Practice Note
Apportioning the price paid for a Business Transferred as a Going Concern

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1. Background

1.1 An apportionment of the price paid for a business as a going concern between the underlying assets may be required for tax purposes in a number of instances, for example:

a. For the purpose of calculating the capital gains arising on the disposal of the separate assets in accordance with the TCGA 1992.

b. On an acquisition for the purpose of calculating the SDLT (Stamp Duty Land Tax) due on the interest in the land and buildings only.

c. On an acquisition for the purpose of calculating the allowances available against Corporation Tax for Capital Allowances, such as Machinery and Plant Allowances (see Section 3), or for purchased goodwill (Schedule 29, FA 2002).

1.2 The price paid for a business sold as a going concern may include any or all of the following assets:

a. The land and buildings including landlord's fixtures ('the property').

b. The trade fixtures, fittings, furniture, furnishings and equipment ('the chattels').

c. Any transferable licences.

d. Goodwill.

e. Other separately identifiable intangible assets (eg registered trade marks).

The purchaser may also separately acquire consumables and stock but these are usually valued separately and will not normally be included in the sale price to be apportioned.

1.3 Some of the principles set out in this Practice Note are applicable to apportionments for all types of businesses but the note deals mainly with the particular issues that have arisen where the property is a 'trade related property' valued using a profits approach (eg public houses, hotels, petrol filling stations, cinemas, restaurants, care homes etc). In these cases there can be particular difficulties in identifying the sum attributable to 'goodwill' and this is fundamental to the apportionment.

2. The Statutory Provisions

2.1 For the purposes of calculating a capital gain s.52 of the TCGA 1992 provides that any apportionment shall be on a 'just and reasonable' basis.

2.2 For the purposes of calculating any SDLT due paragraph 4, Schedule 4, FA 2003 similarly provides that any apportionment shall be on a 'just and reasonable' basis.

2.3 For the purposes of calculating any Capital Allowances claimed s.562 CAA 2001 similarly provides that any apportionment should be on a just and reasonable basis.

2.4 For the purpose of calculating the cost of purchased goodwill paragraph.4, Schedule 29 FA 2002 provides that ‘goodwill’ has the meaning it has for accounting purposes. Accounting guidance (FRS10) provides that ‘goodwill’ should be taken to be the 'difference between the cost of an acquired entity and the aggregate of the fair values of that entity's identifiable assets and liabilities' (see paragraph 11 below).

2.5 The various statutory provisions do not define the method of arriving at a ‘just and reasonable’ apportionment but any apportionment should generally seek to apportion the price paid between the underlying assets included in the sale on the basis of their relative values and the contribution they make to the price that is being apportioned.

3. Legal definitions of goodwill

3.1 Halsbury's Laws of England, 4th edition, Vol 35 at page 1206 states that:

'The goodwill of a business is the whole advantage of the reputation and connection with customers together with the circumstances whether of habit or otherwise, which tend to make that connection permanent. It represents in connection with any business or business product the value of the attraction to the customers which the name and reputation possesses.'

3.2 The definition contained in the Shorter Oxford Dictionary is:

'Goodwill is the privilege granted by the seller of a business to a purchaser of trading as his recognised successor; the possession of a ready-formed connection with customers considered as a separate element in the saleable value of a business.'

3.3 The leading legal authority on the meaning of goodwill is found in IRC v Muller & Co Margarine Limited (1901) AC 217. In answer to the question 'what is goodwill?' Lord Macnaghten said:

'It is a thing very easy to describe, very difficult to define. It is the benefit and advantage of the good name, reputation and connection of a business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old-established business from a new business at its first stage.'

Lord Macnaghten went on to say that:

'Goodwill is composed of a variety of elements. It differs in its composition in different trades and in different businesses in the same trade. One element may preponderate here; and another there.'

3.4 In the decision of the Special Commissioners in Balloon Promotions Ltd v Wilson, SpC 524 (2006) STC (SCD) 167, goodwill for CG purposes was construed in accordance with legal rather than accountancy principles.

