging and labelling information including the patient information leaflet.

57. Mr Engineer described the "recipes" and the MAs as being the key elements of the Product Assets. Confusingly, Mr Palmer said that the MAs were the key component but we prefer, and accept, Mr Engineer's evidence. Mr Engineer stated that the MAs would have to be updated under his guidance to ensure that the product was licensed to a modern standard given that the products were off-patent and therefore old.

58. The trade marks were very rarely used.

59. The total acquisition cost to the Partnership of the Product Assets was agreed to be approximately £1.9 million.

60. The business model was to make available to the NHS products that it wanted and which may not otherwise have been available to it or which would only be available as expensive "Specials".

61. In broad terms the business model operated as follows:

(1) Firstly, the Product Assets were acquired. The drugs in question were either branded drugs or discontinued unbranded drugs. Mr Engineer tried to identify drugs that were difficult to manufacture and, if still being sold, were sold in low volumes and therefore unattractive to big companies.

(2) In the case of the branded drugs, of course, they were within Category C when acquired. The name was then changed to a generic name (having obtained authorisation to do so) and in consequence the drug would be moved to Category A or M.

(3) As no price controls apply to category A or M drugs the price could then be increased by a large amount.

62. Mr Engineer accepted that the price rises implemented under the business model could accurately be described as "massive."

63. As with any other business, some of the Product Assets were success stories and some were not and the profile of some could, and did, change over time.

64. Having decided to acquire the Product Assets, the Partners would look at how they could increase the sales and/or returns in respect of each one.

65. The Partners decided the pricing structure and devised the marketing strategy for each Product Asset and that was then implemented by CPL.

66. On 15 June 2010, the Partnership disposed of a number of, their then, Product Assets to CPL. In the Response those are stated to having been viewed as having zero or relatively modest turnover having been purchased as part of a "basket" or "bundle" of Product Assets. The consideration paid was £2,045,000.

67. In the management information furnished to Mr Palmer it was noted that one of the drivers for the disposal by the Partnership to CGL was Mr Engineer's intention to leave the UK.

68. The Partnership recognised that what it sold to CGL was a fixed portfolio with a finite life. The last purchase had been in 2011 and the significant price rise for Prednisolone (and the other Product Assets) had been achieved before the Valuation Date. The net profits for the two Prednisolone products in 2012 amounted to £2,907,847. It rose slightly in the following year and as with all of the other Product Assets, Mr Engineer hoped, and expected, that over time prices could be increased.

69. The Partnership was reliant on a very small number of products.

70. Mr Palmer agreed with Mr Mitchell's assessment that the growth in revenue from 2011 to 2013 was derived from two products, Prednisolone and Dexamethasone albeit he argued that there had been a fairly stable level of historical profitability. Both accepted that five of the

Product Assets accounted for approximately 85% of the revenue in 2013. (It had been approximately 80% in 2010.) Everyone, including Mr Engineer, accepted that over a period some drugs would be on an upward trajectory but then others would be the reverse. An example, in Mr Mitchell's Table 10 (which is the Revenue and net profit figures for the Partnership), was Bumetanide which produced revenue of £2,121,586 in the year to 30 June 2010 falling to £1,463,489 in the year to 30 June 2012. It fell slightly further in 2013 but that was not a full year of trading. Nevertheless, it was one of the five very profitable Product Assets.

71. The Partners both enjoyed seven figure drawings from the Partnership in each of the years for which we had information from their accounts, being from 2009 to the Valuation Date. The Partnership's only source of income at the Valuation Date was the income generated by licensing the Product Assets to CPL.

72. Because the figures provided to the experts were derived from different sources, it was not entirely clear exactly what payments were made to the Partnership in terms of the PSAs, as Mr Mitchell makes clear at 4.18, 7.4 and 7.9 in his report but the general trend is obvious; there had been a steady growth in the profit share payments from CPL to the Partnership. In the year ending 30 June 2009, the Partnership received at least £2.781million and that rose to in excess of £5.5 million for 2013.

73. Mr Mitchell calculated that the Partnership's revenue increased at a Compound Annual Growth Rate ("CAGR") of 25.1% between the APE 2009 and the end of 2012. The gross profit margin for the Partnership improved from 96% in APE 2009 to 99.7% at the Valuation Date. There was a similar pattern of improvements in the Earnings Before Interest, Tax, Depreciation and Amortisation ("EBITDA") and Earnings Before Interest and Tax ("EBIT") over the same period.

B. *CPL*

74. CPL's revenue was earned by marketing products that it, itself, directly owned and by manufacturing, marketing and selling the Product Assets to third parties. Mr Palmer calculated that the profit share payment to the Partnership rose from 19.2% of its revenue in 2009 to 26.1% in 2013. CPL therefore had a significant business of its own.

75. CPL is a UK company incorporated on 8 November 1982. At all material times the Partners were the shareholders of CPL. Initially each held 50% of the shares then, following the issue of new shares on 25 April 2001, Mr Engineer held 50.9% and Mrs Engineer held 49.1% (rounded to one decimal place).

76. Mr Engineer was Chairman of the Board of Directors of CPL and he and his wife were the only directors until 2 November 2012 when Dr Nikesh Engineer was appointed as a director. Dr Nikesh Engineer, whom we assume to be Mr Engineer's son, signed the Notice of Appeal and we also assume that he is the Dr Engineer referred to in the "Decadron litigation" to which we will refer later. On 15 March 2013, another family member, Dr M Engineer, was appointed as a director. Mr and Mrs Engineer resigned as directors on 28 March 2013 but remained shareholders.

77. Neither Partner was paid anything by CPL. In response to a query from HMRC, in a letter dated 26 February 2018, King & King, the then advisors to all of the Chemidex entities, stated that Mr and Mrs Engineer were "…full-time directors of the company and were involved with the day to day running of CPL". We will revert to that.

78. There is not a great deal of clarity about CPL but certainly, we can see from the documentation that in the period with which we are concerned, but we have limited details,

CPL frequently traded as "Essential Generics". We are surprised that Mr Engineer, in cross-examination, said that Essential Generics was "after 2013". However, it is a long time ago.

79. It is clear from the correspondence that CPL was trading as Essential Generics in 2009 since we can see that from the correspondence and exhibits about Dexamethasone.

80. That should not be confused with what Mr Engineer called Essential Pharma which marketed worldwide, whereas CPL and the Partnership were focussed on the UK (albeit we noticed at least one purchase of Product Assets for Eire).

81. We observe that Essential Pharma Limited was incorporated on 2 February 2011 and in October 2012 bought its first licence. Essential Pharmaceuticals Limited was incorporated on 24 November 2010 and bought its first licence in March 2013. As Note 14 in the Notes to the Financial Statements in CPL's 2013 Accounts record, they are related due to common ownership.

82. Until the retail pharmacies were sold to a German company in 1999 some of those were owned by CPL. Prior to 2005 when the Partnership commenced to purchase the Product Assets, CPL had purchased intellectual property rights on perhaps two or three occasions. Those were branded products which they then sold, also, as branded products.

83. The 2013 Financial Statements show that CPL had 14 employees of which 11 were "production" staff and 3 "administration" staff (in 2012, those figures were 13 and 1 respectively). The description of "production" staff is confusing, and has not been explained, since all production was outsourced; we assume that those were the staff who directly interfaced with the outsourced entities.

84. CPL commissioned research and development into the technical specifications to bring them up-to-date. In some cases the Product Assets required certain changes in the manufacturing or testing process.

85. CPL used Contract Manufacturing Organisations ("CMOs") for manufacturing which was outsourced to the CMOs and the CPL staff liaised with them. Distribution, packaging and storage were also outsourced. All of the contracts with third parties were in CPL's name and were entered into on arm's-length terms.

86. In some cases, the packaging was redesigned and the summary of product characteristics ("SPCs") and pharmacovigilance (adverse safety information) notices updated. Although CPL used an external consultant for pharmacovigilance some of the staff were involved in doing that type of work and liaising with that consultant.

87. The patient information leaflets would also be updated where necessary or desirable.

88. CPL staff applied to the MHRA for the transfer of licences. Once a licence was transferred from the Partnership, CPL would apply to the MHRA for a change of name so that the drug in question could be sold as a generic named drug. They then re-negotiated the price increases with the NHS.

89. CPL made all the requisite reports to, and sought relevant approvals from, the MHRA. There was regulatory work liaising with the MHRA much of which could be described as being a straightforward administrative exercise. The staff analysed the analytical systems and, when the CMOs, having implemented those instructions, reported back, CPL would then revert to the MHRA. They liaised with the packaging companies and again reverted to the MHRA sending examples of patient information notices and packaging with eg the Essential Generics name on it.

90. The regulatory fees payable to the MHRA (and the repackaging and marketing costs) were described as being low.

91. Essentially CPL liaised with all of those involved in monetarising the Product Assets and they monitored what their competitors did.

92. CPL operated from the premises owned, and occupied, by the Partnership and paid no rent in the period until the property was sold to CPL on 24 December 2010 at a price of £2 million. An independent valuation had been obtained by Mr Engineer. Thereafter, until the Valuation Date, there was an undocumented licence to occupy by the Partnership and in terms of clause 2.2 of the Transfer Agreement that was transferred to CGL. It is not disputed that no value was attributed to that licence. The Partnership paid no rent. The landline telephone number in the premises was used by the Partners, CPL and CGL when dealing with third parties.

93. By June 2009, the net book value of CPL's intangible fixed assets was £6,549,471. Its accounts record that its principal activity was "…that of wholesale of pharmaceutical goods, purchase of pharmaceutical brands and licenses and marketing these products."

94. The management information provided to Mr Palmer at a meeting with King & King on 7 March 2019 (the "Management Information") included information that CPL is insured as the "marketers of the product" with the insurance covering both CPL and CGL and that there was a very small budget for marketing which is targeted at doctors and consultants. That marketing involved the provision of free consulting rooms.

95. We note that in a letter from King & King dated 29 June 2018, they told HMRC that the total marketing spend for CPL (including for its own assets) was £206,000 in 2013. However, we also note from CPL's accounts that it had been significantly higher in some of the other years, eg £463,193 in 2010 and £250,456 in 2009. It fell to £193,726 in 2011 before rising to £206,643 in 2012 and £206,895 in 2013. Lastly, in that context we observe that that does not include the staffing costs. Mr Palmer did not separately identify marketing in his projections (which are for the "Chemidex Business" which Mr Mitchell described as a "hypothetical company" being an amalgam of CPL and the Partnership) but simply included it in personnel costs.

96. Furthermore, in relation to Chloramphenicol which was purchased in 2005, in oral evidence, Mr Engineer stated that if one looked at the pricing of the capsules "it rose from £699 to £862" because "…we were heavily marketing it to the hospital microbiologist. We spent a lot of money marketing it to them….".

97. In fact, we can see from Mr Mitchell's Table 10, that that revenue went from £696,929 in the year to 30 June 2010 to £812,975 the following year and then dropped to £666,674 before rising to £862,855 in the year to 30 June 2013. There is an obvious lack of clarity in the detail, but as noted earlier this was a long time ago.

98. Having acquired data identifying specific clinics and doctors, the primary marketing strategy was to target doctors and consultants in hospitals with marketing materials to raise awareness of the existence of these older drugs where the side effects were well known. The Product Assets were advertised in medical journals in order to appeal to GPs.

99. CPL held and exploited numerous products in its own right and Mr Palmer had been told that 70% of CPL's costs related to its own products.

C. *The PSAs between the Partners and CPL*

100. Notwithstanding the terms of the Agreed Statement of Facts, as we had identified in the course of the hearing and thereafter, there were not PSAs for all of the Product Assets. In the Response, it was submitted that the parties agreed, and we accept, that:-

(a) The Partnership decided that some of the Product Assets, having been bought as part of a basket or bundle, should not be exploited. Therefore no PSA was needed,

(b) Two, which were sold to CGL, had not been exploited and had no value attributed to them in either expert's valuation,

(c) Two types of Product Asset purchased in 2008 which were part of the Transfer Agreement, were not subject to PSAs, but no value was attributed to either by the experts.

101. The PSAs are all in almost, if not, identical terms.

102. In Clauses 2 and 3 the Partnership granted CPL a licence to use the Product Assets in order to manufacture, market and sell the specified product(s) and CPL agreed to pay the Partnership 40% of the Net Profit. The Net Profit is defined as "…the revenue from the sale of the Product minus the cost of manufacture and distribution of such Product". Of course, as we have described, manufacture and distribution were outsourced to CMOs.

103. HMRC argue that the definition of Net Profit more closely resembles the concept of gross profit. Mr Palmer was clear that if it were calculated as a percentage of net sales it would be a higher percentage. The relevance of that is that in the comparator companies for royalty rates considered by both the experts, the royalty rate was usually based on revenue, ie sales.

104. In their letter of 9 January 2017, King & King explained that the profit share entitlement had been based on a novated agreement from as long ago as 2005, and written evidence of the basis on which it had been agreed had not been retained. However, their client's recollection was that it was "a reasonable attempt to recognise the value in the totality of the assets retained by the Partnership and licensed to CPL".

105. Having described it as a joint venture they went on to describe how the quantum of the payment had been decided as follows:-

> "The split was based on Gross Profit calculations apportioned as CPL 60%: Partnership 40%, and the intention was for Net Profits to be shared roughly equally. To account for manufacturing/distribution/operational/wage costs paid solely by CPL, CPL was awarded more than 50% of the Gross Profits to offset these costs related to the ongoing maintenance of these products. Profit Share calculations were not based on Net Profit calculations as it would be very difficult to continually work out product specific net profits on a month by month basis. Agreeing on a Gross Profit apportionment would also ensure that there was no argument on CPL's cost allocations and apportionments e.g. marketing budget, wages."

106. Mr Engineer's evidence was that he had decided on that split of revenue having discussed what to do at some length with the accountants (who he conceded did not have formal pharmaceutical industry experience). He had not taken advice from anyone in the pharmaceutical industry because he did not think that others in that industry were like his businesses. He had looked around to see if there were any similar businesses and found that there were none. He viewed his business as being far more profitable than any others that he had researched. He said that he wanted CPL to have the "lion's share of the profit" because they were doing more than the Partnership. He was very clear that he did not see the payments to the Partnership as royalties because they were literally a share of profits and had always been seen as such. He argued that a royalty is very different to a profit share.

107. However, we observe from the Notes to the Financial Statements for CPL for the year ended 30 June 2010 that the payments to the Partnership were described as "royalties of £3,644,560". In the following years the comparable entries were then described as "arm's length trading transactions".

108. In the case of trade marks, at Clause 4 of the PSAs the Partners reserved the right to issue guidelines as to the manner in which the trade marks were use. CPL were bound to comply therewith, and on request to provide samples so the Partners could check on compliance. CPL were bound to fulfil any "reasonable request" to correct any apparent failures in compliance.

109. Apart from that provision, there is no commitment or legal requirement placed upon the Partners to do anything else other than to make the Product Assets available to CPL which was was effectively, a licensee.

110. The key term upon which HMRC relies is Clause 6 whereby CPL indemnify the Partners "in respect of all costs, claims, damages and expenses which may arise as a result of any claim by a third party" relating to the Product Assets.

111. The key terms upon which CGL rely, and which are in every PSA, are Clauses 7 and 8 which read:-

> **"Term**
>
> 7.1 This Agreement shall commence with effect from the Effective Date and shall continue without limit of time provided that it may be terminated by either Party at will upon written notice to the other.
>
> 7.2 The Partners may terminate this Agreement by written notice with immediate effect if:
>
> 7.2.1 Chemidex Pharma ceases to trade or goes into liquidation, administration or receivership, or
>
> 7.2.2 There is a change of control in the ownership of Chemidex Parma.
>
> ***Upon termination and unless otherwise agreed between the Parties***
>
> 8.1 Chemidex Pharma, at the Partner's (sic) option, shall use its best endeavours to transfer to The Partners or such person as The Partners may nominate, any Marketing Authorisation(s) held in the name of Chemidex Pharma, licence(s), permit(s) or approval(s) obtained specifically for the manufacturing and/or marketing of the Product(s) under this Agreement.
>
> 8.2 Subject to agreement with The Partners, Chemidex Pharma may continue to market and sell existing stock of The Products until stock exhaustion or shelf-life expiry, provided however that Chemidex Pharma shall continue to pay a share of the Net Profit to the Partners in accordance with clause 3."

D. CGL

112. CGL is a UK company incorporated on 23 July 1999. It was a dormant company until its first period of trading in the year to 30 June 2013. The accounts for that period state that its principal activity is "…licensing of pharmaceutical products".

113. At all material times the Partners were the shareholders of CGL, each holding 50% of the shares. Until 14 February 2013, when Dr Nikesh Engineer was appointed as a director, Mr and Mrs Engineer were the sole directors with Mr Engineer acting as Chairman. Dr M Engineer was appointed as a director on 15 March 2013 and Mr and Mrs Engineer resigned as directors on 28 March 2013.

114. CGL purchased the business carried on by the Partnership as a going concern in terms of the Business Transfer Agreement on the Valuation Date. In addition to the Business Transfer Agreement there was also a Trade Mark Assignment Deed between the Partners and CGL and a Novation of PSAs between the Partners, CPL and CGL. Attached to that was a Schedule of 16 PSAs.

115. Following the transfer, CGL owned the Product Assets and held the benefit of the various PSAs.

116. The consideration therefor was the allotment and issue of a total of 98 £1 ordinary shares in CGL to the Partners. Those were issued at a premium of £40 million reflecting the agreed value of the Product Assets.

117. At the Valuation Date the Partners and CGL were "related parties" for the purposes of Chapter 12 of Part 8 CTA.

118. For completeness, although it has no impact on the valuation and it is only peripherally relevant in considering the management's forecast of the likely revenue stream after the Valuation Date, overall, CGL's operating profit increased from £2.76 million in its first operating year to 30 June 2014 to £6.25 million in the year to 30 June 2019 which was the last full year of trading.

119. The introduction of The Health Service Medical Supplies (Costs) Act 2017 does not appear to have had a detrimental impact on the business of CGL.

120. CGL was sold on 16 December 2019. We do not have the details beyond Mr Engineer's evidence in his second witness statement that when the business was sold in 2019, he had negotiated the price on the assumption that the sales of the Product assets would remain stable and would not significantly decline. Of course, that is long after the Valuation Date and cannot impact on valuation.

E. The interaction between the Partners, CPL and CGL

121. In the Skeleton Argument for CGL, it described the "Chemidex Business" in March 2013 as having two arms being the Partnership and CPL. Certainly CGL had been dormant until then. The problem, however, is that, legally and for tax purposes, there was not one business and we are only concerned with the Partnership's sale to CGL. Although Mr Engineer was the guiding mind of both CPL and the Partnership, what CGL acquired was <u>one</u> business and that was the Partnership. There was no "Chemidex Business". Whilst, as can be seen from paragraph 7 above, the Partnership business was taken to be the Product Assets, in order to value those, we need to understand how both the Partnership and CPL operated.

122. In the letter from King & King to HMRC dated 9 January 2017 to which we have referred at paragraphs 104 and 105 above, they explained that:-

> "This was effectively a joint venture between CPL and the Partnership; whereby the Partnership put up the money to acquire and own the assets, and CPL markets and pays for the ongoing maintenance of the products".

123. In summary, in Mr Palmer's words, CPL carried out research and development and brought the Product Assets in line with regulatory standards. It executed the commercial relaunch of the Product Assets whilst the Partnership advised on the relaunch strategy and pricing.

124. HMRC have consistently argued that whilst it is accepted that the Partners financed the acquisition of the Product Assets, the maintenance and monetisation of the Product Assets was done by CPL and not by the Partners. CPL had the requisite resources to perform all those

functions relying on its assets, including its workforce and the Partners in their capacities as directors.

125. As we have indicated, the PSAs do not require the Partners to provide any assistance or support beyond providing, if required, guidelines in relation to use of trade marks and no such guidelines were ever produced.