3.5 Traditionally goodwill has been subdivided into different types such as ‘inherent goodwill’, ‘adherent goodwill’ and ‘free goodwill’. These subdivisions are no longer considered helpful as they tend to cause confusion. ‘Inherent’ and ‘adherent’ goodwill are not really goodwill at all as they form part of the value of the property asset.

4. Accountancy and International Valuation Standards Council Definitions

4.1 International Financial Reporting Standards (IFRS 3, 2008 revised version, Appendix A) defines goodwill as:

'An asset representing the future economic benefits arising from assets acquired in a business combination that are not individually identified and separately recognised'.

Intangible assets are defined by IVSC as:

'Assets that manifest themselves by their economic properties. They do not have physical substance; they grant rights and privileges to their owner and usually generate income for their owner'.

4.2 IVG Note 4 defines a subset of intangible assets as grouped intangibles:

'The residual intangible asset value left after all identifiable Intangible Assets have been valued and deducted from total Intangible Asset value. Alternative concepts include patronage, excess earnings and residual value. Grouped Intangibles are often called Goodwill. Goodwill has, at various times, been said to be the tendency for customers to return to a place of business, the extra income generated by a business over and above a fair return to the identified assets, and/or the extra value of the entity as a whole over and above the aggregate value of its constituent identifiable assets'.

5. Goodwill in trade related properties

5.1 It has in the past been argued that because the business in trade related properties is usually largely or wholly incapable of being sold separately from the property there is little or no goodwill (see the Lands Tribunal decision in Coles Executors v IRC (1973) concerning the valuation of a public house for Estate Duty). On the sale of a business operated from such properties, unless there were other separately identifiable intangible assets included in the sale, the whole of the purchase price would normally be apportioned to the property and chattels, it being argued that there was no goodwill.

5.2 The above view was often put forward by taxpayers seeking to claim Capital Allowances on fixtures which formed part of the property. However, since the introduction of SDLT and the provisions in Schedule 29 FA 2002 this view has been challenged by taxpayers seeking to maximise the amount apportioned to goodwill in order to maximise their claim under Schedule 29 FA 2002 and minimise the amount of SDLT payable.

5.3 The view now is that if a business is sold as a going concern then the sale must include some element of goodwill. The question to be answered is not whether goodwill exists but what is the value of that goodwill? That question has to be decided on the facts of each individual case. In some cases the value of the goodwill may be nominal but in some it may be substantial.

6. Valuing goodwill and other intangible assets

6.1 There is a broad consensus across the valuation, accountancy and legal professions that the value of goodwill and any other separately identifiable intangible assets (eg registered trade marks) is represented by the difference between the value of a business as a going concern and the value of the tangible assets included in the sale.

6.2 The value of a business as a going concern will usually be represented by the actual sale price achieved in the open market. However, if it is necessary to value a business as a going concern, because the sale price was not at arm's length, then this is the responsibility of HM Revenue & Customs (HMRC) (SAV).

6.3 Similarly, if it is necessary to apportion the excess value between the goodwill and any other intangible assets this is the responsibility of HMRC (SAV).

6.4 However, the difficulties in arriving at the value of the goodwill usually relate to the assumptions and approach to be adopted when arriving at a valuation of the tangible assets. This is addressed in the paragraphs below.

7. Valuing the tangible assets - assumptions

7.1 Difficulties relating to the assumptions to be adopted when valuing the tangible assets often arise in cases involving trade related properties. Some of the reasons for this relate to the fact that:

a. The established approach to valuation of this type of property typically relies on the profits method and in determining the income and trading potential there can be confusion with valuation of the operator's business. The profits approach remains an appropriate property valuation basis where it is based on expected fair maintainable levels of income that are expected to be achieved from use of the property and other tangible assets by a reasonably competent operator. This is distinct from any valuation of the actual operators own business.

b. The value of such properties is often significantly reduced if the property ceases to be occupied for any length of time because customers go elsewhere and the level of trade has to be built up again by the purchaser. (The enhanced value that arises as a result of the property being occupied by the vendor and any predecessors for the particular use is part of what in the past has been described as 'adherent' goodwill but is properly part of the property value.)

c. The value is often significantly reduced if the property is stripped of chattels because the purchaser has to re-fit the premises and cannot re-open until the property has been fully fitted out and is ready to trade.

d. If licences are lost there may sometimes be difficulties in obtaining new licences.