126. HMRC also argue that CPL was responsible for the development of the goodwill in the customer relationships.

127. Two of the questions that we had raised with the parties were that:-

(a) We had noted from the emails in the Bundle that the telephone numbers that were given when Mr Engineer emailed Merck were his mobile number and the number used by CPL employees so we wanted to know what he used and in which capacity, and

(b) We had noted from the correspondence in the Bundle that on 27 December 2017, HMRC had asked King & King to clarify the extent to which Mr and Mrs Engineer worked within CPL, what their roles were and how many hours they worked. They asked that the reply be supported by reference to third party data. The reply on 26 February 2018 was simply that they were full-time directors and were involved in the day to day running of CPL.

128. In regard to the first question, the answer in the Response was to the effect that those telephone numbers were used for business conducted for each of the Partnership, CPL and CGL (whether as director or shareholder). That did not assist.

129. In regard to the second question, in the Response, the statement from King & King was reiterated with the added explanation that:-

> "They continued to be involved in the running of the business in their capacity as shareholders thereafter [28 March 2013]. They were also partners in the Partnership up until the transfer of the Product Assets to CGL on the Valuation Date and spent as much time as was necessary on the Partnership business."

That did not answer the question.

130. As we have indicated they were only remunerated by the Partnership.

131. However, when writing this decision, and reviewing the valuation evidence in detail, we found a letter from King & King dated 11 September 2019 to HMRC's Shares and Assets Valuation division enclosing copies of the instructions and documents provided to Mr Palmer. They pointed out that on 9 April 2019 they had furnished HMRC with a two page document (that had been provided to Mr Palmer) which summarised Mr and Mrs Engineer's responsibilities when acting in their capacities as directors and as partners. There were 22 as directors and 25 as partners. We annex at Appendix 1 a copy of that document.

132. Bluntly, it confirmed our thinking that, in terms of day to day business, there was little distinction between their roles in the Partnership and CPL. For example, in both categories they are described as:-

(a) "Looking for right quality staff and consultants"; the only distinction being that as directors they were said to manage both and supervise staff.

(b) "Entertain business contacts".

(c) "Ensuring the products are manufactured to correct specification by the CMOs"; the only distinction being that as Partners that also included ensuring that had also been done historically.

(d) "Negotiating contracts and Technical Agreements with CMOs".

(e) "Discussing and involvement in product transfers and technology transfers of acquired products into the CMOs"; the only distinction being that as Partners that also involved transfers from the CMOs.

(f) "Involvement with and discussing regulatory issues with regulatory staff, consultants and the regulatory authorities like the MHRA"; the only distinction being that as directors they were responsible for instructing and supervising regulatory staff and consultants.

(g) Monitoring R&D but as Partners they do so in the context of monitoring CPL's R&D activities and as directors they also ensure that "clinical trials are conducted in accordance with Good Clinical Practice".

133. As Partners, they are described as advising CPL on relaunch strategy including pricing and advising on price increases and marketing strategy. As Directors, it is stated that they calculate increases in prices, negotiate price increases and relaunch products.

134. In that letter, in explaining a lack of documentation, King & King stated that "It is extremely unlikely that any emails or notes of telephone conversations and meetings would specifically confirm in what capacity our client was acting (e.g. as partner in the Partnership or as director of CPL)…".

135. Mr Engineer described CPL as acting like a post-box because most of the work was outsourced. Mr Goldberg argues that CPL was what he described as a pass-through company adding no real value. As we describe later in this decision, Mr Palmer came to that conclusion based on what he was told by Mr Engineer.

136. However, we observe that HMRC had requested detailed information from King & King in relation to Dexamethasone and Propaderm. In an email from HMRC to King & King, dated 23 December 2019, HMRC pointed out that in relation to Dexamethasone in 2006 there had been emails from Mr Engineer copying in Caroline Brockis, who was CPL's Technical Affairs Manager and Bipin Patel who was responsible for CPL's Sales and General Operations referencing their completing due diligence. In late 2008 and early 2009 there were numerous emails involving all three. In particular, on 3 December 2008, Mr Engineer copied Ms Brockis in to correspondence in an email negotiating the contract for the acquisition. All of that was pre-acquisition. In subsequent correspondence, HMRC argued that the Partnership had made "no contribution to the no doubt significant costs of providing" the services of those individuals; that demonstrated the "significant contribution" that CPL had made to the acquisition and subsequent monetisation.

137. As far as Propaderm (Beclometasone) was concerned, HMRC had pointed out that in the period from 16 June 2010 before the acquisition from Glaxo SmithKline ("GSK") on 30 September 2010 there was correspondence involving all three of them.

138. In cross-examination, Mr Henderson pointed out that on 1 May 2009, Mr Engineer wrote to GSK in his capacity as Managing Director of CPL making a conditional offer for Propaderm. He explained that he had done that in that capacity rather than as a Partner in order to save time. Propaderm had been discontinued in 2006 and he wanted to get it to market as quickly as possible. He had spoken to GSK and explained that it was a purchase by the Partnership but he wanted the licence to go straight to CPL who would need to market it. We accept that.

139. In addition to the marketing information to which we refer at paragraph 93 above, the Management Information provided to Mr Palmer on 7 March 2019 states that:-

(a) CPL makes the decision every year as to how much to manufacture.

(b) Price increases are normally made 6 to 12 months after acquisition and CPL makes the pricing decisions.

(c) Mr Engineer's relationships with GPs helps to generate sales.

(d) Personnel costs make up a large part of the operating expenses.

140. In his oral evidence Mr Engineer was adamant that it was always he who decided how much of a given product was manufactured and the price at which it was sold. It was argued that he would have done so in his capacity as a Partner.

141. The first and most obvious point is that the price of the Product Assets changed during the periods after they were relaunched. They both rose and fell. There is clear evidence that pricing changed after acquisition and after the initial price rise, prices and marketing strategies changed as drugs evolved, or not.

142. Secondly, Mr Palmer states explicitly that it was CPL who re-negotiated the first (steep) price rise after the MHRA approval was obtained (see paragraphs 62 and 63 above). Whilst we accept that when negotiating the acquisition of the Product Asset, the Partners would have had an indicative price rise in mind that was not the end of the story. Thereafter it was CPL who progressed matters.

143. It seems to us that, since, with the exception of one of the Bumetanide products, the PSAs were signed either on the date of acquisition of the Product Assets or within a matter of days before or after the acquisition it was CPL which made and implemented these decisions and Mr Engineer would have been doing so in his capacity as a director. Mr Engineer's final approval was required on most matters. As we have pointed out it was Mr Engineer who oversaw the updating of the MAs.

144. As can be seen, in the Management Information it stated that "Mr Engineer's relationships with GPs help generate sales". Since sales occur only post acquisition and once CPL is exploiting the Product Assets that one argument could be that that was Mr Engineer acting in his capacity as a director. However, as can be seen from Appendix 1, one of his responsibilities as a Partner was to "Entertain business contacts". We are aware that, at that time, many drug companies offered hospitality to GP practices, so it could also be argued that that was Mr Engineer acting in his capacity as a Partner.

145. Mr Engineer's uncontested second witness statement stated that:-

> "The activities undertaken by CPL were relatively low-value activities which could have been undertaken by any reasonably competent person and, in particular, could have been undertaken by the owner of the Product Assets."

146. However, the fact is that the Partners decided not to undertake those activities and outsourced them to CPL in return for the monthly payments based on the share of net profits. That was their commercial choice.

147. We understand why the Skeleton Argument for CGL describes the Partnership and CPL as the "Chemidex Business" and why two of Mr Palmer's valuation approaches looked at it in the same way; the reality was that Mr Engineer, in whatever capacity, would have been perceived as the "Chemidex Business". We will revert to that.

148. In summary, the boundaries between the Partnership and what the Partners did in that capacity and what was done by CPL are very unclear. We do not doubt that when researching what products the Partnership wanted to buy, the Partners would have had in mind the likely price increases and marketing strategy that they would wish CPL to achieve. However, it was CPL that delivered that and negotiated subsequent pricing changes etc.

A Tale of Two Drugs

149. In their Skeleton Argument HMRC focussed on two drugs, Dexamethasone and Mebeverine and produced as an appendix a summary of publicly available data about the prices charged for those drugs. We annex that appendix hereto as Appendix 2.

150. Those two drugs had been identified by Mr Mitchell as being two of five drugs which provided the majority (in excess of 82%) of the Partnership's revenue stream in the years to 31 December 2010 to 2012.

Decadron/Dexamethasone

151. As we have indicated the parties stated that Decadron was purchased in March 2009. In fact, on 25 February 2009, CPL applied to the MHRA for a change of ownership stating that "Decadron 500 mcg" tablets had not been marketed since October 2004. With that they submitted the required amended product information. That disclosed the ingredients which included the information that the API was 500 micrograms of dexamethasone.

152. The assignment of the UK MA was dated 20 March 2009. That assignment covered Decadron and the three other drugs and their trade marks. The purchase price for the MAs was £50,000 plus VAT to be paid within 15 days.

153. The trade mark agreement is also dated 20 March 2009. The purchase price was £450,000 plus VAT. The Decadron trade mark had first been registered in 1958.

154. On the same day, the Partners issued a letter indemnifying CPL in respect of the purchases and the directors of CPL resolved that they would sign the contracts on behalf of the Partnership on the basis that the Partnership would "make full payment of the purchase price and all related costs".

155. In a letter dated 22 May 2017, King & King had confirmed to HMRC that there had been no sales of Dexamethasone in the 12 months prior to the purchase.

156. Prior to the Partnership's purchase of Decadron it had had to be purchased by the NHS as Specials. In his oral evidence Mr Engineer said that those were sold at £300 to £400 per packet. When the generic name Dexamethasone was approved by the MHRA it became a Category A drug.

157. As can be seen from Appendix 2, in 2009 the price of Dexamethasone 500 mcg tablets increased by 1449.4%. It was selling at £26.03 per prescription. Mr Engineer argued that, because it was a low volume product, the CMO had to be persuaded to undertake the manufacture and it was not as cheap as if it had been high volume. However, he conceded that most of the benefit of the price increase accrued to CPL and therefore indirectly to the Partnership. He also pointed out that it was still very much cheaper than the liquid alternative 500mcg dose which cost £170.

158. He argued that there was an inherent risk in bringing Dexamethasone, or any drug, to the market and uncertainty as to whether the high price could be achieved.

159. On 24 December 2014, a competitor applied to register a trade mark for Decadron. That competitor was what was known as a parallel importer, which is to say that they wished to import a formulation of Decadron that was trade marked elsewhere in the European Union. CPL lodged an objection on the basis of their ownership of the UK trade mark and the competitor objected on the basis that that trade mark had not been put to "genuine use".

160. In HMRC's Supplemental Bundle there was a copy of the public version of the decision in that litigation which indicates that, since 2009, CPL had sold the drug in the UK as Dexamethasone. The ultimate customers were mainly community and hospital pharmacies.

Subsequently another company was also authorised to sell it in the UK with the generic name of Dexamethasone.

161. As HMRC rightly point out, the implication of that is that that company, having complied with the MHRA requirements had been able to obtain an MA which effectively gave it the same rights in relation to Dexamethasone as the Partnership.

162. The evidence was that there was a shortage of Dexamethasone in 2009 and the MHRA had authorised parallel imports. We know from a letter from King & King to HMRC dated 22 May 2017 that the turnover from Dexamethasone from March 2009 to March 2013 was stated to be:

Turnover	**Jan-Dec 2009**	**Jan-Dec 2010**	**Jan-Dec 2011**	**Jan-Dec 2012**	**Jan-Dec 2013**
Dexamethasone 500mcg Tablets	£818,735	£3,364,504	£3,917,579	£4,266,418	£5,788,969

163. In the course of the litigation, Dr Engineer explained that CPL maximised their market share by selling not only the generically named pharmaceutical (Dexamethasone) but also the branded drug (Decadron). He stated that the sales of Decadron probably averaged 1% or less of the market.

164. The Registrar in that litigation decided to revoke CPL's registration of the trade mark on the grounds of non-use. Mr Engineer stated that that litigation had no impact on CGL's business model.

165. Based on information provided to HMRC by King & King on 10 November 2015, Mr Palmer reported that the net profit for Dexamethasone for the years to 30 June in each of 2010 to 2013 was £1,760,733, £3,694,253, £4,061,618 and £5,007,791.

Mebeverine

166. On 26 July 2005, the Partnership had acquired from Solvay Healthcare Limited ("Solvay") Mebeverine 50mg/5ml liquid which was sold in the UK under the trade marked brand name Colofac. The Acquisition Agreement specifically excludes the trade mark. Exclusive of VAT, the purchase price was allocated as to £270,000 for Goodwill and £30,000 for "Manufacturing Know-how, Records, Registration Information, Marketing Authorisation".

167. The API was mebeverine hydrochloride and on the same day the Partnership entered into a contract with Solvay to purchase supplies of that for a period of five years.

168. On 27 July 2005 the Partnership entered into a PSA with CPL. Since it was in standard terms it included Clauses 7 and 8. Clause 2 granted to CPL the right:-

> "…to use the Assets for the manufacture, marketing and sale of [Mebeverine] including the right to use the Assets to obtain Marketing Authorisations for [Mebeverine]".

The term "Assets", as used in the PSA, was defined to include records, manufacturing know-how, registration information, marketing authorisations and trade mark(s). Of course, in this case, there were no trade marks.

169. As with the other PSAs, CPL agreed to pay the Partnership 40% of the net profit.

170. As can be seen from Appendix 2, in 2005 when the Partnership bought Mebeverine the branded version cost £5.47 per prescription dropping to £4.05 in 2006. When CPL changed it to the generic Mebeverine in 2006 the price per prescription leapt to £150.13. In 2013 the Appendix states that it was selling for £227.28 per prescription.

171. CPL and latterly CGL were the only supplier of Mebeverine in the UK. If they had stopped producing it and there was still a demand then Mr Engineer stated that it would have to have been sourced as a "Special" at a much higher cost to the NHS. His oral evidence was that, because it had been discontinued when he purchased it, it was a Special and was being sold for £400.

172. Based on information provided to HMRC by King & King on 10 November 2015, Mr Palmer reported that the net profit for Mebeverine for the years to 30 June in each of 2010 to 2013 was £2,248,132, £2,562,545, £2,307,528 and £2,035,438. As can be observed, there is a fluctuation and overall a 9.5% fall in the period but, nevertheless, it was one of the five primary sources of revenue from the Product Assets.

Press coverage

173. HMRC argue that the press coverage and the Government paper commenting on unbranded generic medicines that HMRC had produced in the Supplemental Bundle were important because:-

(a) They were relevant to CGL's business model, and

(b) A buyer would have been aware that there was Department of Health and media concern about price increases in unbranded generic medicines so that would affect the risk profile, and thus the valuation, of the CGL business.

174. The Supplemental Bundle included two articles from The Times dated 3 June and 25 November 2016 with the headlines "How the loophole works" and "Drug firm exploits loophole to raise price from £3 to £87". The former article was sparse on detail and talked in very general terms about Category A, C and M drugs in the context of certain companies and wholesalers which were named. The latter article referred to the June article and summarised it explaining that the price increases were possible in a situation where there was no competition because:-

> "The loophole allows suppliers to avoid a cap on the profits they can make from a drug, and therefore the price they can set, if they drop an existing brand name and relaunch it as a generic version".

The example given in the article was Essential Generics having raised the price of lithium carbonate (which was not one of the Product Assets) from £3.22 to £87 in the course of 2016. Mr Engineer agreed that that example was similar to what had happened with Dexamethasone and Mebeverine.

175. The Supplemental Bundle also included an article dated 20 September 2016 from The Pharmaceutical Journal headed "UK Government to tackle high drug prices" relating to the Health Services Medical Supplies (Costs) Bill. It focussed on "the issue of significant price rises in a small number of those medicines where a competitive market is not working" effectively because of a lack of competition. It referred to "recent price increases in 1% of generic medicines, which may or may not be justified".

176. Obviously all three of these articles were written more than three years after the Valuation Date.

177. The Daily Mail Online article was produced on the third day of the hearing because, in cross-examination, Mr Engineer had trenchantly stated that the three articles were all dated 2016 and had no relevance to the Valuation Date. His point was that whilst he accepted that there was apparent concern in 2016, no one was talking about curbing prices in 2013 or indeed in 2014 or 2015. No one within the NHS or the government had ever challenged the CGL business model.

178. The headline in the Daily Mail Online article was:-

> "'NHS doesn't care about costs of medicine': Drugs firm is accused of profiteering by raising prices by ONE THOUSAND per cent".

179. It is not an article about any of the Chemidex entities but commented on increases in prices charged to the NHS for "unbranded so-called 'generic' drugs which had been available for many years".

180. It quoted comments from a number of politicians and stated that the newspaper group had prompted the Department of Health to reveal that it had launched a review of price increases and had stated that it was examining what action could be taken against manufacturers deemed to be making excess profits. There is no evidence that any such review was undertaken at that time. The Government paper in the Supplemental Bundle simply stated that it was "Updated 8 November 2016" but there is no indication as to when the Paper was first issued and in fact it refers to the 2014 PPRS and consultations in 2015.

181. The article then quoted from the Generic Medicines Association which represented a large number of the drugs firms supplying the NHS who said that competition in the industry kept drug prices down and meant that the Health Service paid less for its drugs than anywhere else in Europe. The Government paper stated explicitly at section 2 that having reviewed its legislative powers that:-

> "For unbranded generic medicines, the government relies on competition in the market to keep prices down. This generally works well, but where there is no competition there have been cases of large price increases…".

182. In our view tellingly, notwithstanding the sensationalist headline, the article concludes with the following paragraphs:-

> "But last night the Department of Health said it had launched a review to examine why the cost of some generic drugs had risen dramatically.
>
> A spokesman said: 'We are aware that the prices of a small number of medicines have risen in recent times and we are reviewing what action may be taken'.
>
> He added: 'The average price of a generic medicine has actually gone down. There are approximately 3,700 generic medicines prescribed on the NHS. Between 2004 - 2009 the average price of a generic medicine fell from £5.24 to £3.96'".

183. The material in the Supplemental Bundle was put to Mr Engineer on the first day and the Daily Mail Online article when he was recalled, on the basis that they demonstrated that there was a known concern on the part of the UK Government about the practice of very significant increases in the prices of unbranded generic drugs.

184. On both occasions, whilst Mr Engineer conceded in cross–examination that there was always concern where there were price increases, he was very emphatic that people in the media and in newspapers did not understand NHS pricing and did not do enough research to put together a balanced view. In relation to the Daily Mail Online article he was adamant that he had not been aware of it. Furthermore, prior to the Valuation Date he had not been aware of any controversy at all about the alleged need to curb price increases. Neither the Partnership nor CGL had employed anyone to monitor press reports about other companies.

185. In 2013, prior to the sale to CPL, the Partnership contemplated a sale on the open market and it reached the second round of bidding. We have no information about that, beyond the fact

that agreement could not be reached on a price, but Mr Engineer was clear that no concern had been expressed by the potential purchasers about the possibility of any price controls or further regulation.

186. When all of these articles were put to Mr Palmer and Mr Mitchell, both said that they were aware of the CGL business model but they certainly had not been aware of any controversy such as was described in those articles. They had not factored into their calculations public interest such as that described in the Daily Mail Online article. Neither had seen such articles when doing research.

187. We were somewhat bemused that so much time was absorbed by this issue. We know that there was ultimately legislation in 2017 but we do not have any information as to the extent of its implementation or its impact. Mr Engineer produced as an exhibit with his third witness statement, and was not cross-examined upon it, charts showing the pricing, derived from an independent source, for a number of the Product Assets from approximately the Valuation Date until mid-2022. With the exception of Dexamethasone, where the price having risen, fell steeply in late 2017, all the others had risen and many very sharply.

188. Mr Henderson had not cross-examined Mr Engineer as he considered the exhibit to be irrelevant" because it was common ground between the parties that hindsight has no place in valuation. We refer to it here for two reasons. Firstly, Mr Henderson had pointed out the fall in the price of Dexamethasone in support of his argument that it demonstrated the sort of risks that any purchaser would face. That is not compelling as the other drugs rose in price. Secondly, it adds credence to Mr Engineer's evidence, which we found to be credible, that, as a general proposition, prices for generic drugs continued to rise as he had expected.

189. We do agree with Mr Henderson's concession latterly that the materials in the Supplemental Bundle did not show that there was significant public concern about very high increases in the price of certain generic drugs as at the Valuation Date. We do not accept his arguments to the effect that the Daily Mail Online article demonstrates that, as from as early as 2010, there had been significant public concern.

190. Mr Palmer conceded that since the article was in the public domain it would have been possible to find it. Well, of course HMRC did find it eventually, so it is possible. Mr Mitchell did suggest in re-examination that in the course of commercial due diligence one "may pick up" some press comments but we very much doubt that in 2013 a 2010 article in the Daily Mail Online would feature in that.

191. We say that on the basis that none of the experts had been aware of the alleged public interest or of any media controversy. Furthermore, HMRC had only found the Daily Mail Online article half way through the hearing. The Supplemental Bundle was introduced at a very late stage and only traced interest in the issue of pricing in 2016 following Government consultation in 2015. Lastly, the final paragraphs of the Daily Mail Online article itself do not suggest that it was a material issue in 2010.

The agreed facts in relation to financial matters (as they were included in the Statement of Agreed Facts at items 4, 5 and 6 respectively)

A. The accounting treatment of the acquisition of the Product Assets

192. Under the Transfer Agreement, the Partners agreed to sell and CGL agreed to "purchase and take over as a going concern the whole of" the business being carried on by the Partnership. As a result of the completion of the Transfer Agreement, the Partnership ceased to trade.

193. The Transfer Agreement provided that, in consideration for the sale of the business, CGL would "allot and issue" 98 ordinary shares of £1 each in its capital. The 2013 Financial Statements indicate that these shares were issued at a premium of £40 million.

194. The 2013 Financial Statements record the acquisition of the business from the Partnership, and note the following points:

(a) The Intangible Fixed Assets Note shows an addition of goodwill totalling £40 million in the year and an amortisation charge, pro-rated for the period, of £1 million.

(b) The accounting policies in the 2013 Financial Statements state that goodwill will be written off over an expected useful life of 10 years.

(c) No separate intangible fixed assets are recognised in the financial statements.

195. Notwithstanding the accounting treatment, it is agreed between the parties that the Product Assets acquired by CGL were not goodwill.

196. The Financial Statements for CGL for the accounting periods ended 30 June 2014 through to 30 June 2019 continued to recognise the Product Assets acquired on 27 March 2013.

197. The Product Assets were amortised as follows in CGL's Financial Statements as follows:

(a) accounting period ended on 30 June 2013 amortisation charge of £1,000,000;

(b) accounting period ended on 30 June 2014 amortisation charge of £4,000,000;

(c) accounting period ended on 30 June 2015 amortisation charge of £3,985,000;

(d) accounting period ended on 30 June 2016 amortisation charge of £3,985,000;

(e) accounting period ended on 30 June 2017 amortisation charge of £3,985,000;

(f) accounting period ended on 30 June 2018 amortisation charge of £3,985,000; and

(g) accounting period ended on 30 June 2019 amortisation charge of £3,985,000.

B. CGL's tax returns

198. CGL brought into account debits to reflect the amortisation of the Product Asset(s) said to have been acquired under the Transfer Agreement in calculating its profits for corporation tax purposes for the accounting period ended 30 June 2013 and for the six accounting periods that followed, up to and including the accounting period ended 30 June 2019.

199. The debits claimed in each accounting period ended 30 June 2013 to 30 June 2019 inclusive were as follows:

(a) accounting period ended on 30 June 2013 debits of £1,000,000;

(b) accounting period ended on 30 June 2014 debits of £4,000,000;

(c) accounting period ended on 30 June 2015 debits of £3,985,000;

(d) accounting period ended on 30 June 2016 debits of £3,985,000;

(e) accounting period ended on 30 June 2017 debits of £3,985,000;

(f) accounting period ended on 30 June 2018 debits of £3,985,000; and

(g) accounting period ended on 30 June 2019 debits of £3,985,000.

C. Enquiries, amendments and closure notices

200. On 9 March 2015, HMRC opened an enquiry into the CGL's corporation tax return for the accounting period ended 30 June 2013.

201. Subsequent enquiries were opened into CGL's corporation tax returns for the accounting periods ended 30 June 2016 to 30 June 2019.

202. On 5 April 2019, CGL obtained a valuation from Duff and Phelps which estimated the market value of the Partnership as at 27 March 2013 at £45 million to £60 million. A copy of the valuation report was provided to HMRC on 9 April 2019.

203. On 10 July 2020, HMRC wrote to King & King giving their opinion of the market value of the Partnership as at 27 March 2013 as £10.5 million and explaining that this would form the basis of closure notices expected to be issued shortly.

204. On 31 July 2020 HMRC issued closure notices under paragraphs 32 and 34, Schedule 18, Finance Act 1998 in respect of the CGL's corporation tax returns for the accounting periods ended 30 June 2013, 30 June 2016, 30 June 2017, 30 June 2018 and 30 June 2019.

205. On 5 August 2020, HMRC issued further notices to make consequential amendments to CGL's corporation tax returns for the accounting periods ended 30 June 2014 and 30 June 2015 under paragraph 34(2A), Schedule 18, Finance Act 1998.

206. HMRC's amendments to the CGL's corporation tax returns are summarised in the following table:

Year	***Revised Assessment***	***Amount postponed***
2013	£335,034.12	£174,990.64
2014	£1,288,814.33	£663,790.40
2015	£1,200,517.80	£607,774.48
2016	£1,112,262.40	£585,787.40
2017	£1,592,064.40	£578,485.12
2018	£1,798,960.28	£556,498.03
2019	£1,750,834.61	£556,498.03

The Law

207. There is no dispute between the parties about the relevant legislation for the Intangibles Regime or its interpretation. HMRC had helpfully set that out at paragraphs 12 to 18 of their Skeleton Argument and, for completeness, we annex that at Appendix 3.

Discussion

208. As we have indicated at paragraphs 12 to 15 above, in summary, the issues for the Tribunal are, firstly, the market value of the Product Assets and, secondly, whether the period of ten years for amortisation of that value was UK GAAP compliant.

The Expert Evidence

209. The two disciplines of the experts for whom permission had been given were valuation and accountancy. There was an area of overlap and the main area of disagreement related to valuation. Both the valuation and the accountancy experts had produced Joint Statements.

210. In both cases the experts had different instructions and that compounded our difficulties since in some, if not many, regards we were comparing apples and pears.

211. A striking problem in relation to all of the reports is that the business model, in terms of taking advantage of the pharmaceutical drugs pricing rules, had not been made explicit and with the exception of Mr Palmer none had been fully aware of the possible implications. In cross-examination, Mr Palmer conceded that, although he had written about price rises, he had not specifically identified the significant rises, and hence the business model, in his report and that with hindsight he should have done so.

212. We found all four experts to be straightforward and credible witnesses who had had to produce reports where, because of the unique nature of the Partnership business, they all faced a number of difficulties particularly in relation to the use of comparators.

213. In relation to valuation, the experts did not have access to the same information.

214. The accountancy experts had limited areas of disagreement as the accountancy issues had narrowed as a result of the expert evidence process. We therefore agree with Mr Henderson and Mr Waldegrave when they state in their Skeleton Argument that the main area of disagreement between the parties in this appeal concerns the valuation of the Product Assets at the Valuation Date.

215. It may seem counterintuitive given that throughout, the primary focus has been on the valuation aspects, but we propose to address amortisation first. As we have indicated at paragraph 15 above, quantification is not currently a matter for us so the amortisation issue can be decided by the Tribunal.

Amortisation and the Accountancy Experts

216. As far as the period of amortisation is concerned, CGL argue that they had adopted a prudent position, justified by the particular nature of the Product Assets, to use a period of 10 years which was within the range permitted by GAAP.

217. HMRC's view is that given that the Product Assets had been on the market for 30 years and management's view was that they would remain on the market for a similar period following the Valuation Date a longer period would be more appropriate for amortisation. Prior to the hearing their suggested period was 20 years, which, as a general rule, is the maximum possible in terms of GAAP. In her evidence in chief, Ms Brotherston said that having heard the evidence, she could not give an exact figure, but 15 years would probably have been appropriate. She still thought that ten years was too low, albeit in certain circumstances and for some of the Product Assets, ten years may have been appropriate.

218. In addition to their Joint Statement, we had expert reports from Mr Chidgey and Ms Brotherston. Both are Fellows of the Institute of Chartered Accountants in England and Wales. Mr Chidgey is an independent consultant and Ms Brotherston is an employee of HMRC.

219. In large measure the experts were in agreement. In their oral evidence both experts were very straightforward and fair.

220. The instructions to the two experts were different but their Joint Statement confirmed that:-

> "…overall the questions asked of the experts were to ultimately provide their views on what the assets acquired comprised under UK GAAP. The main difference was the period over which the experts were asked to provide a view. Mr Chidgey was asked in

relation to the accounting periods ended 30 June 2013 and 2014 whereas Ms Brotherston was asked to provide evidence for the periods ended 30 June 2013 to 30 June 2019."

221. Of course, the years in dispute in this appeal are those covered by the instructions to Ms Brotherston. However, helpfully, (a) she had identified the fact that three different sets of accounting standards were applied by CGL in preparing the accounts for the periods with which this appeal is concerned, and she agreed that those standards were applicable, and (b) she concluded that the same treatment would apply under the first and third of those (FRSSE and Old UK GAAP and FRS 102) and no adjustment would be required as part of the transition (being the third) to FRS 102.

222. The experts are agreed that:-

(1) CGL's accounts in the relevant periods had not recognised the Product Assets separately from any goodwill and were not presented as such on the balance sheet. Accordingly, the goodwill was overstated and the intangible assets were understated.

(2) As the valuation experts had attributed no value to goodwill the Product Assets should not have been classified as goodwill. Their disposal should have been presented as a disposal of an intangible asset rather than as a reduction of goodwill.

(3) The reason for the period of amortisation should have been disclosed in the accounts to accord with UK GAAP but was not.

Therefore, the accounts were not in accordance with UK GAAP in that regard.

223. That leaves the amortisation period for the Product Assets.

224. In the Joint Statement they agreed the following general principles of amortisation as far as the Product Assets are concerned:-

"*General*

(1) It should be on a straight-line (or more appropriate) basis over the "useful economic life" ("UEL").

Useful Economic Life

(2) The UEL is the period over which economic benefit could be derived.

(3) The Financial Reporting Standard for Smaller Entities ("FRSSE") being the Old UK GAAP for small entities caps the UEL at 20 years.

(4) Financial Reporting Standard ("FRS") 10, being the "Old UK GAAP" contains a rebuttable presumption that the UEL is limited to a period of 20 years or less unless the durability can be demonstrated and justifies a longer period and the Product Asset is capable of continued measurement.

(5) FRS 10 gives examples of factors that contribute to the durability of intangible assets including the nature of the business, the stability of the industry, the typical lifespan of the products involved, and the effects of future competition.

(6) FRS 10 explains that UELs of intangible assets will usually be uncertain. This uncertainty does not mean that a period of 20 years should be used by default. Where the UEL is expected to be less than 20 years an estimate, on a prudent basis, of the UEL should be made but that does not form the grounds for choosing an unrealistically short UEL.

(7) FRS 10 also states that 'Whilst uncertainty forms grounds for estimating the [UEL] on a prudent basis, it does not form the grounds for choosing a life that is unrealistically short.'

(8) They referenced PriceWaterhouseCoopers' Manual of Accounting UK GAAP 2012 which says in that regard that: 'A long life [for an intangible asset] (20 years plus) will generally require a business, industry and products with a long track record of stability and achievement and having high barriers to market entry.'

(9) FRS 102 (New UK GAAP) contains no cap on the UEL but in this case it is assumed to be finite and either reliably estimated based on evidence or restricted to 10 years.

(10) On transition to FRS 102, the cost model would have applied meaning the method of amortising the intangible assets over their UELs would continue.

(11) Under the FRSSE and FRS 10 the UEL is to be reviewed at the end of each accounting period and revised if necessary. Under FRS 102 it is only reviewed if there are factors that indicate that it has changed.

Method of Amortisation

(12) The method of amortisation is to reflect the expected pattern of depletion of the intangible asset. Methods of amortisation include the straight-line method, the diminishing/reducing balance method and the production method.

(13) A straight-line method will normally be the most appropriate. However there may be circumstances,…, where another method is more appropriate…".

Relevant to Chemidex Generics Limited

(14) The product life (time in the market) and UEL are not necessarily the same.

(15) UELs could have been applied to each composite Product IP intangible asset.

(16) A systematic basis of amortisation in relation to Chemidex would aim to reflect the pattern of depletion of the intangible assets. This would relate to the expected level of benefits (ie profit share cash flows from product sales) derived from the use of the Product IP. If a reliable estimate could have been made of the expected pattern, the basis should have reflected this. If a reliable estimate could not be made, then the straight line method should have been adopted."

225. They also agreed that:

(1) The product life (time in the market) and the UEL are not necessarily the same.

(2) UELs could have been applied to each composite Product Asset.

(3) A systematic basis of amortisation would aim to reflect the pattern of depletion of the Product Assets. This would relate to the expected level of benefits (ie profit share cash flows from sales) derived from the use of the Product Assets. If a reliable estimate could have been made of the expected pattern the basis should have reflected this. If a reliable estimate could not be made, then the straight-line method should have been adopted.

226. The valuation of the Product Assets and the appropriate UEL(s) determine the amount of amortisation subsequently recognised in each of the periods from 30 June 2013 to 30 June 2019.

227. Of course. the experts did not know what the valuation might be, and as Ms Brotherston pointed out that was not a matter for her but she accurately recorded that:

(a) King & King's valuation was £40 million based on Mr Engineer's valuation, but he seemed to focus "on the value of the assets acquired rather than the value of the business attached to the ownership of those assets".
(b) Mr Palmer's 2019 valuation gave a market value of £45 million to £60 million.
(c) CGL had argued that the value should have been at least £45 million in their Grounds of Appeal.
(d) HMRC had valued the Product Assets at £10.5 million.
(e) Mr Palmer's Expert valuation was £45 million to £60 million.
(f) Mr Mitchell's valuation was £9 million to £22.5 million.

228. UEL(s) are a matter for the management and accountants and ultimately, if accounts are audited, the auditors.

229. Mr Chidgey had not looked at the Product Assets individually, or at them in detail, whereas Ms Brotherston argued that because five of the Product Assets accounted for approximately 85% of the revenue it would have been realistic for an attempt to have been made to determine a reliable estimate of the UEL for those and apply an average to the balance.

230. CGL had simply treated them as a basket or bundle and as goodwill.

231. HMRC had placed considerable emphasis on the fact that on the one hand Mr Engineer argued that the revenue stream from the Product Assets would continue for at least 30 years but, on the other hand, the amortisation period chosen was only 10 years. Although at first glance, there is some force in that argument, we do not find that to be inherently contradictory.

232. The evidence is very clear that the principles to be applied in respect of valuation and accountancy are completely different. Indeed, in the Joint Statement Ms Brotherston made it explicit that she "was not suggesting management has to apply the same techniques as the valuation experts to determine the UEL". When the apparent contradiction, described as "incongruous" was put to him, Mr Chidgey argued that valuers and accountants approached matters differently and used different techniques. We agree with both experts.

233. Of course, the underlying facts are the same for both valuation and accountancy but it is how the differing principles are applied to those facts that we must consider.

234. Mr Chidgey pointed out that the accounting standards (FRSSE and FRS) stipulate maximum periods for UEL so an accountant looks at what management states and then adjusts it "quite heavily" using the only available tool being the UEL.

235. Although using different language, Ms Brotherston concurred stating in cross-examination that the accountants would have listened to Mr Engineer (or management) and then would employ a level of "professional scepticism" and "prudence" from an "accountancy perspective" to that.

236. Both were agreed that the period for amortisation, based on the UEL, would depend on the factual circumstances. Mr Chidgey made the point that that would require "significant management judgement" given the uncertainties. Ms Brotherston also identified the need for input from management or family members. She made it clear in her evidence that "it depends on the circumstances of the entity".

237. Mr Engineer's evidence as to the choice of the ten year period of amortisation in the accounts was that he had been involved in the decision, and in all of his businesses, on the advice of the accountants, a ten year period had been used. Of course, that was amortisation of goodwill and intangibles are not goodwill. However, we find that on the balance of probabilities, had the Product Assets been described as intangibles, the same thought processes

would have been engaged. From Mr Engineer's perspective, and, in our experience, for most businessmen, it would simply have been the "label" used by the accountants.

238. In essence, it was simply the period that they always used. That does not really assist us.

239. We agree with Mr Chidgey when he stated that: "Amortisation for an intangible is quite a difficult process…".

240. He went on to say that that was why he had looked at comparators to establish a range of UELs which would be acceptable.

241. In the Joint Statement, Mr Chidgey had stated that "In practice, non-patented pharmaceutical IP assets are regularly written off over periods ranging from 7 to 15 years" and he attached a schedule of companies and commented on their UELs ("the Schedule"). We are dealing with non-patented Product Assets.

242. He conceded in cross-examination that the companies on the Schedule were all large pharmaceutical companies and would largely be selling patented drugs and those may well have a longer UEL. However, he argued that they would also have intangibles. In his view, a generic product is less secure in terms of income stream so the amortisation period would be shorter.

243. The amortisation period for the companies in the Schedule ranged from a straight-line basis of up to 20 years for two companies, to ones with 5-20 years for marketed products, 9-15 years for developed technology, one with a range between 3 and 16 years with an average of 9 years for developed product rights and license agreements and one with an average of 8 years. Two had no disclosed period.

244. Ms Brotherson pointed out that they were multinational pharmaceutical companies and it was difficult to establish whether the companies, the markets they operate in or the intangibles were comparable.

245. Mr Chidgey argued that it was very difficult to find comparators for generic drugs. He accepted that the companies that he had selected presented a very mixed picture as they were "large multifaceted groups which would carry out a number of things within both the pharmaceutical industry and outside". In cross-examination he accepted that although they might sell some generic drugs, they would "largely" be selling patented drugs.

246. Given that the first company in the Schedule was GlaxoSmithKline, and the others were of a similar ilk, we not only agree that it is difficult to see any basis for comparison but find that those comparators are very different to CGL's business in numerous ways.

247. In response, for comparison purposes, Ms Brotherston had produced a schedule and financial statement extracts. The schedule details the amortisation policies of the generic pharmaceutical companies detailed in both of the valuation expert reports. She quoted from Mr Palmer's expert report at paragraph 7.4.3 where he stated that the companies which he had cited were "all considerably larger and more diversified than the Chemidex Business" and the "…comparable companies are businesses with continuous investments into future products and growth opportunities beyond their respective existing product portfolios". She did so to support her argument that "For the companies with sufficient information, the amortisation policies vary between 10 and 20 years with several at 14 – 16 years."

248. Mr Chidgey accepted that, based on those comparators alone, he could not conclude that CGL's choice of amortisation was UK GAAP compliant. However, his argument was that the comparators were only one factor. He had also considered how long the Product Assets were likely to be revenue producing.

249. As Ms Brotherston accurately pointed out, "UK GAAP is a widely used term but is not defined in the Companies Act 2006 or accounting standards….". We are aware that UK GAAP has sometimes been described as a nebulous concept! What it is not is a "tick box" or precise standard. We assume that it is for that reason that Ms Brotherston's evidence used phrases such as "Chemidex's amortisation policy (straight-line over a UEL of 10 years) may not have been appropriate…" and "Ms Brotherston's view is that a 20-year useful economic life may have been a more appropriate period of amortisation". We have added the emphasis.

250. The experts agreed that to be UK GAAP compliant, the amortisation period has to be in a range that means that the accounts are reliable and give a true and fair view.