If it were to be assumed for the purposes of valuation that the property has lost any licences, been stripped of chattels and left vacant for a period of time then the value will be significantly reduced and the value of goodwill in the final apportionment, arrived at by deduction, would be inflated.

7.2 When valuing goodwill using the approach outlined in paragraph 6 above it will usually be appropriate to value all the tangible assets together for sale as an operational entity so that a purchaser can if they wish trade from the day of purchase. It is critical that this availability is reflected to ensure a fair apportionment of the sale price (and any premium arising from a sale of combined assets) between the tangible and intangible elements and avoid any over or understatement.

7.3 Another area of difficulty regarding the assumptions to be made relates to the benefit of contracts entered into by the vendor with customers, staff and suppliers. In reality, if the business is sold as a going concern, any benefit attached to these contracts will normally pass to the purchaser and will be reflected in the price paid for the business as a going concern. However, these contracts do not form part of the tangible assets so, if they add any value, the added value should not be reflected in the valuation of the tangible assets.

7.4 When valuing goodwill using the approach outlined in paragraph 6 above it is considered appropriate to assume that the benefit of any contracts with customers, staff and suppliers would either have to be acquired separately from the vendor or the purchaser would have to make their own arrangements.

7.5 Applying the assumptions in paragraph 7.4 will have different effects depending on the facts of the particular case in question. For example:

a. A small public house to be run by the purchaser with help from part-time bar staff. The purchaser has acquired the business as a going concern but there are no contracts with customers and the purchaser wishes to enter their own contracts with suppliers and employ their own staff. In such a case there may be no identifiable difference between the price paid for the business as a going concern and the price that a purchaser would pay to acquire all the tangible assets. In such a case the value of the goodwill may be nominal.

b. A nursing home, offering an element of specialist care, that is fully occupied by residents and to be run by the purchaser with the help of full-time medically qualified staff. In such a case (depending on the degree of difficulty the purchaser may face in finding any new residents and staff) there may be a significant difference between the price paid for the business as a going concern and the price a purchaser would pay to acquire all the tangible assets. In such a case the value of the goodwill may be more substantial.

7.6 When purchasing such a business as a going concern the purchaser will often have obtained a valuation of the tangible assets as an ‘operational entity’ in accordance with the RICS Red Book GN1. An alternative valuation of the property based on special assumptions (eg vacant following a failure of the business, no accounts providing evidence of trade, stripped of chattels and licences lost) may also be obtained for bank lending purposes. For the purposes of valuing goodwill it would not be appropriate to deduct a valuation based on such special assumptions that do not reflect the actual circumstances prevailing at the valuation date. The question of the assumptions underlying a valuation of the 'operational entity' and how they may differ from a valuation in accordance with paragraphs 7.2 and 7.4 above is considered in paragraph 10 below.

8. Valuing the tangible assets – valuation approach

8.1 Having decided on the appropriate assumptions (paragraphs 7.2 and 7.4 above) it is then necessary to consider the most appropriate method of valuation. For trade related properties that are valued on a profits basis two alternatives need to be considered, these are a capitalised EBITDA/Fair Maintainable Trade (FMT) approach and a rental value/investment based approach. The aim should be to arrive at a capital value that fairly represents the price that an owner-occupier purchaser would be prepared to pay to acquire all the tangible assets, having regard to the circumstances existing at the valuation date.

8.2 The advantages of a capitalised EBITDA/FMT approach are as follows:

a. This is the method that is used in the market to arrive at both going concern values and valuations of the tangible assets as an operational entity under the RICS Red Book GN1.

b. The valuation represents the value to an owner-occupier purchaser.

c. The purchase price paid for the going concern and any GN1 valuation of the tangible assets as an operational entity can be analysed to provide evidence of the FMT and a multiplier for the actual subject property at the valuation date.

d. It produces a value for all the tangible assets to be valued together as a single operational entity.

The difficulty with this approach is that in cases where the contracts with customers, staff and suppliers are of some value it is necessary to reflect this in the valuation. However, it is considered that in most cases this approach will nevertheless give a reliable valuation in most cases.