251. In his oral evidence, Mr Chidgey was very clear that he had not arrived at a ten year amortisation period; what he had said was that ten years falls within an acceptable range based on the comparator analysis and the specific factors that needed to be considered in this instance. He said that "there would not be a completely right answer". Mr Henderson argues that Mr Chidgey's evidence did not establish that a ten year amortisation period was definitely within the range of acceptable UK GAAP amortisation periods. We take the view that Mr Chidgey may not have used those words but his expert opinion was that ten years was UK GAAP compliant.

252. In cross-examination, Mr Chidgey was taken to FRS 102 at paragraphs 18.19 and 18.20 which read:

> "18.19 For the purposes of this FRS, all intangible assets shall be considered to have a finite useful life. The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant costs.
>
> 18.20 If, in exceptional cases, an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall not exceed 10 years."

253. Although he said that he did not know what management might have said in that regard, his view was that they would have argued that the period should have been 10 years because of the difficulty in coming to a reliable estimate.

254. We observe that the existence of the PSAs might well have been relevant since CPL could have terminated those with the effect that the income stream ended, albeit possibly only temporarily. Having said that, Ms Brotherston took the view that, because CPL and CGL were related parties that would not happen and therefore 18.19 would not apply. We are not convinced that it can be put that strongly. They were related parties when they agreed those clauses.

255. We can certainly see an argument for saying that a prudent accountancy approach would be to say that because CGL had:

(a) a small and finite portfolio,

(b) reliance on only a small part of that portfolio for most of the income stream, and

(c) a very unusual, if not unique, business model without obvious comparators,

then CGL was not only exceptional but also it might not be possible to make a reliable estimate of the UEL. Therefore 18.20 could be in point.

256. For completeness, we observe that Ms Brotherston had pointed out that the FRSSE was the applicable standard for the 2013 and 2014 accounts and that capped the amortisation at 20 years. She said that for the periods ending 30 June 2015 onwards, a 30 year UEL could have been applied prospectively if it was deemed appropriate because "the durability of the intangible asset can be demonstrated and justifies the UEL to exceed 20 years". We do not find that there is evidence in this case to suggest that the Product Assets fell within that provision and therefore the presumption that there is a cap of 20 years remains intact. Neither expert suggested anything else.

257. Initially, in evidence in chief, Ms Brotherston had indicated that she had not appreciated the Chemidex pricing strategy and therefore now considered something nearer to 15 years to be an appropriate period for amortisation. However, she made it clear that if the Tribunal did not find the risk of capping or reducing pricing to be significant, and effectively accepted Mr Engineer's assessment that revenues would be maintained for 30 years, then she adhered to her original suggestion that 20 years would be the starting point.

258. Ms Brotherston's concluding comment in the Joint Statement was to the effect that 20 years "may have been an appropriate starting point based on management's view of a product life of 30 years". However, depending on other factors that "may have impacted on the UEL (amortisation period) that should have been chosen, a shorter period may have been appropriate".

259. Ms Brotherston was not able to give a final view as to the correct amortisation period because it depended on the debate between parties as to the facts. Neither she nor Mr Mitchell had had an opportunity of discussing what might be an appropriate period with management. We agree with Mr Henderson that her evidence was very fair in that regard.

260. Mr Henderson and Mr Waldegrave argued in their Note on the Evidence that both experts had had difficulty in identifying what the correct amortisation period should be because of the uncertainty about the underlying facts.

261. It was then suggested that if the Tribunal did not wish to prescribe an amortisation rate, because that was a technical accounting matter, one option would be, in the light of the findings and valuation, to see if the parties in light of the findings and valuation can arrive at a suitable amortisation period.

262. In their Skeleton Argument Mr Goldberg and Mr Brodsky had relied upon Mr Justice Knox at page 783 in *Johnston (Inspector of Taxes) v Brittania Airways* [1994] STC 763 where he said:-

> "Which of the three ways in which the attribution of cost to a period or periods of accounting is adopted is in my view, essentially a matter of accountancy judgment, and I am quite unable to detect any legal basis for excluding any of them."

263. They argued that the issue is whether the ten year period is within the acceptable range for GAAP and the question for the Tribunal is not which precise period of amortisation was "correct" or "preferable".

264. Neither expert was prepared to opine on a precise period and nor are we. We agree that that is indeed a matter for accountancy judgement. Although, Ms Brotherston remained of the view that she thought that ten years was too low, she very fairly recognised the many uncertainties and the lack of information and the possibility that in certain circumstances ten years "may" be applicable.

265. The fact is that, in discussion with the accountants, Mr Engineer chose a period of ten years. Is that UK GAAP compliant?

266. Firstly, we accept that both experts did the best that they could in terms of looking for appropriate comparators, but they faced a major challenge given Mr Engineer's unique *modus operandi*. We will comment further on the comparators used for valuation when we come to valuation, but we find that neither they nor the comparators in the Schedule were of any assistance in terms of the amortisation period because the companies involved are so very different to CGL. Secondly, we find that, albeit at the lower end, ten years is within a range of figures that would be compliant with UK GAAP throughout the periods with which this appeal is concerned.

Valuation and the Valuation Experts

267. In summary, CGL argues that:

(1) The original value of £40million for the Product Assets was conservative and, in the event too low, as Mr Palmer's expert report demonstrated a range of £45million to £60million. had a high market value as at the Valuation Date because they generated very substantial revenues and profits for both the Partnership and CPL. They argued that any purchaser would take the view that those revenues and profits, albeit not at the same rate, would be sustained over a lengthy period of time.

(2) Secondly, in his second witness statement, Mr Engineer argued that because the PSAs were terminable by either party but, once terminated, the owner of the Product Assets had all the rights in those assets and could exploit them as it saw fit, any purchaser was in effect buying the ability to secure the total income generated from the Product Assets.

(3) There was no risk to the owner of the Product Assets from the termination of the PSAs by CPL because it would lose its rights and would be most unlikely to do that but, even if it did, the owner could exploit the Product Assets itself.

268. In summary, HMRC contend that the growth was historical and reliant upon very few of the Product Assets. A hypothetical purchaser would have had real concerns about the sustainability of the relevant income streams. One of those risks was that there might be regulatory changes which would undermine the business model of charging high prices for generic drugs which had previously been relatively cheap when sold in their branded form. CGL were putting forward an excessively high valuation for the product assets based on very optimistic future performance prospects but then seeking to amortise this cost over only 10 years. It was very unlikely that the PSAs would be terminated. The purpose of Mr Mitchell's royalty rate analysis was to determine what royalties would be paid to the hypothetical purchaser in the open market and therefore the terms of the PSAs were irrelevant.

269. There was broad agreement between the parties on the applicable valuation principles.

Valuation Principles

270. One of the many annexes to the Joint Statement was the "International Valuation Standards 2013 Framework and Requirements" ("IVS13") upon which both parties relied. We annex at Appendix 4 extracts of the relevant paragraphs.

271. Both experts had exhibited the IVS which was effective from 31 January 2020 ("IVS20").

272. Both parties had relied on Hoffman LJ in *IRC v Gray* [1994] STC 360 ("Gray") which Mr Goldberg rightly said reflected the paragraphs in the IVS 13 upon which he particularly relied (paragraphs 29, 30(d) and (e), 31 and 32).

273. We take from *Gray* the following principles:

(1) The hypothetical vendor is anonymous but reasonable and prudent; the vendor is neither over-anxious nor unduly reluctant.

(2) The buyer is slightly less anonymous but also reasonable and makes proper enquiries; the buyer is not too eager to buy.

(3) Although the sale is hypothetical, there is nothing hypothetical about the open market and the demand for the property in question at the relevant time must be considered.

(4) The valuation may be a figure within a range of prices and is a retrospective exercise in probabilities.

(5) The vendor must be supposed to have taken the course which would get the largest price without undue expenditure of time and effort.

274. As far as the "largest price" is concerned, we agree with Mr Goldberg that that reflects paragraphs 30.4 and 140 of IVS 104 from IVS20. We have set out those paragraphs in full at Appendix 5.

275. In Mr Goldberg and Mr Brodsky's Skeleton Argument they relied on paragraphs 3 to 6 of Mr Justice Lewison's judgment in *HMRC v Bower* [2009] STC 510 ("Bower") and that includes *inter alia* quotations from *Gray.* At paragraph 6 it stated:

"Thus, although the whole world is in theory free to bid, there must be an inquiry into who is in the market. This is an inquiry, not an assumption, and in my judgment, an inquiry is an inquiry into the facts."

276. Amongst the quotations from *Gray,* one quotation to which Mr Henderson took us, was included at paragraph 3. It reads:

"...The concept of the open market involves assuming that the whole world was free to bid, and then forming a view about what in those circumstances would in real life have been the best price reasonably obtainable. The practical nature of this exercise will usually mean that although in principle no one is excluded from consideration, most of the world will usually play no part in the calculation. The inquiry will often focus on what a relatively small number of people would be likely to have paid. It may have to arrive at a figure within a range of prices which the evidence shows that various people would have been likely to pay, reflecting, for example, the fact that one person had a particular reason for paying a higher price than others, but taking into account, if appropriate, the possibility that through accident or whim he might not actually have bought. The valuation is thus a retrospective exercise in probabilities, wholly derived from the real world but rarely committed to the proposition that a sale to a particular purchaser would definitely have happened."

277. Mr Henderson relied upon paragraph 203 of *Netley v HMRC* [2017] UKFTT 442 (TC) ("Netley") where Judge Cannan said:-

"203. The following principles of valuation are not controversial:

(1) The sale is hypothetical. It is assumed that the relevant property is sold on the relevant day (see *Duke of Buccleuch v IRC* [1967] AC 506 at 543 per Lord Guest).

(2) The hypothetical vendor is anonymous and a willing vendor, in other words prepared to sell provided a fair price is obtained (see *IRC v Clay* [1914] 3 KB 466 at 473, 478).

(3) It is assumed that the relevant property has been exposed for sale with such marketing as would have been reasonable (*Duke of Buccleuch v IRC* at 525B per Lord Reid).

(4) All potential purchasers have an equal opportunity to make an offer (re *Lynall* [1972] AC 680 at 699B per Lord Morris).

(5) The hypothetical purchaser is a reasonably prudent purchaser who has informed himself as to all relevant facts such as the history of the business, its present position and its future prospects (see *Findlay's Trustees v CIR* (1938) ATC 437 at 440)."

278. Although we are not bound by *Netley*, we agree with that analysis.

279. In the subsequent paragraphs Judge Cannan went on to consider what information would have been available to a prudent purchaser. He observed that in *re Lynall*, the House of Lords had pointed out that a sale in the open market will not involve the release of any confidential information to prospective purchasers. Mr Henderson exhorted us to read *re Lynall*; we did and we agree with Judge Cannan as we discuss at paragraphs 350 and 351.

280. He discussed the significance of experts taking different views of the market value (of the shares) and decided that:

"230….The ultimate question based on all the evidence, including that of both experts, is what the hypothetical prudent purchaser would pay in the open market.

231. Both expert reports contained certain errors and omissions. Where errors were identified I have discounted them for the purposes of this decision. Further, whilst I have had regard to the opinions expressed by Mr Weaver and Mr Houghton, it is the underlying evidence referred to in their evidence which is more significant".

We also agree with, and adopt, that approach.

The information available to the experts

281. As we have indicated at paragraph 29 above, on 15 July 2022, HMRC formally raised a number of concerns in relation to Mr Engineer's second witness statement. At the outset of the hearing, whilst both counsel pragmatically, and helpfully, agreed that if the Supplemental Bundle were to be admitted in evidence then the second witness statement should be admitted. Mr Henderson confirmed that the concerns raised in the email were maintained.

282. One of the concerns articulated in the email, and described as significant, related to the expert evidence on valuation.

283. HMRC argued that the proper approach to the instruction of experts was discussed in *Imperial Chemical Industries Ltd v Merit Merrell Technology Ltd* [2018] EWHC 1577 (TCC) where Mr Justice Fraser stated at paragraph 237(1) "Experts of like discipline should have access to the same material. No party should provide its own independent expert with material which is not made available to his or her opposite number".

284. We observe that that statement was made by reference to the Civil Procedure Rules ("CPR") Part 35, Practice Direction 35 which Mr Justice Fraser said that every expert should read. It is trite law that the CPR are not applicable in proceedings before the Tribunal. However, the CPR is a relevant point of reference.

285. HMRC argued that Mr Palmer "…appears to have had various, possibly unstructured, discussions with "Management". In early February 2022, after HMRC had raised concerns, Mr Palmer had provided a three page document headed "Summary of Information Provided by

Management" which is what we have referred to as the "Management Information". HMRC's point was that the "experts have potentially not been working from the same information…".

286. HMRC had asked for the Management Information as what they described as a "pragmatic attempt to achieve at least some equality of arms between the experts". HMRC argued that that perceived inequality was "likely to generate considerable difficulties for the Tribunal". It did.

287. Although HMRC have pointed out in relation to long-term growth rate, at paragraph 5.5.2 of his report, Mr Palmer had referred to "… per discussions with Management", we observe that, in fact, at paragraph 1.3.2 there were repeated references to "Discussions with Management" which were said to underpin a number of aspects of his report.

288. We have noted that at 5.10 and 5.16 respectively in his report, Mr Mitchell stated that he had "… not had sight of any long-term forecasts produced by Management of the Partnership or CPL ('Management')" albeit HMRC had "requested forecasts for the Partnership/CPL from Management but no reliable long-term forecasts were provided".

289. The Management Information is described as being derived from a meeting on 7 March 2019 between Mr Palmer and two other employees of Kroll Advisory Ltd (t/a Duff and Phelps) ("D&P") and two employees of King & King and subsequent meetings and telephone calls between them and also with Mr Engineer. It was prepared by Mr Palmer who stated that its purpose was to "summarise the material substance of the information provided by Management" for the purposes of preparing his expert report.

290. In a letter to HMRC dated 11 September 2019, King & King stated clearly what information had, and had not, been furnished to Mr Palmer. The relevant paragraph read:-

> "a) D&P have not reviewed contemporaneous documentation evidencing the approaches made to large pharmaceutical companies and/or the due diligence undertaken. All the documentation reviewed by D&P is referred to on pages 5 and 6 of the Report. D&P's view has been based upon discussions with us and Mr Engineer and the *"Summaries of Mr and Mrs Engineer's Responsibilities When Acting in Their Capacities as Directors and as Partners"* referred to above….
>
> b) No review of significant people functions has been performed by D&P. D&P have based their valuation on the information referred to at a) above."

That is contemporaneous evidence and unequivocal. We find it as fact.

291. We have discussed "Mr and Mrs Engineer's Responsibilities" and the issues arising from them at paragraphs 131 to 134 above.

292. Pages 5 and 6 of Mr Palmer's first report (which is largely replicated in the expert report and in both defines "Management" as being "the management of the Partnership and CPL as well as these entities' accountants") state that D&P had relied upon *inter alia*:-

> (a) Correspondence (with attachments) between HMRC and King & King and "Chemidex Generics" from 9 March 2015.
>
> (b) "Financial and other information obtained from Management".
>
> (c) CPL's financial statements from the year end 30 April 2005 to 30 June 2014.
>
> (d) The Partnership's financial statements from the year end 30 April 2005 to 30 April 2008.

(e) CPL's profit and loss details for the period year end 30 June 2009 to year end 30 June 2013.

(f) Discussions with Management about the "history, current state and future operations of the Chemidex business.

(g) Discussions with Management to clarify and explain the financial and operational information provided by Management for the Chemidex business which were used as the basis for developing financial forecasts as an input into D&P's Income Approach analyses.

(h) Discussions with Management concerning the anticipated long-term revenue growth (decline) rates and prevailing profitability in the geographic regions relevant to the Chemidex Products.

(i) Discussions with Management to obtain an explanation and clarification of supporting data provided.

293. An obvious point is that, as HMRC have pointed out, some of the Financial Statements upon which Mr Palmer relied were not available at the Valuation Date. They would not have been available to a hypothetical purchaser. Mr Palmer argued that estimates might have been available.

294. We do accept that a hypothetical vendor would very probably disclose their management accounts and projections in the interests of optimising the sale proceeds.

295. It was asserted in Closing Submissions for CGL, that Mr Mitchell was given the information that Mr Palmer was given and that was by reference to the Briefing Note prepared by HMRC for Mr Mitchell and the Management Information. We simply cannot accept that. Certainly, both experts had those documents and Mr Mitchell did have access to Mr Palmer's two reports, HMRC's correspondence and some accounting information, but, as can be seen, Mr Palmer had access to a great deal more information and specifically access to King & King and Mr Engineer.

296. In summary, HMRC are correct to argue that there was not equality of arms between the experts. We will revert to that in the context of Mr Palmer's expert report.

High level overview of Mr Palmer and his approach to the evidence

297. CGL had instructed Mr James Palmer who is a chartered accountant and a Managing Director of D&P, a global provider of valuation and corporate finance advisory services. During HMRC's enquiry he had provided a report to CGL dated 5 April 2019 and that had reached the same valuation conclusions and ranges (£45 million to £60 million) as his expert report dated 28 January 2022. He agreed that he had imported a lot of the material in the first report into the expert report. He had not changed the analysis but he had altered the second report to make it appropriate as an expert witness report.

298. In cross-examination, he stated that he wished to depart from two sources upon which he had relied in his expert report (Professor Damoradan data and a D&P report) that he acknowledged were too wide in scope to be relevant. He reverted to the analysis in the first report.

299. Mr Palmer explained that because there no conventional way to determine the value of the Product Assets he had adopted the recommended multiple approach at paragraph 55 of IVS 2013. He therefore adopted three approaches.

300. Both of Mr Palmer's first two approaches sought to value the "Chemidex Business", ie the Partnership and CPL as a whole. Of course, as we have pointed out, that did not exist.

301. He explained at 4.2.2 in his report that:-

> "As both the Partnership and CPL generate revenue from the Product Assets, I need to consider the revenues and profits of the Chemidex Business as a whole, before determining the allocation attributable to the Partnership."

302. In brief summary, to do that, because the two had different year ends he annualised the figures to make them effectively in line with the same year end. For the Partnership, in his words, he "included estimates for the period ending 30 June 2013 based on the average of prior years or based on the annualised figure for June 2012".

303. He allocated the total costs in CPL on either the 30:70 basis advised by management (see discussion below) based on the product numbers advised by management or directly proportionate to revenues.

304. He had to exclude CPL's income and expenditure in relation to its own extensive product base. One of the problems with that was that, as he freely admitted, there were a number of costs that "serve both parts of the CPL business". He then had to allocate the value of that hypothetical business between the Partnership and CPL based on what he perceived to be the "different risks, roles, activities and costs incurred by each entity".

305. Mr Palmer's first approach was a "Top-Down Approach" whereby he sought to value the Chemidex Business as a whole.

306. He worked out the value of both of the businesses, so far as attributable to the Product Assets, and then allocated that total value between the Partnership and CPL using a range of factors. He described that as a qualitative assessment of the relative value contribution of each entity to the Chemidex Business via an assessment of the relevant functions performed, assets used and risks assumed by each entity respectively.

307. In doing so he used two different methodologies. The first was an "income approach" and involved using forecasts which he had developed for the Chemidex Business and sought to value that on the basis of projected income streams. He estimated the future cash flows for the hypothetical business as a whole and, in so doing, had to reach conclusions about the growth rate and the discount rate. He confirmed that as far as the gross rate was concerned there was no mathematical basis for it and that he looked at the basket of Product Assets in the portfolio taking a relatively low growth rate that reflected historical core growth up to that point.

308. In that regard, as he pointed out in the Joint Statement, he deemed it appropriate to capture the risks each party bears. In that regard, in the Joint Statement, he highlighted the fact that:

> "In particular, the PSAs could be terminated at any time and by either party. If the partnership were to terminate the PSAs CPL would lose all revenue associated with the Products, but the partnership could continue by contracting with another party."

309. The "market approach" involved ascertaining the "enterprise value" of the Chemidex Business by reference to trading multiples of publicly listed companies which he referred to as "trading comparables" and transaction multiples of comparable transactions which he referred to as "transaction comparables". We observe that paragraphs 56 and 57 of IVS 2013 recommend using comparables which are "identical or similar" and then adjust the figures to help make comparisons.

310. The outcome of that approach was that he concluded that between 50% and 60% of the value of the Chemidex Business should be attributed to the Partnership, which implied a value for the Product Assets of between approximately £41 million and £61 million with the midpoint being £50.05 million.

311. His second approach was the "Bottom-Up Approach" which involved considering the market value of the Partnership based on the income approach by splitting the projected EBITDA of the Chemidex Business as a whole based on certain market benchmarks. Specifically, he had estimated a range for the EBITDA margin that CPL could reasonably expect to achieve in light of the services it performs and value it contributes to the Chemidex Business relative to, what he described as, comparable service providers and generic pharmaceutical businesses. Effectively, as Mr Goldberg argued, he was looking at the matter from the point of view of a licensee of the product assets and he apportioned to CPL a level of profitability being the EBITDA based on the market benchmarks.

312. The outcome of that approach was that he allocated a proportion of the EBITDA which he had calculated for the Chemidex Business (using the forecasts he developed for the Chemidex Business) which resulted in CPL achieving a 20% EBITDA margin. The main EBITDA from the Chemidex Business was allocated to the Partnership. He then valued the Partnership by reference to the income streams projected to arise to it on that basis and concluded that the enterprise value for the Partnership was between £57 million and £79 million with the midpoint being £67 million.

313. The third and last approach was the "Contractual Approach" which considers the market value of the Partnership based on the income approach whereby the profits of the Chemidex Business are split between the Partnership and CPL based on the contractual agreement in place as at the valuation date, ie the PSA's. The starting point of the analysis was the total revenue projected for the Chemidex business as a whole in line with the projections completed for the Top-Down Approach. The next step was to project the Ex-Works profit on that revenue stream which was based on the Ex-Works profit margin in 2013 which was assumed to remain flat throughout the projection period. That did not involve either market comparators and the subjectivity involved in such a process or the possible termination of the PSAs.

314. The outcome was that he calculated that the enterprise value for the Partnership was between £34 million and £45 million with the midpoint being £39 million.

315. At 10.4.2 in his report, he used an average of his conclusions giving a concluded range of between £45 million and £60 million with the midpoint being £52 million.

316. The production of the Joint Statement led to some amendments and, ultimately, those three approaches produced a range of £42 million to £62 million (there is an error at page seven of the Joint Statement where it says £61 million), £55 million to £75 million and £35 million to £45 million. Based on those three approaches, Mr Palmer remained of the view that the concluded range was £45 million to £60 million.

High level overview of Mr Mitchell and his approach to the evidence

317. HMRC had instructed Mr David Mitchell who is a fellow of the Association of Chartered Certified Accountants and a Chartered Tax Adviser. He is a partner in the UK Valuations team at BDO LLP. His expert report is dated 18 February 2022.

318. Mr Mitchell had been instructed to provide comments on Mr Palmer's expert report and to provide an opinion on the market value of the Product Assets using the definition of market value in section 845 CTA which states that the market value is "the price the asset might reasonably be expected to fetch on a sale in the open market".

319. Mr Mitchell had both of Mr Palmer's reports and King & King's valuation. He also had HMRC's original valuation dated 10 July 2020 (using a relief-from-royalty approach based on a 10% royalty rate derived from data relating to drugs that were "on-patent") which had arrived at a valuation of £10.5 million.

320. Since the Partnership had only one source of revenue, being the income generated by licensing the Product Assets to CPL, Mr Mitchell took the view that those payments were akin to royalty payments so he used the relief-from-royalty approach.

321. Mr Mitchell quoted paragraph 60.19 of IVS 210 from IVS20 which cited the key steps to be applied when using a relief-from-royalty approach (being the approach that he had adopted). We annex at Appendix 6 the full extract of the section on relief-from-royalty.

322. That approach works on the premise of determining the net present value of the future savings (based on a selected royalty rate) made by the party exploiting the asset through direct ownership. He sought to identify what a market royalty rate would be and performed a valuation on two different bases, namely an arm's-length royalty rate and the royalty rate in the PSAs. His preferred valuation at £9 million is based on the former rate.

323. Mr Mitchell identified the fact that the Partnership was generating income in 2012 of approximately £5 million and that was effectively what the third party buyer was acquiring. The value of the Partnership stems from its ability to generate earnings from licensing the Product Assets that it owns. He therefore proceeded on the basis that the most reliable way to value the Partnership would be to perform a valuation based on the income that the Partnership actually receives subject to any adjustments necessary to assess a maintainable earnings estimate.

324. He stated that his report worked on two bases. Firstly, it valued the contractual terms of the PSAs and assessed whether the PSAs were at arm's-length or not. He thought that it was not at arm's-length. His opinion was that, in those circumstances, he would expect the party who was "on the unfavourable side of the agreement" to terminate the PSAs.

325. If it was not at arm's-length, then it was then appropriate to consider what would be an appropriate arm's-length basis. At 5.61 in his report, he said that if the PSAs had been on an arm's-length basis then he saw no reason why the PSAs would be terminated.

326. His view was that the Partnership would not terminate the PSAs and take on the roles and responsibilities of CPL because that would involve substantial investment and effectively changing the business. They would have to work out what investment was needed, the timeframe and the relationships with the hospitals etc. He had not had the information to do that calculation. He also took the view that a lender might not be prepared to lend because of the risk of termination by CPL.

327. In cross-examination he argued that if it was not an arm's-length arrangement then CPL might well terminate the PSAs in order to bring the arrangement into a "proper arm's length basis". His calculations were, in part, predicated upon that. Hence the lower royalty rate.

328. When asked if it was fair to say that his valuation did not include any element related to what could be done with the Product Assets, Mr Mitchell succinctly stated that "Possibly it is fairer to say that my valuation incorporates the value of the income stream that is currently generated in the partnership from licensing out the assets to CPL". His calculations were predicated on the basis that there was no intention to buy any new product assets so he valued only the Partnership in his report. He did not value CPL. His opinion, in the Joint Statement, was that "CPL took on more risk than the Partnership as it was the entity that was responsible for commercially exploiting the Partnership's Products".

329. Mr Mitchell's valuation was approximately £9 million on the assumption that the terms of the PSA should be amended, such that they are at a royalty rate of 15% (although his range was 10% to 20%). On the basis that the royalty agreement or the PSA at 40% is representative of an arm's-length basis, then the value is approximately £22.5 million.

330. In order to arrive at an appropriate arm's-length royalty rate, Mr Mitchell had reviewed some 20 agreements from which he considered five to be comparable to the PSAs.

331. In oral evidence Mr Mitchell stated that he was valuing the Product Assets at approximately £9.5 million on the assumption that the terms of the PSAs should be amended such that a royalty rate of 15% was used although his range was 10%-20%. If the 40% in the PSAs had been at arm's-length then, in his view, the value would have been approximately £22.5 million.

332. He had not valued the combined business. However, based on 40% being worth £22.5 million then the value of that part of CPL that dealt with the Product Assets would be worth approximately £55 or £60 million.

333. He accepted that the majority of the royalty agreements to which he had referred were based on sales, ie revenue so that was different to the PSAs as was the fact that "it was very unlikely" that any had comparable termination clauses.

King & King's Valuation

334. King & King's valuation of the Product Assets using a market approach was dated 11 May 2015. That valuation was based on the last set of accounts prepared for the period ending with the Valuation Date. Those figures were annualised. Based on historical profit growth, the projections were extrapolated for the next 12 months profit at an increase of 5%. Using a multiple of 7.5 (which they argued was comparable to the multiples in the current market for a similar size and profitability of business) they had arrived at a valuation of an average value of £40,680,002.32 which they rounded down to £40 million.

335. On 23 February 2016, King & King wrote to HMRC explaining that CGL's business model was unique and they had not been able to identify any companies that had such high gross profit or net profit percentages.

336. In that regard, we observe that in his third witness statement, Mr Engineer stated that CGL's turnover increased from £6.79 million for the year ending 30 June 2014 to £10.26 million for the year ending 30 June 2019, which were the last accounts before the 2019 sale. In the same period CGL's operating profit rose from £2.72 million to £6.25 million. We do acknowledge that that cannot form part of the valuation exercise as at the Valuation Date.

Areas of Agreement

337. Both witnesses are very experienced in the field of valuation but neither have particular expertise in relation to pharmaceuticals.

338. They conceded that there was a degree of subjectivity in their approaches.

339. They recognised that the Partnership's business model was, if not unique, certainly very different and that it was therefore very difficult to identify similar businesses.

340. Mr Mitchell correctly stated in his report that "finding comparable companies to the Partnership [is] extremely difficult due to the specific nature of the Partnership's operations … There does not appear to be any listed companies that exclusively license generic pharmaceutical products". Mr Palmer agreed confirming that "identifying a public comparable to the Chemidex products is obviously difficult".

341. In the Joint Statement they agreed that:-

(a) They had to consider market value as defined by section 845 CTA as at the Valuation Date.

(b) There is no standard or conventional methodology to arrive at the market value of the Product Assets.

(c) The relief-from-royalty approach can be used to value the Partnership, whose value is materially the same as the Product Assets.

(d) A variation of the Income Approach is appropriate. Mr Palmer has used that for all three of his approaches.

(e) The relief-from-royalty approach used by Mr Mitchell is broadly, and arithmetically, the same as the Contractual Approach used by Mr Palmer.

342. Section 845 (in so far as is relevant) reads as follows:

> **845 Transfer between company and related party treated as at market value**
>
> (1) The basic rule is that a transfer of an intangible asset –
> (a) from a company to a related party, or
> (b) to a company from a related party,
> is treated for all the purposes of the Taxes Acts as being at market value (as respects both the company and the related party) if condition A or B is met.
>
> (2) Condition A is that the asset is a chargeable intangible asset in relation to the transferor immediately before the transfer.
>
> (3) Condition B is that the asset is a chargeable intangible asset in relation to the transferee immediately after the transfer.
> …
> (5) In subsection (1) –
> "market value" means the price the asset might reasonably be expected to fetch on a sale in the open market, and
> "the Taxes Acts" means the enactments relating to income tax, corporation tax or chargeable gains.

Discussion on the Valuations

343. As can be seen, the parties' views are polarised and nowhere more obviously than in the stark difference between Mr Palmer's approach in valuing the "Chemidex Business" and Mr Mitchell's approach in only valuing the income stream as at the Valuation Date. However, there are numerous other areas where there is far from a meeting of minds.

344. The experts agreed that market value is as defined by section 845 CTA.

345. In Mr Palmer's expert report, at paragraph 1.3.1, his definition of market value was stated to be as it is defined for the purposes of both section 421 of the Income Tax (Earnings and Pensions Act 2003 ("ITEPA") and section 273 of The Taxation of Charitable Gains Act 1992 ("TCGA") which he said could be summarised as:

> "…the price which might reasonably be expected to be achieved in a sale on the open market between a hypothetical and willing vendor and a hypothetical and willing purchaser, each of whom is deemed to be acting for self-interest and gain and both of whom are deemed to be equally well informed about the business and the markets in which it operates".

346. He went on to refer to section 845(5) CTA which he said, in his view, amounted to the same thing. Mr Henderson pointed out to him that it was section 272 of TCGA (not section

273) which defined market value for Capital Gains Tax purposes and it was the same definition as section 845(5) for Corporation tax. Therefore, his summary was not accurate. It was not.

347. Mr Henderson, rightly, put it to Mr Palmer that the case law means that one has to look at it from the position of a hypothetical vendor and a hypothetical purchaser and that the hypothetical purchaser will not usually be "equally well informed".

348. Mr Palmer responded saying that:

> "…the way I have approached this, given that in this situation the buyer and seller are related parties, I think the buyer and seller are equally well informed about the business in which it operates…".

349. We do not accept that that is the correct approach and that for the following reasons.

350. As we have said, as far as the available information was concerned, Judge Cannan in *Netley* observed that in *re Lynall,* the House of Lords had pointed out that a sale in the open market will not involve the release of any confidential information to prospective purchasers.

351. Judge Cannan explained that the test was by reference to what a reasonable board of directors would disclose, and not what the particular board of directors would have disclosed. The question of what a prudent purchaser would reasonably require is essentially a value judgement, informed by the expert evidence. We are a specialist Tribunal and whilst we accept that confidential information should not be disclosed in the world of sales to privately owned companies, in our experience, <u>some</u> degree of confidential information is often made available by the sellers simply to ensue maximisation of the sale price. Therefore, we do accept Mr Palmer's argument that, in a hypothetical situation the hypothetical purchaser would do due diligence and there would be conversations with management. Our caveat is that we also agree with Mr Henderson that such conversations would be likely to be treated with a "healthy degree of scepticism".

352. In cross-examination, Mr Palmer said that he had "received information from management and that is important in the valuation and I have sought to challenge …and corroborate that information where possible to form my own conclusions".

353. However, he also conceded that what he described as a Value Chain Analysis, (Appendix 5 of his report) which narrated his understanding of the respective roles of the Partnership and CPL, had been derived from discussions with Mr Engineer.

354. His conclusion, under the heading "Conclusion of Value Chain Analysis", at 1.7.1 of his report, based on that analysis, was that "…the functions performed by CPL related to the exploitation (via manufacturing and distribution) of the Product Assets is also limited and of low value-add". He had previously concluded that the activities related to protection and enhancement of the Product Assets was "low value-add". We will revert to that in more detail.

355. HMRC's Note on the Evidence points out that Mr Mitchell was not aware of the business model of the "Chemidex entities" in terms of them taking advantage of the pharmaceutical drugs pricing rules and the full extent of the price rises. Mr Mitchell's oral evidence was that he knew that the business model was to increase the prices and that that was vital to generate the profits. He was not aware of the detail of how the pricing regime worked.

356. We say that because at paragraph 7.7.4 of his report and also at paragraph 1.7.2 of Appendix 5, Mr Palmer said that, based on his understanding of the Chemidex Business, in terms of value creating activities, he believed that:

(a) the Partnership was responsible for "the successful identification and acquisition of rights to products which can be acquired at low cost and subsequently can be successfully re-launched to achieve attractive unit economics", and

(b) CPL was responsible for "successfully enacting price increases and executing enhanced marketing efforts to market the products to prescribing physicians/hospitals as part of the re-launch of the products".

Perhaps more pertinently, at paragraph 2.2.3 of his report, Mr Palmer stated:

> "As the Chemidex Products address relatively small and niche patient populations with limited competition from other generic pharmaceutical companies, CPL has been able to re-negotiate prices with the NHS allowing for significant price increases. Considering the niche nature of the products, the barrier to changing medications for patients is significant and as such CPL has been able to increase prices without material regulatory pushback".

Mr Mitchell had access to all of that information.

357. It is relevant to state at this juncture that we do not accept the assertion in Submissions that it was only when Mr Engineer's second witness statement was lodged that the true nature of the business model became clear. In his first witness statement Mr Engineer had said that their research was focussed on identifying products with the potential for future earnings and "…identify opportunities to acquire these niche products at a good price and exploit them based on what we thought would sell". Certainly, the intricacies of NHS pricing only became clear in oral evidence but, in our view, that is something that could have been researched by any of the experts; the information is in the public domain. It appears that there was a lack of curiosity about the detail of the business model on all sides.

358. The Management Information itself is a thorny issue.

359. The first point is that on the first day of the hearing, Mr Engineer said that he had "met" Mr Palmer only after Mr Palmer had completed writing his report. The impression was given that he had not provided Mr Palmer with information. We have emphasised the word "met" since Mr Palmer confirmed that there had been no physical meetings only telephone conversations or conference calls.

360. In his evidence, Mr Palmer was very clear that "…we would not have been able to produce the report without discussions with Mr Engineer". He confirmed that he was referring to his first report and, as he confirmed, the expert report replicated the findings of the first report.

361. Although, in a footnote [146] in their Note on the Evidence, HMRC stated that it was unclear what the position had been, in relation to whether Management Information came from King & King or Mr Engineer, and they did not pursue it, we find that it is in fact very clear and we consider it to be material.

362. We find that Mr Engineer was a key source of information for Mr Palmer. Furthermore, Mr Engineer's unchallenged evidence was that "I discussed all matters with King & King before responses [to HMRC] were drafted and I believe that the facts given to HMRC by King & King in their letters was correct". His input was pivotal.

363. We have explained at paragraph 285 that the Management Information was provided by Mr Palmer in February 2022 in response to HMRC's concerns about inequality of arms. We have a number of problems with it. It states that it is a summary of a meeting with King & King on 7 March 2019 "together with any material additional information/clarifications provided

through subsequent interactions". As far as the detail of the Management Information, is concerned, we comment as follows:

(1) Under the heading "Control/Risk" it states that:-

(a) "Management advised that when a product is acquired, CGL already has in mind how much to manufacture and how to target it to patients." CGL did not purchase the Product Assets or decide on the marketing or the quantities that should be manufactured. That was the Partnership. CGL was dormant until 2013.

(b) (i) "The current products are expected to have a useful life of at least 30 years from the date of acquisition. The majority of the products have been on the market for around 30 years and were expected to remain on the market for a similar period following 27 March 2013".

(ii) And "….some products naturally die off, but over a long period of time (e.g. 40-50 years)".

Mr Palmer relied on the second sentence in the first quotation at 5.5.2 in his report and presumably deemed the word "acquisition" to mean the Valuation Date. Whilst acknowledging that, Mr Mitchell pointed to the first sentence (at footnote 311 relating to paragraph 11.11 of his report) stating that it was not clear whether the useful economic life was in excess of 30 years or around 30 years. He had therefore operated on the assumption that it was 30 years after acquisition by the Partnership.

As HMRC pointed out in their email of 15 July 2022, CGL's Skeleton Argument responds to that at paragraph 13(5)(i) where it was argued that "…the position was that cash flows were expected from the Product Assets for 30 or more years and the product assets were expected to have value at the end of the 30 year period". The footnote [48] states that "The 30 year period was taken because it relates to the period up to the valuation date for which the Partnership was in existence". That is difficult since the Partnership only commenced buying the Product Assets in 2005 and some had been discontinued by their previous owners.

(c) "It then seeks to break into the market via price increase and market share. Increasing the price is the key to generating larger profits". Mr Palmer conceded in cross-examination that his report had not identified the focus on price increases in the context of the pharmaceutical pricing rules and that there should have been more information on that.

(d) "Price increases are normally made 6-12 months after acquisition …CPL makes the pricing decisions but then profits are shared". That is not consistent with the correspondence from King & King to HMRC which repeatedly stated that the Partnership decided the pricing strategy and nor is it consistent with Mr Engineer's evidence. We have explained at paragraph 133 that CPL only calculated the price increases and negotiated those once the Partnership had decided on the pricing.

(e) "CPL is insured as the marketers of the product: with the insurance covering both CPL and CGL". As at the Valuation Date, CGL did not market the Product Assets and as we understand it, it never had done so. It simply owned them and licensed CPL to monetise them from and after the Valuation Date.

(2) Under the heading "Financials" it states that:-

(a)"One person was employed by CPL". That is inaccurate. Mr Mitchell's assumption that it was the Partnership that had only one employee is correct and that was confirmed by Mr Engineer in cross-examination.

(b) "The assumption should be that there will not be any additional products acquired by the Partnership: new products will go into a different entity. There have been no acquisitions for nearly 10 years now". We are not sure what was meant by that because:-

(i) An earlier bullet point under that heading stated that "Mr Engineer decided to leave the UK in 2013 which drove the decision to move from a partnership (i.e., the Partnership) to a company (i.e., CGL), as you have to be in the UK to run a partnership."

(ii) The accounts for CGL for the period to 30 June 2013 record that:-"The shareholders were trading as a Partnership which was incorporated into the company during the period." As we understand it the Partnership ceased to trade in 2013.

(iii) The Product Assets were sold as a "package" which was viewed as a finite portfolio and, as can be seen, the last of them had been purchased in January 2011 which was more than two years before the Valuation Date and certainly not 10 years previously.

(iv) Although Mr Mitchell's calculations were predicated on the basis that there was no intention to buy any new Product Assets it is clear from 4.1.1 of Mr Engineer's first witness statement where he says that "we had previously experienced difficulties in buying products in the name of the Chemidex partnership from some US pharmaceutical companies" that there was an intention to continue purchasing.