Example

A simple example may be a nursing home like the one described in paragraph 7.5(b) above:

Say the business had been sold as a going concern for £2 million and an analysis of this sale price was say FMT £250k pa × 8YP.

If it was estimated that it would take a purchaser of the tangible assets 1 year to get the property staffed, fully occupied and trading at FMT level again a valuation using this approach may be:

£250k × 8YP	=	£2,000,000
Defer for 1 year @ 10%	=	0.909
		£1,818,000

The value of the goodwill (and any other intangible assets) would be £2m - £1.818m = £182k.

8.3 A rental value/investment based approach may be useful in some cases but as a primary method of valuation the difficulties and flaws of this approach are as follows:

a. In order to arrive at a capital value the method involves making difficult judgements not only about the FMT but the percentage of profits to adopt as the rental value and the appropriate investment yield, both of which can only be derived from comparison with lettings and sales of other properties at different dates, which significantly increase the scope for disputes over the analysis and comparability of the evidence.

b. Much of the available comparable rental evidence will relate to new lettings of properties that are either new or have previously been vacant or rent reviews/renewals that disregard the occupation of the property by the tenant and predecessors in title in accordance with s.34 LTA 1954.

c. Much of the comparable rental evidence will relate to lettings where the tenant has had to provide the chattels and the return on this capital and risk is reflected in the rents paid.

d. The valuation using this approach represents the value of the property to an investor not an owner-occupier.

e. The valuation produces a valuation of the property only to which it is then necessary to add a valuation of the chattels. It will not include the premium value to an occupier of acquiring the tangible assets together as a package with the enhanced trading potential due to the established trading history and the ability to continue trading from day1. Isolating the bare property asset may unfairly apportion any premium or share of marriage value away and overstate the intangible elements.

However, in cases where there are particular difficulties in arriving at a valuation using the capitalised EBITDA/FMT approach the rental value/investment approach may provide a guide as to the minimum value of the property to an incoming purchaser.

Example

A simple example of the problems with the rental approach may be illustrated by considering a small public house like the one described in paragraph 7.5(a) above:

Say the property was trading at FMT level, it had been sold as a going concern for £1 million and an analysis of this sale price was say FMT £125k pa × 8YP.

For illustration purposes, the rental value on a new letting without chattels may be say £62,500 and an investment yield may be say 8 per cent. This would give a capital value of £781,250 leaving a balance of £218,750. If the in situ value of the chattels was say £50,000 this would leave a sum of £168,750 being attributed to the goodwill when in reality most valuers would agree that the purchaser had acquired nothing of any value beyond the value of the tangible assets. The excess is artificially created because the valuation of the property reflects its notional investment value whereas, just as with some other classes of property, the owner-occupier market is influenced by different factors and the price an owner-occupier may pay is not always the same as an investor.

9. RICS Red Book GN1 - valuations of the 'Operational Entity'

9.1 The question of the assumptions underlying a valuation of an 'operational entity' in accordance with the Red Book GN1 and how those assumptions may differ from the valuation required to arrive at the value of goodwill in accordance with paragraphs 7.2 and 7.4 above is a matter of some debate amongst valuers.

9.2 The following reasons are put forward by some valuers as the justification for not adopting a GN1 valuation of the operational entity as representing the value of the tangible assets:

a. A valuation of the operational entity will include 'transferable goodwill' and this includes all goodwill which is capable of being transferred.

Comment

'Transferable goodwill' is defined in GN1 as 'That intangible asset that arises as a result of **property-specific name and reputation, customer patronage, location and similar factors**, which generate economic benefits. **It is inherent to the specialized trading property** and will transfer to a new owner on sale'. GN1 goes on to say 'In previous RICS guidance **transferable goodwill has also been referred to as inherent goodwill. In the valuation context these terms are identical**'. The use of the word 'intangible' in the definition causes some confusion but from the description of the trading potential included (in bold above) it seems clear that the only goodwill that should be included in a GN1 valuation is inherent goodwill which forms part of the value of the property. As advised at paragraph 3.5 above, inherent and adherent 'goodwill' are not strictly goodwill but form part of the property asset value.

b. A GN1 valuation of the operational entity is a notional value because in practice it is always based on an assumption that the property is trading at FMT level even when in reality it is not.