364. Our concern is the extent to which any of these inaccuracies influenced the valuation approaches. A good example is the issue of pricing at 1(d) above because Mr Mitchell quotes that statement about pricing, which is inaccurate, in the Joint Statement at page 11 to support his argument about "the importance of CPL's responsibilities". HMRC went on to rely upon that in their Skeleton Argument to support their argument that CPL bore more risk than the Partnership.

365. There were other more subtle issues, for example, although the two experts had adopted different valuation approaches both have valued the income stream that the Product Assets generated for the Partnership. As we have indicated, Mr Mitchell reviewed Mr Palmer's reports and the other information to which he had access before preparing his report. However, as we noted at paragraph 72 above, the figures provided to the experts were derived from different sources. Mr Mitchell could not reconcile that and nor could we. At 4.18 in Table 7 in his report, Mr Mitchell demonstrated the difference between what Mr Palmer and King & King had identified as the quantum of the payments made by CPL to the Partnership under the PSAs. At 7.9 in Table 18 he demonstrated that Mr Palmer's calculated revenue was on average 15.7% higher than the figures provided by King & King. He opted to use the latter's figures.

366. In response to Mr Mitchell's valuation, Mr Palmer then amended some of his calculations. However, that had no impact on his overall conclusion and what he described as only a low value impact on each of the three approaches that he had adopted.

367. Those amended calculations were attached to the "Joint Statement of the Valuation Experts" dated 11 May 2022. It extends to 43 pages without the Exhibits. It sets out the areas of agreement and disagreement between the experts and their reasons for disagreement.

368. Consequently, unless we narrate otherwise, the figures used in this decision are derived from the Joint Statement and Exhibits rather than the figures in the expert reports.

369. Another area that caused us concern was that in cross-examination Mr Palmer confirmed that the very specific figures in his report in a Table, at 5.4.2, which had allocated the costs of CPL between the Product Assets and CPL's own assets on the basis of a roughly 30:70 split had been derived from discussions with management.

370. The only evidence that we know was provided to Mr Mitchell in regard to the 30:70 split is under "Financials" in the Management Information which simply states:

> "….In relation to the costs of CPL, Management estimate that:
>
> > The majority should be allocated between Chemidex and non-Chemidex Products on a 30%/70% split by the number of products. The registration cost is the same for every product, and R&D costs would be 30/70% regardless of how much they sell, as they increase the team based on how many products they buy. There is (sic) very little costs relating to sales as the products are already marketed. Mr Engineer's relationships with GPs help generate sales."

It is also referred to in the King & King correspondence with HMRC so he may have seen that.

371. At Table 5 ("Minor areas of agreement and disagreement on cash flow projections") in the Joint Statement this is identified as an area of disagreement with Mr Mitchell stating that he had seen no evidence supporting the 30:70 split.

372. He also thought that it would be too low because in excess of 70% of CPL's revenue related to the Product Assets and, in his opinion, it would be unusual for it to account for only 30% of the costs borne by CPL.

373. Whilst that may be the case in the abstract, in the unique *modus operandi* of Mr Engineer and CPL, we find that is plausible since CPL paid nothing for Mr Engineer's time and expertise, and, as can be seen, it appears that he was involved in most aspects of what CPL did.

374. In oral evidence, Mr Palmer argued that although some of the detail of that allocation might be difficult to find in the absence of discussions with management, most of it was available from the financial statements that were in the public domain. As Mr Henderson rightly pointed out there are a number of problems with that.

375. Firstly, Mr Palmer conceded in cross-examination that throughout his report he had relied upon information from the accounts for 2013 for both the Partnership and CPL. Mr Henderson pointed out that the CPL 2013 accounts were dated 25 November 2013 and the Partnership's accounts were dated 5 September 2013. Mr Palmer said that he had treated those figures for costs, which were very specific, as being estimates but given that the precise figures were available not very long after the Valuation Date, he considered that to be the best evidence of the estimates. In his report at 5.4.2, Mr Palmer had stated that he had taken "the line item 'Profit Share Payment to Partnership' from CPL's financial statements" but in cross-examination he conceded that there was no such line item and so it did not come from the financial statements but had been derived from additional information in a breakdown of the financial statements.

376. Clearly, the detailed information would not have been available to a hypothetical purchaser in the context of due diligence leading up to the Valuation Date or indeed to Mr Mitchell. Mr Palmer confirmed that his calculations had been based on an assumption that the Partnership would have provided the hypothetical purchaser with information as to CPL's likely profits for 2013 since they would have had a "pretty good idea" about it.

377. We have major difficulties with that. Mr Henderson rightly pointed to paragraph 30(e) of IVS 13 where the final sentence reads:- "The factual circumstances of the actual owner are not part of this consideration because the willing seller is a hypothetical owner".

378. We have to work on the statutory hypothesis that CPL would not be a related party to either the hypothetical buyer or seller.

379. Having said that, we find that it was possible for Mr Mitchell, and it would have been possible for a hypothetical purchaser, to work out approximately how much of CPL's revenue was derived from the Product Assets since the Partnership would disclose the level of its receipts and, of course, the other 60% went to CPL.

380. We accept that a hypothetical purchaser would have had access to a limited amount of information. The running and production costs were fixed and so a reasonable projection of profits might have been available but the detail of the allocation of the costs in CPL as 30:70 would not.

381. Quite apart from the question of allocation of costs, the whole question of "allocation of value" to the Partnership is very difficult.

382. In the Joint Statement, Mr Mitchell stated that in valuing the Chemidex Business, Mr Palmer may be allocating value that is attributable to CPL to the Partnership. Mr Palmer refuted that saying that he was satisfied with the allocation which was based on the "different risks, roles, activities and costs incurred by each entity". Therein lies the major issue in this appeal.

383. One of the key issues is where the balance of risk lies and that goes hand in hand with the roles and activities of CPL and the Partnership respectively and that is not as black and white as either party depicted.

384. On the one hand, Mr Goldberg urged us to find that CPL was what he described as a "pass-through" company which, having outsourced or sub-contracted most of its activities to third parties, carried out only routine administrative functions. CPL was easily replaceable. It was insured against risk and had not taken the risks in purchasing the Product Assets. CGL had the benefit of the PSAs, and it could terminate the relationship with CPL at any time which in itself was a considerable asset.

385. On the other hand, HMRC "strongly disputed" any suggestion that CPL carried out only routine functions. It was argued that CPL was the business entity which delivered value, had infrastructure costs and bore the greater risk. It monetised the Product Assets and dealt with the CMOs, "deciding the marketing strategy and determining how aggressively to increase prices". The word was not used but the suggestion was that CPL was "exploited" by CGL because the PSAs were not commercial; hence their argument that in an arm's-length situation CPL would terminate the PSAs. Lastly, HMRC suggested that once the Product Assets had been purchased, the Partnership was almost a passive investor which received the income stream from CPL. Its risk was the loss of its investment and that was a comparatively small sum.

386. Mr Palmer addressed the issue of risk at 7.7.5 of his expert report stating that it would be wrong to assume that because the acquisition cost of the Product Assets was comparatively low then the Partnership did not assume material risk. He argued that the direct product acquisition costs were only one factor and that the opportunity costs were also important, ie if time, effort and capital are expended by the Partnership on acquiring products which cannot achieve the high prices there would be no value creation. We agree with that argument because, looked at commercially, the decisions made by the Partnership in selecting and buying the Product Assets

and setting the pricing and marketing strategy underpin the premium achieved in the return to them via the PSAs and also the profits earned by CPL.

387. We were not persuaded by the argument for HMRC that because the Partnership had paid only £1.9 million for the Product Assets then their value could not be as high as their sale price of £40 million. We are aware of numerous examples, in many sectors, of fortuitous purchases and then a huge gain on sale. We also observe that, as we have noted at paragraph 66, albeit it was a sale between related parties, a number of Product Assets were sold for £2,045,000 and they were viewed as having zero or relatively modest turnover.

388. We agree with Mr Palmer that what Mr Engineer had done was to take the Product Assets and repurpose them thereby making them more valuable and in that context, cost was a very bad indication of value.

389. Lastly, in that regard, at the Valuation Date the substantial price increases had already been negotiated albeit over time further changes might be needed; that explains in part the difference between the purchase and sale prices of the Product Assets. It was because the work had been done.

390. Quite apart from the profitable business exploiting the Product Assets, we accept Mr Goldberg's statement that in relation to its own products, CPL had a substantial business with inherent risks etc. However, we know little about that.

391. In relation to the Product Assets what are the inferences that we have drawn from the facts that we have found?

392. It was a deliberate choice by Mr Engineer not to draw a salary from CPL and his express view was that CPL performed only an administrative function. Clearly, he did not regard his added value as happening within CPL.

393. As long ago as 15 July 2015, King & King told HMRC that the Partnership were responsible for the identification of new products, pricing, and the targeting of marketing spend. Although it was CPL who did the marketing it was the Partnership, when purchasing the Product Assets, that had decided how and where they could be marketed and what pricing strategy should be adopted.

394. We do not accept HMRC's argument that it was CPL who decided the marketing and pricing for the reasons that we have set out at paragraphs 363 and 364 and elsewhere. Further, we accept Mr Engineer's evidence that he only purchased Product Assets if he had already identified the pricing opportunities and the market. That was his business model.

395. Although there is a blurring of their different roles, given the terms of Clauses 7 and 8 of the PSAs, we find that from a commercial perspective, even if CPL had been an entirely arms-length company, it would have been prudent for CPL to have validated any proposed changes in the marketing and pricing frameworks provided by the Partnership with the Partnership as the owner of the Product Assets. If they did not do so, they risked triggering the termination of the PSAs.

396. CPL carried insurance and therefore had limited risks and almost everything was outsourced. We do not accept the bland assertion for CGL that CPL would never be in a loss-making position. As we know only too well, any company can find itself in a loss-making position. However, we do accept that it was very unlikely.

397. CPL did carry a risk in that Clause 6 of the PSAs provided that it would indemnify the Partnership, and therefore CGL against third party claims. There are four points in that regard, namely:-

(a) CPL was insured,

(b) Since almost everything was outsourced, CPL would have been expected to have indemnity arrangements with the CMOs,

(c) That provision was of value to the Partnership and CGL and should be reflected in the valuations, and

(d) There is a possibility that if the indemnity were to be called in then CPL might wish to invoke the termination provisions in Clauses 7 and 8.

398. Certainly, CPL was responsible for all compliance issues with the MHRA, and that was an administrative function, but, as can be seen from Appendix 1, the Partners also had a role to play in that.

399. We also accept Mr Engineer's evidence in his second witness statement that the value lay in identifying the Product Assets which, once acquired, could be monetised relatively easily through the marketing strategy which had been devised by the Partnership. As at the Valuation Date, there was not only the marketing strategy but also a pricing strategy, devised by the Partnership, which were already in place and those could be simply followed to maintain the income flow. He described it as the "real value". We find that it was.

400. Furthermore, crucially CGL ultimately had the right, on no notice, to cancel the PSAs and retrieve the right to exploit the Product Assets.

401. That takes us to the PSAs and to Clauses 7 and 8.

402. The PSAs are not hypothetical and would have to be taken into account by any hypothetical purchaser. That purchaser is buying not only the Product Assets but also the PSAs and both the purchaser and CPL could terminate those PSAs. Albeit in a different context, in her report, Ms Brotherston stated that CGL had a contractual right to receive cash via the PSAs and that the future cashflows were "value already attached to the Product IP asset". We agree.

403. As long ago as 13 May 2016, in a letter to King & King, HMRC argued that they could not understand why CPL would want to continue operating under the terms of the PSAs and their view was that, if they were not related parties CPL would terminate the PSAs leaving the owner of the Product Assets with little or nothing to profit from. As can be seen, Mr Mitchell has adopted the same approach as HMRC.

404. King & King responded pointing out that if the PSAs were terminated then CPL would not have been able to manufacture or deal with the Product Assets. The Partnership would then simply find someone else to do so or monetise them themselves.

405. In their Skeleton Argument, HMRC rejected CGL's argument that Mr Mitchell had wrongly assumed that "CPL would make the wholly uncommercial decision to terminate [the PSAs] and could then immediately re-negotiate the terms of the PSAs…". HMRC argued that CPL would have wished to pay only 10-20% to the owner of the Product Assets. We find that, although re-negotiation of any contract is technically possible, it would be inherently unlikely in this instance. If CGL refused to renegotiate and themselves terminated the PSAs, CPL would no longer have the right to exploit the Product Assets. They would then be exposed in terms of their contracts with the CMOs for manufacture, storage and transportation. They would lose the not insubstantial income that the Product Assets generated; as Appendix 3 in the Joint Statement shows, at the Valuation Date, the income from the Product Assets was rising.

406. It was argued for HMRC that Mr Mitchell had adopted the correct approach of trying to work out what income the owner of the Product Assets could obtain and it could not be assumed that the hypothetical purchaser would try to exploit the Product Assets because that would be

too speculative and uncertain. Mr Mitchell argued that it would take too long and too much money to put in place the infrastructure to monetise the Product Assets. However, we find that the mere possibility that that could be done, and at will, would mean that a hypothetical purchaser might well wish to consider doing so if not immediately after purchase but in the future. It would have been an option and potentially a very valuable one.

407. We find that because CPL sub-contracted most of its activities to third parties it was certainly replaceable. Therefore, on the balance of probabilities, the owner of the Product Assets, if it terminated the PSAs, could have monetised the Product Assets with comparative ease.

408. Mr Goldberg had argued that "One of the more likely hypothetical purchasers is somebody else in the pharmaceutical business…" and therefore might already have the expertise to successfully exploit the Product Assets in house. In their Note on the Evidence HMRC argued that that was an impermissible approach to valuation since, as *Gray* made clear, the hypothetical buyer is anonymous. That is true. However, we have quoted paragraph 6 from *Bower* and paragraph 3 from *Gray* (paragraphs 275 and 276 above) because those make it clear that one should be looking at who, "in the real world" would be likely to be in the open market. All the experts have agreed that the Product Assets were decidedly "niche". Indeed, as we will mention in regard to competition, Ms Brotherston had noted that there was not a competitive or active market for the Product Assets. It is a minor point but, on the balance of probability, Mr Goldberg is correct in what he said.

409. In summary, we find that for CPL the risk of termination of the PSAs was material and conversely for CGL, the right to terminate at will was an asset. The sale of the Product Assets was not just a sale of the "recipes" and MAs with the income stream flowing from that via the PSAs, but the PSAs themselves were an asset in the sense that the ability to terminate at will gave the owner of the Product Assets the "upper hand" *qua* CPL. Specifically, we do not accept Mr Henderson's argument in Closing Submissions that the Product Assets were being transferred "with no wherewithal to exploit it attached to it". The ability to terminate at will meant that in retaining the reversion the Partnership or CGL retained the potential to exploit the Product Assets.

410. Obviously, a hypothetical purchaser might simply view the purchase of the Product Assets as being the purchase of an income stream and leave the PSAs in place unless something were to go wrong.

411. However, the valuation principles that we have described mean that we must look at what would get the largest price without undue expenditure of time and effort.

412. In our view, the hypothetical purchaser of the Product Assets might well have seen the right to terminate the PSAs as a real opportunity. Mr Engineer had chosen the structure utilising CPL but a hypothetical purchaser would have had "a clean sheet" and, presumably, would have wished to maximise profits. Given that CPL was making significant, and rising, profits having outsourced the majority of the activities required to monetise the Product Assets, we take the view that the termination of the PSAs would be a possible "best use" of the Product Assets because those profits could then be taken in house with comparative ease.

413. The ability to terminate would give a hypothetical buyer a range of options depending on their attitude.

414. We observe that the Management Information narrates that at least one of the CMOs made a margin of 3.5% so one possibility is that on the assumption that the contracts with the CMOs were profitable for both parties, if there were a termination of the PSAs, the CMOs

involved may well have wished to minimise their risk and would have contracted directly with CGL. There was a defined and stable market for which they were providing delivery.

415. Another possibility is that a hypothetical buyer might have considered threatening to use Clauses 7 and 8 to negotiate a change from a straight 40% arrangement to a cost plus basis that might have been higher.

416. We do not accept the arguments advanced in HMRC's Note on the Evidence to the effect that there was a significant risk of competition. As we have pointed out in relation to dexamethasone another company had acquired MHRA authorisation and did market that drug. HMRC placed great reliance on that but, as we can see from the significant profits made in relation to that drug, that could not have had any real impact. In cross-examination, Mr Palmer had said that that risk had been adequately factored into his valuation primarily by virtue of his use of a long-term growth rate ("LTGR") and a discount rate. HMRC argue that that was an inadequate answer because he had not discussed in his reports what they saw as the risks including competition and a change to the pricing rules.

417. Firstly, we agree with HMRC's own expert, Ms Brotherston, who stated explicitly at paragraph 6.75 of her report that:

> "…there is evidence to suggest that there was not a competitive or active market for the Product IP… and consequently, a quoted market value is unlikely to be available to determine the fair values of the Product IP".

That was based on D&P's narrative in the 2019 valuation that:-

> "None of the products were acquired in a competitive tender or auction process…the Partnership negotiated with the sellers in the absence of competition…".

That is accurate.

418. Mr Engineer's evidence, which we have accepted, is clear. There was no competition; that is why his businesses were so very successful.

419. Of course, there could be parallel importing and other companies entering the market and acquiring the relevant MAs but (a) there was no history of that having any impact on the Partnership's profits in a situation where many of the drugs had been on the market for years, and (b) those are conventional business risks which every hypothetical purchaser would have considered.

420. We accept Mr Palmer's evidence that he had covered those risks by using a declining growth rate despite the fact that the business had grown successfully, and he had used a discount rate reflecting those risks. His growth rate had been a judgement call at minus 1% for 30 years which would be approximately 70% of the revenue in 30 years but long term inflation at even 2% would mean that that was a significant decline.

421. As far as change in the pricing rules are concerned, we have discussed that under the heading "Press coverage". For the reasons given there, we do not accept the argument in HMRC's Note on the Evidence that there had been "significant adverse publicity both before and after the Valuation Date" and therefore a prudent hypothetical purchaser would adopt "an extremely cautious approach". Of course, the pricing rules could have changed but again that is a conventional risk.

422. We agree with Messrs Henderson and Waldegrave when they state in their Skeleton Argument that "Obviously, a valuation approach is only useful if it produces a reliable assessment of values and is also applied accurately to the factual circumstances". As can be seen there is a problem with how the factual circumstances were approached by both experts.

423. We do not care for the term pass-through company but we understand what Mr Godberg was arguing. We have found that, in relation to the Product Assets, CPL was not the entrepreneurial entity that HMRC portrayed. It certainly had an administrative function but in relation to the Product Assets there was not a substantive business because almost everything, other than of an administrative nature, was outsourced.

424. We do not agree with CGL, or Mr Palmer, that it is the Chemidex Business that falls to be valued. That does not exist because Mr Engineer decided to hive off the monetisation of the Product Assets. We understand that it was approached in that way because King & King described CPL and the Partnership as being a joint venture. However, for valuation purposes, we must consider the situation as if they were not related parties.

425. At paragraph 296 above, we have said that we have found that there was no equality of arms between the experts and that we would revert to that in the context of Mr Palmer's expert report. For the further reasons that we have given, as can be seen, there certainly was no equality of arms.

426. Mr Palmer conceded in cross-examination that if the information from CPL had not been available to a hypothetical purchaser because it was not in the public domain then neither the Top-Down nor the Bottom-Up approach would "get off the ground". He is right.

427. For the reasons given we find that a lot of the information used by Mr Palmer would not have been available. Accordingly, we agree with HMRC that neither the Top-Down nor the Bottom-Up approach is relevant when assessing the expert reports.

428. If we are wrong in that, having spent so much time analysing the evidence, we should at least make some comment on our findings in relation to those two approaches.