Comment

The GN1 valuation is supposed to represent the '**market value**' of the property and other tangible assets (ie what a willing purchaser would actually pay in the open market). GN1 does not require valuers to assume FMT is achievable from day 1 but they may choose to do so because in reality the period to build up the trade is negligible. Alternatively valuers may choose to reflect some element of deferment in the YP adopted when capitalising the FMT.

c. A GN1 valuation is a valuation of the actual business and usually the same as the going concern value.

Comment

GN1 makes it clear that the valuation 'should only reflect the transferable goodwill that relates to the **trading potential of the property**' (GN1, para. 4.4), not the trading potential of the particular business. GN1 paragraph 6 also makes it clear that a GN1 valuation of the operational entity is not the same as the going concern value of the business.

d. A GN1 valuation is based on a capitalisation of the EBITDA/FMT and this includes the occupier's share of the profit. This element of occupier's or tenant's profit needs to be excluded and the way to do this is to adopt the rental/investment value approach described above.

Comment

Valuers may well capitalise the total EBITDA/FMT but the fact that this is a 'gross' figure is reflected in the YP. If the element of occupier's profit were deducted from the EBITDA/FMT figure then the yield would have to be increased to reflect this (ie valuers would have to analyse sales on a similar basis and then value on the same basis as they devalue). The tenant's share of the profit on taking a new lease is supposed to represent a fair reward for running the business and the risks involved but this potential share of the income on its own would not be expected to have a capital value (ie one would not expect a tenant to pay a premium for the right to receive this income alone.) This is illustrated by the fact this income of course exists from day 1 when a new business takes a new lease but tenants do not generally pay landlords a premium to receive it. If they did then it would simply represent a premium for the property, it could not possibly represent goodwill because a new business does not have any goodwill, goodwill is something that grows over time.

e. A GN1 valuation assumes that the purchaser receives the benefit of any contracts with customers, staff and suppliers (as they do in reality when they acquire the business as a going concern) so the valuation includes or reflects an element of value that is not automatically available to a purchaser of just the tangible assets.

Comment

The assumptions that should be made by valuers regarding such contracts is not set out in GN1 and actual practice seems to vary. In some cases the valuer may have taken the view that the contracts in the particular case in question add little or no value but in others they may have assumed that any benefits automatically pass to the purchaser of the tangible assets. Some argue that a GN1 valuation should assume that such contracts are available but that they are not cost free (ie if they are of value to the purchaser the purchaser would have to pay the vendor an additional sum to acquire the benefits). If in a particular case the contracts do add value then one would expect a GN1 valuation on this basis to be less than the sale price of the business as a going concern. Until such time as this area of confusion is clarified, caseworkers should value on the basis set out in paragraph 7.4 above - and in some cases there may therefore be a difference with a GN1 valuation of the operational entity.

10. Apportionment approach - CGT and SDLT cases

10.1 In CGT (Capital Gains Tax) and SDLT cases the apportionment of the sale price paid for a business as a going concern should be approached by first identifying the value of any goodwill (and other separately identifiable intangibles assets) along the lines described above. After deducting this from the total sale price, the in-situ value of the chattels may then be deducted to leave the value of the property.

10.2 In practice, for trade related properties, the approach outlined in paragraph 10.1 above will involve the following steps:

Step 1 - Estimate the market value of all the tangible assets together as an operational entity having regard to the special assumptions in paragraphs 7.2 and 7.4 above. (See paragraphs 10.3 and 10.4 below.)

Step 2 - Identify the sum attributable to goodwill and any other intangible assets included in the sale by deducting the value of the property, licences and chattels (Step 1 value) from the sale price (or market value) of the business as a going concern. (See paragraph 10.5 below.)

Step 3 - Identify the sum attributable to the chattels by estimating their 'in-situ' value (ie the value to an incoming purchaser. (See paragraph 10.6 below.)

Step 4 - Identify the sum attributable to the property by deducting the value of the chattels (Step 3 value) from the Step 1 value. (See paragraph 10.7 below.)