429. The Top-Down Approach used both an income and a market approach and for the latter, Mr Palmer had looked for trading and transaction comparables. He conceded that the trading comparables that he had utilised were "very, very different types of company to the hypothetical 'Chemidex Business'" as they were much larger and more diversified and did not have a finite portfolio of products. He acknowledged that there were differences in size and operations. They were involved in very different activities. He conceded that there were differences in size and operations but said that he had chosen them because they focussed on the generic sector and were therefore subject to some similar market and industry pressures. His argument was that he had found it very difficult to identify a public comparable equivalent to CGL and these were the best comparables available; it was his starting point.

430. Mr Henderson took him to a number of the companies which he had used for trading comparables starting with Teva Pharmaceutical Industries Limited whose revenues were generated as to 50% from generic medicines. It was one of the biggest generic pharmaceutical companies in the world with 3,600 products and 37,000 employees. It spent $398 million in a nine month period on R&D. Mr Palmer had used a 7.5 times enterprise value over EBITDA multiple and Teva was 7.8 times.

431. We do not intend to address the detail of each comparable trading company upon which Mr Palmer relied because they were so diverse including Perrigo Company plc which carried out contract manufacturing services for third parties. In summary, there was a variety of similar problems with all of them.

432. Lastly, in regard to trading comparables, Mr Palmer agreed that the EBITDA margins were broadly in the region of 30% whilst the margin for the "Chemidex Business" was approximately 80%.

433. It is clear to us that, as Mr Mitchell pointed out, multiples from companies that develop other products, have the ability to change strategies and are valued on the assumption that they do not have a finite number of products with a limited economic life and are not helpful in valuing the Product Assets.

434. Mr Palmer argued that he could make "adjustments" to reflect the differences but we find that these companies were not even remotely comparable, and we use the word "remotely" advisedly. We make it clear that we are not criticising Mr Palmer; it is a reflection of the unique nature of CGL's business.

435. We take the same view in relation to the transaction comparables. Again, these were very different companies and did not use a similar business model. One example is Amdipharm UK Limited which he had identified as the "most comparable" but it sold products in 80 countries whereas almost all of the Product Assets were only marketed in the UK. Another, Kent Pharmaceuticals Limited, carried on business as a pharmaceutical wholesaler with 1,200 product lines.

436. We have already addressed the issues in relation to the income approach in that what should be valued is not the "Chemidex Business".

437. We had a similar problem with the Bottom-Up Approach. As we have explained at paragraph 311 above, Mr Palmer used comparables that he described as "comparable service providers and generic pharmaceutical businesses". He very fairly noted that there is a "lack of publicly listed comparable companies with an identical business profile" to CPL. He had therefore expanded his search to include Contract Research Organisations ("CROs") to select an appropriate EBITDA margin that CPL could reasonably achieve and he had identified seven that he considered to be appropriate.

438. Mr Palmer had also stated at 8.1.6 in his report that there are "limitations to the comparability of these service providers to CPL" so he had used them as "directional guidance" when estimating a cost-plus markup to CPL's operating costs when estimating a range of EBITDA margins that CPL could reasonably expect to achieve.

439. Mr Mitchell's unequivocal opinion was that they were not comparable not least because CPL operated only in the UK and they operate across a "number of geographies" and CPL was significantly smaller. Furthermore, the business descriptions appear to date from 2019 and it is not known what whether that would have been the case in 2013. Since they are not comparable they cannot be directional guidance. We agree.

440. CROs provide specific services relating to the development of pharmaceutical drugs where it is hoped to obtain a patent. They provide outsourced services such as early-stage clinical trials to the pharmaceutical companies or IP owners. One example is ICON plc which was paid by third parties to undertake clinical research.

441. Mr Palmer argued that they provided a guideline for the sort of margins that CPL might make. Again, we do not accept that they are remotely comparable.

442. We turn then to Mr Mitchell's valuation and Mr Palmer's Contractual Approach.

443. Whilst Mr Mitchell was of the opinion that Mr Palmer's approach is broadly the same as his own relief-from-royalty methodology, Mr Palmer agreed that both were mathematically similar but he considered them to be fundamentally different. That was because his approach was based on the PSAs but Mr Mitchell's approach required the assessment of comparable royalty agreements from which to assess a suitable royalty rate.

444. However, Mr Mitchell and Mr Palmer did come close to agreeing on the methodology for the Contractual Approach. Where they differ is that Mr Mitchell selected a royalty rate for

the alternative to the actual contract (ie the PSAs) and Mr Palmer tried to establish what a fair return to each the parties might be, taking the view, based on his other two valuations, that the 40% in the PSAs was fair.

445. We have explained the outline of Mr Mitchell's approach at paragraphs 322 *et seq.* He confirmed that that approach involved selecting "appropriate royalty rates from agreements that are comparable to the PSAs". He accepted that there would not be directly comparable royalty rates but he said that he had tried to find agreements that also licence the ability to manufacture, market and sell off-patent generic pharmaceutical products. He then adjusted the royalty rates to reflect the risks that he perceived that the Partnership faced at the Valuation Date. Of course, his stance was that the Partnership faced very little risk and conversely it was CPL that bore the brunt of the risk. As we have indicated, we disagree on the issue of risk.

446. Mr Palmer argued that trying to compare royalty rates (40% in the PSAs) to a selection of other royalty rates and the market is "notoriously difficult" and the relief-from-royalty approach hinges on (a) the chosen royalty being correct, and (b) the particular nuances in the contract or agreement in question. He said that it is very difficult to select a comparable royalty rate. He argued that the royalty agreements selected by Mr Mitchell were not comparable to the PSAs. He agreed with Mr Henderson that there was not enough information available in relation to any of the agreements, whether the ones that Mr Mitchell had selected and with which he disagreed or the ones where he had agreed that they could / should be included.

447. His position was that Mr Mitchell should have used Multi Period Excess Earnings Model ("MPEEM") rather than trying to assess an arms-length royalty. MPEEM involves estimated cash flows associated with intangible assets after excluding cash flows that are attributable to other asset functions, ie isolating the cash flows that are relevant to the Product Asset.

448. Mr Mitchell rejected the argument on MPEEM because its use is primarily where there is a need to isolate excess cash flows attributable to a leading intangible asset. Since the Partnership's only income was from the Product Assets that would be pointless. We agree. Furthermore, Mr Palmer did not do a MPEEM model.

449. He had originally selected five agreements out of the 20 that he had reviewed but when preparing the Joint Statement he proposed the addition of others. The range of royalties in the agreements that were reviewed was between 2% and 75%.

450. Mr Palmer made the point that EBITDA margins were a key driver of a royalty rate so the lower the margin then the lower the royalty rate would be and most of the comparable companies had lower margins. However, Mr Mitchell argued that Mr Palmer had not performed an EBITDA margin analysis on any other pharmaceutical products in order to identify where the Product Assets ranked.

451. As we have indicated at paragraph 328, in the context of the PSAs, Mr Mitchell had been very clear in cross-examination that he had valued only the income stream (ie the monies that he thought should have been paid to CGL by CPL) and had not taken any account of the potential effect of the PSAs.

452. Mr Goldberg relied on paragraphs 31 and 32 of IVS 13 (see Appendix 3) to show that Mr Mitchell had gone wrong in law when making his valuation because he had not calculated the value which reflected the highest and best use of the Product Assets and he had gone wrong in fact because, in ignoring the PSAs, he had valued only part and not the whole of the Product Assets.

453. We accept the argument that the valuation must be done on the basis of the highest and best use. Mr Mitchell was adamant that the best use of the Product Assets would be to license them within the pharmaceutical market, ie simply to obtain the income stream.

454. For the reasons that we have given, we have found that the PSAs did not fall to be ignored and, on the balance of probability, the highest and best use could have included considering the right to reversion. We do not accept HMRC's argument that the terms of the PSAs are "irrelevant". Accordingly, we accept that Mr Mitchell's valuation was incomplete.

455. HMRC argue that because, other than in a brief exchange, Mr Mitchell was not cross-examined on the comparables, then his analysis stood. Mr Goldberg confirmed that he had not cross-examined Mr Mitchell on the comparables because Mr Mitchell had not valued the right thing, ie not only the income stream but the rights to the reversion in terms of the PSAs.

456. In our view, that brief exchange is very relevant. Mr Mitchell confirmed that the majority of the agreements upon which he relied were based on sales, ie revenue. It was put to him that that was different to the contractual terms for CGL, namely the PSAs. He was asked whether any of them had termination provisions that were similar to those in the PSAs and his response was that he could not recall and would have to go through them all "but I would probably agree that they are unlikely to".

457. We do not accept HMRC's argument that CGL failed to establish evidentially that none of the comparable agreements were similar to the PSAs. On the contrary, Mr Mitchell, who had chosen the comparables in the knowledge that none had an identical business model to the Partnership or CGL, failed to establish that those agreements were comparable.

458. We observe that, although it was in the context of explaining why he had not used a Market Approach, at 5.19 and 5.20 of his report Mr Mitchell had stated that:

> "5.19 The Partnership solely acquires and licences off-patent pharmaceutical products to CPL and therefore operates in a very niche aspect of the pharmaceuticals industry. This makes finding comparable companies to the Partnership extremely difficult due to the specific nature of the Partnership's operations.
>
> 5.20 In an ideal scenario, appropriate comparable companies for the Partnership would consist of businesses that also licence out pharmaceutical products. There does not appear to be any listed companies that exclusively licensed generic pharmaceutical products."

In our view that neatly sums up the problem with using comparables in any of the valuations.

459. In summary, looking at the totality of the evidence, like with Mr Palmer's two other approaches, we find that, again, the agreements are not remotely comparable.

460. Mr Mitchell argued that because the Partnership had no plans to acquire future products as at the Valuation Date, that restricted the ability for future revenue growth in the Product Assets. We find that to be something of a *non sequitur*.

461. It was clear from the evidence that the use of drugs could change and, depending on the marketing, the demand could both rise and fall. Dexamethasone is a case in point. As can be seen from Appendix 2, the number of prescriptions varied over the period but more than doubled between 2005 and 2013. One of the annexes to the Experts Joint Statement was an article dated 10 May 2022 from Medical News Today stating that Oxford University's clinic trials had found that Dexamethasone had increased the chance of survival on patients from Covid-19 who required respiratory support. Obviously, as Mr Mitchell pointed out, that could not have been foreseen in 2013 and both experts were agreed that hindsight had no place in valuation but it supports the general tenor of Mr Engineer's evidence that individual drug prices could vary.

462. In that context, Mr Engineer had given as another example, Prednisolone Foam which was a drug which he said had been doing an excellent job for the patients for whom it was

prescribed for about 30 years prior to the Valuation Date. In his view there was no reason why anybody should look for a replacement for it, there was no reason why it would stop being prescribed and there was no reason to suppose that demand for it would drop over a long period. It was reasonable to suppose that the Prednisolone Foam would go on selling for another 30 years as other useful drugs go on selling for years. The same was generally true of all of the Product Assets. If the price of one drug fell, although it was a small portfolio, there is a degree of hedging impact. We accept that.

463. We observe that at 4.35 in his report Mr Mitchell pointed out that sales of that drug had increased from nil in the year to 31 December 2010 to £1.2 million in the year to 31 December 2011 which represented 98% of the growth in sales for the Product Assets that year. That trend could also be seen in the following year where the revenue growth was 95%. In the same paragraph, he noted that Dexamethasone sales had increased by "c.£550k in the year to 31 December 2011 and by c.£350k in the year to 31 December 2012".

464. King & King had stated in their letter dated 10 November 2015 that there were no detailed forecasts but the Partners had projected a ballpark growth of 5% to 10% per annum. Mr Palmer's growth rate for 2014 was 4.5% based on 2013, whereas Mr Mitchell's growth rate was negative 7.5%. Given that it was a static portfolio, a hypothetical purchaser would be unlikely to put much faith in a 10% projection but negative 7.5% is a long way from that.

465. Mr Mitchell's report did not deal with the significant price rises in the business model since he said that he had not been aware of it. He said that had he been aware of it, he would have factored it in by adjusting the LTGR or adjusting the discount rate (making the former higher or the latter lower). Mr Mitchell had assumed that either the volume or the price would fall and hence he had arrived at his negative 7.5% figure. Mr Palmer's figure was negative 1%.

466. In brief summary, Mr Mitchell had arrived at his LTGR on the basis that there were likely to be short-term and insecure cash flows, but Mr Palmer had proceeded on the basis that the income stream had been, and was, robust and expected to last for 30 years or more. It should not be forgotten that on the one hand, at the Valuation Date the income was rising and on the other hand both experts had also forecast inflation at 2%.

467. Mr Palmer agreed that the Partnership was reliant on a very small number of products and that Mr Mitchell had included a firm specific risk premium because of that. Mr Palmer did not have an additional risk premium and his report did not involve any discussion of the reliance on the small number of products. Mr Mitchell argued that Mr Palmer's Contractual valuation should have included a firm specific risk premium.

468. Mr Palmer argued that he and Mr Mitchell had used a size risk premium of 6.03%. That represented the characteristics of small companies which typically would rely on a smaller number of products. An additional risk premium would be double counting. In his view the additional premium was subjective and Mr Mitchell conceded that it was.

469. In his forecasts Mr Palmer was projecting a declining revenue and not projecting any new activities. Mr Mitchell was predicting a very significant decline and then adding the additional risk premium and Mr Palmer did not consider that to be appropriate.

470. Ultimately, Mr Palmer had a 12% discount rate and Mr Mitchell argued that it should be 14% so that was a 2% difference. The major difference between them was the firm specific risk premium of 2%.

471. We agree with Mr Palmer's arguments on the firm specific risk premium because the discount rate number reflects risk and future value.

The Bridge Chart

472. In his expert report Mr Mitchell devised what he described as a "bridge chart" to show the change in the valuation if certain key inputs, that he considered appropriate, were amended to the inputs used by Mr Palmer in his contractual valuation approach. He had noted that there appeared to be three main inputs that were driving the difference when comparing his approaches, namely:-

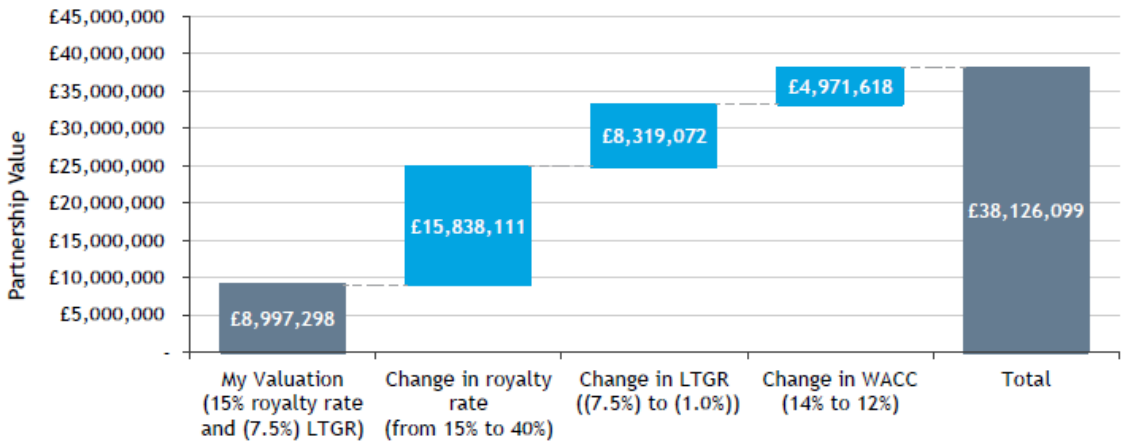
(a) the royalty rate (the income received from CPL in terms of the PSAs),
(b) the LGTR, and
(c) the discount rate.

473. He explained that the use of a lower royalty rate meant that the Partnership receives less income, thereby reducing free cash flows resulting in a lower valuation. A lower long-term growth further reduces the cash flows into perpetuity and results in a lower terminal value. Lastly, he stated that a higher discount rate decreased the present value of future cash flows resulting in a lower valuation.

474. He explained that if the royalty rate in his valuation was changed to 40% from 15%, the LGTR is changed to negative 1% from negative 7.5%, and the Weighted Average Cost of Capital ("WACC") is changed from 14% to 12%, that would result in the valuation of the Partnership being £38,126,099. He pointed out that that is roughly aligned with the middle of Mr Palmer's Contractual Approach valuation range of £39 million.

475. The bridge chart is as follows:-

Figure 3 - Partnership Valuation Bridge Chart



476. In cross-examination, Mr Goldberg asked Mr Mitchell to then recalculate the position if the royalty rate was increased from 15% to 100% and the LTGR and WACC remained unaltered at negative 7.5% and 14% respectively. He did so using a computer programme during an adjournment. The answer was that there would be an increase of £52.9 million so the figure of £15,838,111 would increase to £53.9 million and the total valuation would increase to approximately £62 million.

477. Mr Mitchell's argument was that the £52.9 million was the value in CPL not the Partnership. Mr Goldberg put it to him that that was highly improbable given Clause 7 of the PSAs. Mr Mitchell remained of the view, articulated in his report, that the PSAs would have been renegotiated to reflect, what he viewed as, a realistic royalty rate which would be between 10% and 20%. He had used 15%.

478. He was insistent that if the Partnership was entitled to a 15% royalty that was valued at £9 million, then the remaining value must reside in CPL. Mr Goldberg put it to him that because of the PSAs that was improbable which Mr Mitchell did not accept.

479. We find that the bridge chart raises three issues being:-

(1) Is the royalty rate fair?

(2) What should the LTGR be?

(3) What is the cost of capital?

We have discussed those, but in his Closing Submissions Mr Goldberg urged us to prefer Mr Palmer's LTGR and WAAC (Weighted Average Cost of Capital) but said that he would not stress the point. Accordingly, we did not pursue that further.

480. In Closing Submissions, Mr Goldberg argued that this bridge chart was at the heart of CGL's case. In his Closing Submissions, Mr Henderson said that it was important.

481. The calculation of the £62 million done by Mr Mitchell, at Mr Goldberg's request, is mathematically correct. Mr Woodman asked Mr Goldberg whether a hypothetical purchaser would have had to have put in place additional costs to compensate for those that were not included in that valuation and specifically the time and value of Mr Engineer and CPL's infrastructure.

482. Mr Goldberg's response was to the effect that that point was not put to Mr Mitchell in evidence but that "It may be that there is scope for saying that you would take into account some costs …" but no one knows what those costs might have been, albeit Mr Palmer had taken those matters into account in his first two valuations.

483. He went on to say that if the hypothetical purchaser were in the pharmaceutical industry they would not have those costs so there should be no deduction.

484. In our view that departs from the valuation principles that we have described.

485. We have no doubt that a hypothetical purchaser would take such costs into account. Indeed, we observe that in his report Mr Mitchell had noted that for his Contractual Approach, Mr Palmer had not included a rent cost for the Partnership's offices or salary costs for Mr and Mrs Engineer. Mr Mitchell had therefore made adjustments to reflect that a hypothetical purchaser would expect to pay both. We agree.

486. Mr Henderson argued that the £62 million was merely a mathematical exercise and Mr Mitchell had been clear that he had not valued CPL. Certainly, in his report he had not valued CPL, not least because he did not have the information to do so. However, as we have indicated at paragraph 478, he was insistent that if the Partnership was entitled to a 15% royalty that was valued at £9 million, then the remaining value shown in the bridge chart must reside in CPL.

487. Since we have found that, in relation to the Product Assets, CPL's primary function was largely administrative, that simply does not make sense.

488. Mr Goldberg had criticised Mr Mitchell for utilising only one approach to valuation since paragraph 55 of the IVS 13 recommends more than one approach where there are "insufficient factual or observable inputs for a single method to reach a reliable conclusion".

489. Both experts agree that the Partnership was a very unusual business and as our Findings in Fact make explicit, there is an extensive lack of clarity in relation to many facts, so we can see why Mr Goldberg advances that argument.

490. As can be seen, the real problem in this case is that there are significant challenges to all of the methods of valuation and of the detail in both reports. We have accepted that, because of the inequality of arms as between the experts, Mr Palmer's first two approaches cannot be used when comparing the expert reports.

491. As long ago as 11 September 2019, King & King pointed out to HMRC that Mr Palmer had considered the royalty rates contained in publicly available licensing data and noted that a) the range of royalty rates was relatively wide and b) such data does not provide any of the detail behind the relevant arrangements e.g. upfront payments, contingent payments, tiered royalty rates etc so that it was not possible to make a direct comparison between such data and the arrangements adopted by the Partnership. In our view, nothing has changed in the interim.

492. As we have indicated at paragraph 417, Ms Brotherston had said that "a quoted market value is unlikely to be available to determine the fair values" of the Product Assets. Of course, that was in the context of accountancy but she went on to point out that CGL had obtained independent valuations from King & King and D&P. The D&P report came to the same conclusion as Mr Palmer's expert report. Whilst the latter has to be discounted in our deliberations on the expert reports because of *ICI* (see paragraph 283), the former does not fall into that category.

493. Where does that leave us?

494. We commenced the discussion on valuation by saying at paragraph 343 that the parties' views were polarised and we referenced the expert reports. We agree with the proposition advanced by Mr Palmer that there was no conventional way to determine the value of the Product Assets. The Judge in *Violet Yorks Ltd v Property Holding Investment Trust Ltd* (1968) is often quoted by surveyors as describing valuation as "art not science" and this case clearly demonstrates that.

495. There is no precise and definitive figure that is the correct valuation. We must look for a justifiable range.

496. At paragraph 280 above, under the heading "Valuation Principles", we chose to quote Judge Cannan in *Netley* because ultimately, having carefully considered in great detail all of the expert evidence from Messrs Palmer and Mitchell, we have adopted Judge Cannan's approach; it is the underlying evidence that is significant.

497. Our conclusion, after exhaustive analysis of both expert reports including the many footnotes and cross references, is that the deficiencies or omissions in both, mean that despite the time and expense involved, they really do not assist us to any material extent.

498. We make it clear that we accept that both experts have genuinely tried to put together as coherent a case as possible based on the differing information with which they were provided. They were severely hampered by the unique features in this case. Those include, but not exclusively:-

(1) the PSAs,

(2) the outsourcing of manufacture, storage and transportation,

(3) the niche market which faced little or no competition,

(4) a small but hedged portfolio,

(5) a very lucrative and rising income stream,

(6) the licensing of the Product Assets after the pricing and marketing strategies had been devised, and

(7) the lack of even vaguely similar comparable companies or licensing agreements.

499. We have analysed all of that underlying evidence. Since we accept Mr Engineer's evidence and find that the source of his very considerable success was an understanding of the open market in which he worked, we have come to the view that the price that a hypothetical purchaser would have paid can be found in Mr Engineer's and King & King's valuations which are within a justifiable range.

500. That view is further supported by (a) our findings in relation to the respective roles of CPL and the Partnership and the importance of the terms of the PSAs in that context, and (b) the apparent similarity of the valuation of the combined business in the amended bridge chart with D&P's valuation of the Chemidex Business.

Decision

501. For all these reasons we find that:-

(a) the market value of the Product Assets for the purposes of section 845 CTA at the Valuation Date was £40 million, and

(b) albeit as originally stated CGL's accounts were not UK GAAP compliant, the use of a period of ten years for amortising the value of those Product Assets is UK GAAP compliant.

502. The appeal is allowed.

Postscript to Decision

503. Unfortunately, and unavoidably, this Decision has been very delayed in being issued in large part because of repeated bouts of ill-health and ultimately an accident resulted in a protracted period of sick leave.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

504. 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.

ANNE SCOTT
TRIBUNAL JUDGE

Release date: 19th DECEMBER 2024

Appendix 1

SUMMARIES OF MR AND MRS ENGINEER'S RESPONSIBILITIES WHEN ACTING IN THEIR CAPACITIES AS DIRECTORS AND AS PARTNERS

RESPONSIBILITIES OF MR & MRS ENGINEER WHEN ACTING IN THEIR CAPACITIES AS PARTNERS:

1. Market research to identify potential products to acquire.
2. Meetings with contacts in the Pharma industries and building relationships.
3. Negotiating with Pharma companies to acquire rights to pharmaceutical products.
4. Dealing and working closely with solicitors so contracts are negotiated with Pharma companies when buying rights to pharmaceutical products.
5. Instructing and working with advisers to effect licensing of acquired products to Chemidex Pharma Limited ("CPL").
6. Entering into Profit Share Agreements ("PSAs") with CPL.
7. Monitoring the compliance of CPL with the terms of the PSAs.
8. Monitoring that CPL carries out appropriate R&D on the products licensed to the CPL under the PSAs.
9. Monitoring that CPL relaunches the product and that adequate stocks are held by CPL.
10. Developing, and issuing to CPL, guidelines on the use of products licensed under the PSAs. Advising CPL on price increases and sales and marketing strategy.
11. Checking samples provided by CPL to ensure compliance of CPL with any guidelines regarding use of products issued by the partners.
12. Dealing with existing Contract Manufacturing Organisations ("CMOs") and ensuring they are carrying out manufacturing practices in accordance with Good Manufacturing Practices to meet EU standards.
13. Negotiating contracts and Technical Agreements with CMOs.
14. Discussing and involvement in product transfers and technology transfers of acquired products from and/or into the CMOs.
15. Ensuring the products are/have been manufactured to correct specifications by the CMOs.
16. Involvement and discussing regulatory issues with regulatory staff, consultants and the regulatory authorities like the MHRA.
17. Looking at day to day cashflows, accounts, VAT returns, authorising payments / invoices and checking bank balances.
18. Discussing accounts with Accountants / Auditors and finalising and approving accounts so they are filed in time and tax due is paid on time.
19. Looking for right quality staff and consultants.
20. General administration.
21. Partners meetings.
22. Dealing with Bankers and other advisers.
23. Advice to company on relaunch strategy, including pricing.
24. General duties of partners, as and when required.
25. Entertain business contacts.

RESPONSIBILITIES OF MR & MRS ENGINEER WHEN ACTING IN THEIR CAPACITIES AS DIRECTORS OF CPL:

l. Identifying CMOs around the world and inspecting their sites to ensure they are carrying out manufacturing practices in accordance with Good Manufacturing Practices to meet EU standards.
2. Negotiating contracts and Technical Agreements with CMOs.
3. Discussing and involvement in product transfers and technology transfers of acquired products into the CMOs.
4. Ensuring the products are manufactured to correct specifications by the CMOs.
5. Involvement with and discussing regulatory issues with regulatory staff, consultants and the regulatory authorities like the MHRA. Instructing and supervising regulatory staff and consultants.
6. Looking at day to day cashflows, accounts, VAT returns, authorising payments / invoices and checking bank balances.
7. Financial planning of the business.
8. Discussing accounts with Accountants / Auditors and finalising and approving accounts so they are filed in time and tax due is paid on time.
9. Looking for and managing right quality staff and consultants. Supervising staff.
10. Arrange for R&D and clinical trials. Negotiating terms for any required R&D services and, if required, instructing advisers regarding contracts for R&D services.
11. Monitoring progress of R&D and ensuring clinical trials are conducted in accordance with Good Clinical Practice.
12. Stock control and ordering product from the CMOs.
13. Relaunch of products.
14. Sales and marketing of products.
15. General administration.
16. Directors meetings.
17. Dealing with Bankers.
18. Calculate appropriate increases of price of products and negotiate price increases.
19. Market research regarding competitor products and forming sales and marketing strategy.
20. General Director duties, as and when required.
21. Entertain business contacts.
22. AGM - arrange and attend.

Appendix 2

Drug Name:	Dexamethasone							
Formulation:	500mcg tablets							
Brand Name:	Decadron							
Acquisition Date:	20-Mar-09							
Notes:	Data for unbranded product is for "Dexameth_Tab 500mcg"; data for branded product is for "Decadron_Tab 500mcg"							
	Unbranded				Branded			
Year	Price Per Prescription	Change	Prescriptions	Change	Price Per Prescription	Change	Prescriptions	Change
2004	1.83	N/A	24,100	N/A	1.80	N/A	100	N/A
2005	1.79	-2.19%	25,900	7.47%	No Data	N/A	No Data	N/A
2006	1.87	4.47%	27,842	7.50%	No Data	N/A	No Data	N/A
2007	1.79	-4.28%	32,161	15.51%	No Data	N/A	No Data	N/A
2008	1.68	-6.15%	37,149	15.51%	No Data	N/A	No Data	N/A
2009	26.03	1449.40%	16,727	-54.97%	1.17	N/A	519	N/A
2010	50.94	95.70%	29,578	76.83%	0.97	-17.09%	133	-74.37%
2011	51.71	1.51%	45,261	53.02%	No Data	N/A	No Data	N/A
2012	51.86	0.29%	51,725	14.28%	0.22	N/A	1	N/A
2013	60.41	16.49%	57,022	10.24%	No Data	N/A	No Data	N/A

Drug Name:	Mebeverine							
Formulation:	50mg/5ml suspension							
Brand Name:	Colofac							
Acquisition Date:	26-Jul-05							
Notes:	Data for unbranded product is for "Mebeverine HCl_Oral Susp 50mg/5ml S/F"; data for branded product is for "Colofac_Liq 50mg/5ml S/F"							
	Unbranded				Branded			
Year	Price Per Prescription	Change	Prescriptions	Change	Price Per Prescription	Change	Prescriptions	Change
2004	No Data	N/A	No Data	N/A	5.98	N/A	16,400	N/A
2005	No Data	N/A	No Data	N/A	5.47	-8.53%	10,000	-39.02%
2006	150.13	N/A	2,253	N/A	4.05	-25.96%	2,343	-76.57%
2007	156.03	3.93%	5,657	151.09%	4.18	3.21%	1,649	-29.62%
2008	157.38	0.87%	7,266	28.44%	4.44	6.22%	892	-45.91%
2009	157.45	0.04%	7,394	1.76%	4.61	3.83%	531	-40.47%
2010	194.33	23.42%	9,552	29.19%	5.17	12.15%	245	-53.86%
2011	211.13	8.65%	8,771	-8.18%	4.71	-8.90%	13	-94.69%
2012	210.56	-0.27%	8,053	-8.19%	1.51	-67.94%	3	-76.92%
2013	227.28	7.94%	7,243	-10.06%	2.10	39.07%	2	-33.33%

Appendix 3

International Valuation Standards 2013

The Market

11. In order to estimate the most probable price that would be paid for an asset. It is of fundamental importance to understand the extent of the market in which that asset would trade…

Market Participants

18. … The willingness to trade and any views attributed to market participants are typical of those of buyers and sellers, or prospective buyers and sellers, active in a market on the valuation date not to those of any particular individual or entity.

19. In undertaking a market-based valuation, matters that are specific to the current owner or to one particular potential buyer are not relevant because both the willing seller and the willing buyer are hypothetical individuals or entitles with the attributes of a typical market participant. The conceptual framework also requires the exclusion of any element of *special value* or any element of value that would not be available to market participants generally …

20. The factors that are specific to a particular buyer or seller and not available to market participants generally are excluded from the inputs used in a market-based valuation. Examples of entity specific factors that may not be available to market participants include the following:

…

(e) an ability to exploit an asset that is unique to that entity.

Market Value

29. *Market value* is the estimated amount for which an asset or liability should exchange on the *valuation date* between a willing buyer and a willing seller in an arm's-length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

30. The definition of *market value* shall be applied in accordance with the following conceptual framework:

…

(d) 'between a willing buyer' refers to one who is motivated, but not compelled to buy. This buyer is neither over eager nor determined to buy at any price. This buyer is also one purchases in accordance with the realities of the current market and with current market expectations, rather than in relation to an imaginary or hypothetical market that cannot be demonstrated or anticipated to exist. The assumed buyer would not pay a higher price than the market requires. The present owner is included among those who constitute 'the market';

(e) "and a willing seller" is neither an over eager nor a forced seller prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the asset at market terms for the best price

attainable in the open market after proper marketing, whatever that price may be. The factual circumstances of the actual owner are not a part of this consideration because the willing seller is a hypothetical owner;

(f) 'in an arm's length transaction' is one between parties who do not have a particular or special relationship, eg parent and subsidiary companies or landlord and tenant, that may make the price level uncharacteristic of the market or inflated because of an element of *special* value. The *market value* transaction is presumed to be between unrelated parties, each acting independently;
…

(h) 'where the parties had each acted knowledgeably, prudently' presumes that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the asset, its actual and potential uses and the state of the market as of the *valuation date*. Each is further presumed to use that knowledge prudently to seek the price that is most favourable for their respective positions in the transaction. Prudence is assessed by referring to the state of the market at the *valuation date*, not with benefit of hindsight at some later date …

Valuation Approaches

31. The concept of *market value* presumes a price negotiated in a local and competitive market where the participants are acting freely. The market for an asset could be an international market or a local market. The market could consist of numerous buyers and sellers, or could be one characterised by a limited number of market participants. The market in which the asset is exposed for sale is the one in which the asset being exchanged is normally exchanged …

32. The *market value* of an asset will reflect its highest and best use. The highest and best use is the use of an asset that maximises its potential and that is possible, legally permissible and financially feasible. The highest and best use may be for continuation of an asset's existing use or for some alternative use. This is determined by the use that a market participant would have in mind for the asset when formulating the price that it would be willing to bid.

55. One or more valuation approaches may be used in order to arrive at the valuation defined by the appropriate basis of value (see paras 25 to 28 above). The three approaches described and defined in this Framework are the main approaches used in valuation. They all are based on the economic principles of price equilibrium, anticipation of benefits or substitution. Using more than one valuation approach or method is especially recommended where there are insufficient factual or observable inputs for a single method to produce a reliable conclusion.

Market Approach

56. The market approach provides an indication of value by comparing the subject asset with identical or similar assets for which price information is available.

57. Under this approach the first step is to consider the prices for transactions of identical or similar assets that have occurred recently in the market. If few recent transactions have occurred, it may also be appropriate to consider the prices of identical or similar assets that are listed or offered for sale provided the relevance of this information is clearly established and critically analysed. It may be necessary to adjust the price information from other transactions

to reflect any differences in the terms of the actual transaction and the basis of value and any assumptions to be adopted in the valuation being undertaken. There may also be differences in the legal, economic or physical characteristics of the assets in other transactions and the asset being valued.

Appendix 4

International Valuation Standards 2020 ("IVS20")

Extracts from IVS 104 from IVS20

30.4 The Market Value of an asset will reflect its highest and best use (see paras 140.1-140.5). The highest and best use is the use of an asset that maximises its potential and that is possible, legally permissible and financially feasible. The highest and best use may be for continuation of an asset's existing use or for some alternative use. This is determined by the use that a market participant would have in mind for the asset when formulating the price that it would be willing to bid.

140. Premise of Value – Highest and Best Use

140.1 Highest and best use is the use, from a participant perspective, that would produce the highest value for an asset. Although the concept is most frequently applied to non-financial assets as many financial assets do not have alternative uses, there may be circumstances where the highest and best use of financial assets needs to be considered.

140.2 The highest and best use must be physically possible (where applicable), financially feasible, legally allowed and result in the highest value if different from the current use, the costs to convert an asset to its highest and best use would impact the value.

140.3 The highest and best use for an asset may be its current or existing use when it is being used optimally. However, highest and best use may differ from current use or even be an orderly liquidation.

140.4 The highest and best use of an asset valued on a stand-alone basis may be different from its highest and best use as part of a group of assets, when its contribution to the overall value of the group must be considered.

140.5 The determination of the highest and best use involves consideration of the following:

(a) To establish whether a use is physically possible, regard will be had to what would be considered reasonable by participants.

(b) To reflect the requirement to be legally permissible, any legal restrictions on the use of the asset, eg, town planning/zoning designations, need to be taken into account as well as the likelihood that these restrictions will change.

(c) The requirement that the use be financially feasible takes into account whether an alternative use that is physically possible and legally permissible will generate sufficient return to a typical participant, after taking into account the costs of conversion to that use, over and above the return on the existing use.

Appendix 5

International Valuation Standards 2020 ("IVS20")

Extract from IVS 210 from IVS20

Relief-from-Royalty Method

60.18. Under the relief-from-royalty method, the *value* of an intangible *asset* is determined by reference to the *value* of the hypothetical royalty payments that would be saved through owning the *asset*, as compared with licensing the intangible *asset* from a third party. Conceptually, the method *may* also be viewed as a discounted cash flow method applied to the cash flow that the owner of the intangible *asset* could receive through licensing the intangible *asset* to third parties.

60.19. The key steps in applying a relief-from-royalty method are to:

(a) develop projections associated with the intangible *asset* being valued for the life of the subject intangible *asset.* The most common metric projected is revenue, as most royalties are paid as a percentage of revenue. However, other metrics such as a per-unit royalty *may* be appropriate in certain valuations,

(b) develop a royalty rate for the subject intangible *asset.* Two methods can be used to derive a hypothetical royalty rate. The first is based on market royalty rates for comparable or similar transactions. A prerequisite for this method is the existence of comparable intangible *assets* that are licensed at arm's-length on a regular basis. The second method is based on a split of profits that would hypothetically be paid in an arm's-length transaction by a willing licensee to a willing licensor for the rights to use the subject intangible asset,

(c) apply the selected royalty rate to the projections to calculate the royalty payments avoided by owning the intangible asset,

(d) estimate any additional expenses for which a licensee of the subject *asset* would be responsible. This can include upfront payments required by some licensors. A royalty rate *should* be analysed to determine whether it assumes expenses (such as maintenance, marketing and advertising) are the responsibility of the licensor or the licensee. A royalty rate that is "gross" would consider all responsibilities and expenses associated with ownership of a licensed *asset* to reside with the licensor, while a royalty that is "net" would consider some or all responsibilities and expenses associated with the licensed *asset* to reside with the licensee. Depending on whether the royalty is "gross" or "net", the *valuation should* exclude or include, respectively, a deduction for expenses such as maintenance, marketing or advertising expenses related to the hypothetically licensed asset.

(e) if the hypothetical costs and royalty payments would be tax deductible, it *may* be appropriate to apply the appropriate tax rate to determine the after-tax savings associated with ownership of the intangible *asset.* However, for certain *purposes* (such as transfer pricing), the effects of taxes are generally not considered in the *valuation* and this step *should* be skipped,

(f) determine the appropriate discount rate for the subject intangible *asset* and present value or capitalise the savings associated with ownership of the intangible *asset*, and

(g) if appropriate for the *purpose of the valuation* (see paras 110.1-110.4), calculate and add the TAB for the subject intangible *asset.*

60.20. Whether a royalty rate is based on market transactions or a profit split method (or both), its selection *should* consider the characteristics of the subject intangible *asset* and the environment in which it is utilised. The consideration of those characteristics form the basis for selection of a royalty rate within a range of observed transactions and/or the range of profit available to the subject intangible *asset* in a profit split. Factors that *should* be considered include the following:

(a) Competitive environment: The size of the market for the intangible *asset*, the availability of realistic alternatives, the number of competitors, barriers to entry and presence (or absence) of switching costs.

(b) Importance of the subject intangible to the owner: Whether the subject *asset* is a key factor of differentiation from competitors, the importance it plays in the owner's marketing strategy, its relative importance compared with other tangible and intangible *assets*, and the amount the
owner spends on creation, upkeep and improvement of the subject *asset.*

(c) Life cycle of the subject intangible: The expected economic life of the subject *asset* and any risks of the subject intangible becoming obsolete.

60.21. When selecting a royalty rate, a *valuer should* also consider the following:

(a) When entering a licence arrangement, the royalty rate *participants* would be willing to pay depends on their profit levels and the relative contribution of the licensed intangible *asset* to that profit. For example, a manufacturer of consumer products would not license a tradename at a royalty rate that leads to the manufacturer realising a lower profit selling branded products compared with selling generic products.

(b) When considering observed royalty transactions, a *valuer should* understand the specific rights transferred to the licensee and any limitations. For example, royalty agreements *may* include *significant* restrictions on the use of a licensed intangible *asset* such as a restriction to a particular geographic area or for a product. In addition, the *valuer should* understand how the payments under the licensing agreement are structured, including whether there are upfront payments, milestone payments, puts/calls to acquire the licensed property outright, etc.