Step 5 - Stand back and consider whether the answer produced is reasonable in the particular circumstances of the case (see paragraph 10.8 below).

10.3 **Step 1**

The market value of the tangible assets should be assessed as at the date of disposal/sale on the basis defined in UKGN3 (valuations for CGT, Inheritance Tax and SDLT), subject to the special assumptions in paragraphs 7.2 and 7.4 above and the following:

a. The valuation should reflect the market's perception of the trading potential of the property excluding goodwill.

b. The valuation should reflect the benefit of any transferable licences, consents and certificates. (If any of the licences[(1)] etc have been lost or are in jeopardy at the valuation date that fact should be reflected in the valuation.)

c. The valuation should have regard to all the facts pertaining at the valuation date.

d. The valuation should assume that any accounts available to the purchaser are available at the valuation date to inform judgments as to reasonable future trading potential.

e. The valuation should assume that the purchaser may either bring in their own staff or seek to re-employ some of the existing staff.

f. The valuation should assume that the purchaser will take into account the likelihood of any future bookings sticking with the property if they choose to run the business in the same manner as the vendor.

g. The valuation should assume that the purchaser will take into account the likelihood of any existing care home residents opting to stay with the property if they choose to run the business in the same manner as the vendor.

10.4 The market value should reflect only that trade that can reasonably be expected to be maintained by a reasonably efficient operator purchasing the property and chattels. ‘Reasonably efficient operator’ has the same meaning as that used in the RICS Red Book GN1, paragraph 2.4:

A market-based concept whereby a potential purchaser, and thus the valuer, estimates the maintainable level of trade and future profitability that can be achieved by a competent operator of a business conducted on the premises, acting in an efficient manner. The concept involves the trading potential rather than the actual level of trade under the existing ownership so it excludes personal goodwill.

© IVSC GN 12, para 3.4.

The market value of the property interest should capture the true value of the property asset reflecting any enhancement from the established generic use at the valuation date but ignoring any additional value of the actual business carried on in the premises at that date. The aim is to establish the value that an incoming purchaser would bid for the property based on their views as to what might reasonably be achieved in terms of trading potential as distinct from the actual trade achieved by the current business.

[(1)] Licences are a separate asset for CGT purposes.

10.5 **Step 2**

The sum attributable to goodwill and any other intangible assets included in the sale should be arrived at by deducting the value of the tangible assets (from Step 1 above) from the sale price (or market value) of the business.

10.6 **Step 3**

The sum attributable to any chattels included in the sale should be arrived at by estimating the value of the chattels to an incoming purchaser. The value of the chattels to an incoming purchaser will normally be based on their depreciated replacement cost but in some cases they may be of no value, for example, if the purchaser intends to refit the premises.

10.7 **Step 4**

The sum attributable to the property should be arrived at by deducting the value of the chattels (the Step 3 value) from the value of the tangible assets (the Step 1 value).

10.8 **Step 5**

Caseworkers should always stand back and consider whether the answer produced by the above approach is reasonable in the particular circumstances of the case. For instance, if a business is sold in an arms length transaction at a price that is significantly in excess of the market value of the business as a going concern it may be appropriate to firstly value the business and then apportion the excess sale price on a pro-rata basis.

Example

Sale price	=	£600,000
Market value of business	=	£500,000
Property	=	£450,000
Chattels	=	£ 20,000
Goodwill	=	£ 30,000
		(ie. £500,000 - (£450,000 + £20,000))

Pro-rata apportionment:

Property	=	450/500 × £600,000	=	£540,000
Chattels	=	20/500 × £600,000	=	£ 24,000
Goodwill	=	30/500 × £600,000	=	£ 36,000

10.9 A criticism of the above approach may be that it adopts a deduction approach and such an approach was criticised by the High Court in the case of Bostock v Totham (HMIT). However, the above approach does not just consider the value of one element, as was the taxpayer’s approach which was criticised in the Bostock case, it considers the value of all elements on a basis that reflects the contribution of the various elements to the price being apportioned. If one were to value all of the elements in strict isolation then the apportionment may become artificially distorted to the extent that the answer may not be just and reasonable. For instance, the property value in isolation may be less than when it is lotted with the other tangible assets, the value of the chattels if not sold in-situ with the property may be little more than scrap value and any goodwill may be of nominal value if the business is not sold with the property as a going concern.

10.10 Taxpayers may also challenge the above approach based on the Special Commissioner's decision in the case of Balloon Promotions Limited v Wilson (Insp of Taxes) in which it was suggested that goodwill should be looked at as a whole and that the value of adherent goodwill was not automatically subsumed in the property value. The decision of the Special Commissioner in the Balloon case concerned appeals against a refusal to grant rollover relief under S152 of the Taxation of Chargeable Gains Act 1992 in respect of chargeable gains following the sale of the Company's franchised Pizza Express restaurants to the franchisor. Whilst the decision includes discussion of existing legal authorities dealing with goodwill the conclusions reflect the individual circumstances of the case. It is worth noting that in this case the values of the property interests submitted by the taxpayers were not challenged and there was no evidence to demonstrate whether or not those values included adherent goodwill. As mentioned above, the subdivisions of goodwill that were previously used are no longer considered helpful as they tend to cause confusion. The view now is that what used to be referred to as 'inherent' and 'adherent' goodwill are, in reality, attributes which add value to the property in which a business is carried on and that they do not represent goodwill at all.

11. Apportionment approach – Schedule 29 FA 2002 cases

11.1 As noted above, for the purpose of calculating the cost of purchased goodwill paragraph 4, Schedule 29 FA 2002 provides that 'goodwill' has the meaning it has for accounting purposes. Accounting guidance (FRS10) provides that 'goodwill' should be taken to be the 'difference between the cost of an acquired entity and the aggregate of the fair values of that entity's identifiable assets and liabilities'

11.2 FRS 15 sets out the principles for calculating the 'fair value' of tangible fixed assets and provides that non-specialised properties should be valued on the basis of existing use value (EUV) (FRS15, para 53).

FRS15, para 56 states:

'Certain types of non-specialised properties are bought and sold 'and therefore valued' as businesses. The EUV of a property valued as an operational entity is determined by having regard to trading potential, but excludes personal goodwill that has been created in the business by the present owner or management and is not expected to remain with the business in the event of the property being sold'

FRS 15, para 85 states:

'It would not be appropriate, however, to treat the trading potential associated with a property that is valued as an operational entity, such as a public house or hotel, as a separate component where the value and life of its trading potential is inherently inseparable from that of the property'.

The above guidance on the value to be deducted appears to accord with a valuation of the operational entity in accordance with GN1. Accordingly it would not be acceptable in a Schedule 29 case for a taxpayer to put forward a value different from their valuation in accordance with GN1.

12. Leasehold interests

12.1 In some cases it will be necessary to apportion the price paid for a leasehold interest but the same principles apply. The valuations and apportionment should be approached using the same assumptions and approach described above.

12.2 It should be borne in mind that for trade related properties it is quite common for leasehold interests to be sold for substantial premiums even when the rent has recently been reviewed. The premium in such cases may be attributable to any or all of the following:

a. The reviewed rent may not reflect the full rental value because it may disregard the enhanced trading potential attributable to the occupation of the property by the tenant and predecessors (in accordance with s.34 LTA 1954).

b. The reviewed rent may not reflect the value of improvements carried out by the tenant or predecessors when fitting out the property (in some cases the rent may only represent a shell rent).

c. The value of the chattels and fittings belonging to the tenant.

d. The premium value to an occupier of offering the tangible assets together as a package with the enhanced trading potential due to the established trading history and the ability to continue trading from day 1.

e. There may be some element of goodwill, particularly if the business is trading at above FMT level and contracts of some value are included in the sale.

f. There may be other separately identifiable intangible assets included in the sale (eg registered trade marks).

g. Market perception and prevailing conditions whereby it is expected there will be some ‘key money’ or premium to acquire the interest in order to move in to this market sector.

12.3 The value of any goodwill and other intangible assets included in the sale should be determined by adopting the same valuation assumptions and approach outlined in paragraphs 7 and 8 above.