[2011] UKFTT 645 (TC)

TC01487

Appeal numbers TC/2009/14366/14389/14391

Capital Gains Tax – valuation of shares – claim of negligible value – Taxation of Chargeable Gains Act 1992 section 24(2) – whether sections 272 & 273 applicable - appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

SIMON BARKER, KEVIN HARPER & JAMES WICKES **Appellants**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS (*capital gains tax*) **Respondents**

TRIBUNAL: Judge Malachy Cornwell-Kelly
Ms Sheila Wong Chong FRICS

Sitting in public at 45 Bedford Square, London WC1B 3DN on 24-28 & 31 January and 4-6 & 9-11 May 2011

Mr Kevin Prosser QC and Ms Laura Poots instructed by Baker Tilly for the Appellants

Mr Michael Gibbon QC instructed by the Solicitor and General Counsel of the Respondents

DECISION

Overview

1 These are three joined appeals against closure notices dated 26, 28 & 29 May 2009 refusing claims that shares acquired by the taxpayers in a company called Diligenti Limited on 19 December 2000 had, by 5 April 2001, become of negligible value. The claims were made under section 24(2) of the Taxation of Chargeable Gains Act 1992. The issue of fact in the appeal is whether the shares had indeed become of negligible value by that date, and the issue of law is what is meant by the expression 'negligible value' in section 24(2) - a matter on which there is only one direct authority, and only at first instance.

2 Each holding was of 11,000 ordinary shares of one penny, which were subscribed at par with a premium of £303.0203 per share, so that each taxpayer paid a total of £3,333,333 for his shares. The appeals are joined because the issues in each of the three cases are the same, but the claims and the appeals are distinct.

Legislation

3 Section 24 of the Taxation of Chargeable Gains Act 1992 (TGCA 1992) is headed "Disposals where assets lost or destroyed, or become of negligible value". At the material time, the section provided:-

> (1) Subject to the provisions of this Act and, in particular to section 144, the occasion of the entire loss, destruction, dissipation or extinction of an asset shall, for the purposes of this Act, constitute a disposal of the asset whether or not any capital sum by way of compensation or otherwise is received in respect of the destruction, dissipation or extinction of the asset.
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> (2) Where the owner of an asset which has become of negligible value makes a claim to that effect:
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> (a) this Act shall apply as if the claimant had sold, and immediately reaquired, the asset at the time of the claim or (subject to paragraphs

(b) and (c) below) at any earlier time specified in the claim, for a consideration of an amount equal to the value specified in the claim.

(b) an earlier time may be specified in the claim if:

(i) the claimant owned the asset at the earlier time; and

(ii) the asset had become of negligible value at the earlier time; and either

(iii) for capital gains tax purposes the earlier time is not more than two years before the beginning of the year of assessment in which the claim is made; or

(vi) for corporation tax purposes the earlier time is on or after the first day of the earliest accounting period ending not more than two years before the time of the claim.

(c) Section 93 of and Schedule 12 to the Finance Act 1994 (indexation losses and transitional relief) shall have effect in relation to an asset to which this section applies as if the sale and reacquisition occurred at the time of the claim and not at any earlier time.

(3) For the purposes of subsections (1) and (2) above, a building and any permanent or semi-permanent structure in the nature of a building may be regarded as an asset separate from the land on which it is situated, but where either of those subsections applies in accordance with this subsection, the person deemed to make the disposal of the building or structure shall be treated as if he had also sold, and immediately reaquired, the site of the building or structure (including in the site any land occupied for purposes ancillary to the use of the building or structure) for a consideration equal to its market value at that time.

4 Section 272 provided:-

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

5 Section 273 provided:-

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

> (2) The assets to which this section applies are shares and securities which are not quoted on a recognised stock exchange at the time at which their market value for the purposes of tax on chargeable gains falls to be determined.
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> (3) For the purposes of a determination falling within subsection (1) above, it shall be assumed that, in the open market which is postulated for the purposes of that determination, there is available to any prospective purchaser of the asset in question all the information which a prudent purchaser of the asset might reasonably require if he were proposing to purchase it from a willing vendor by private treaty and at arm's length.

6 The issue between the parties in relation to these provisions concerns the meaning of the term 'value' in section 24(2). Does it mean market value as defined in section 272? Does it mean market value as defined in section 272 as modified by section 273? Or does it have another meaning altogether, and if so what?

Submissions on the law for the taxpayers

7 It was common ground between the parties that 'negligible value' means 'worth next to nothing', but not 'nil', and that the concept has no room for any notion of materiality in which the previous value of the asset would be taken into account by way of comparison with the value which is said to be negligible. The test in that regard is therefore an absolute one, the same for an asset previously worth a million pounds and an asset previously worth much less. No authority was cited to us for this view, and no attempt was made to translate the concept into figures so that it could be said with confidence that any particular value would undoubtedly be 'negligible' within the meaning of the section – though Mr Gibbon QC for the Crown expressed the view that a value of even £1,000 would not be negligible. It was also common ground that the shares in question did have value on their acquisition.

8 For the taxpayers, it was argued by Mr Prosser QC that there is no justification for importing the qualification that the value referred to in section 24(2) must be the market value. It was submitted that the subsection refers to the actual value of the asset to its owner in money or money's worth, that is,

the net amount which the owner could obtain from the asset, in particular by disposing of it. The test is based on the reality of the situation, where the seller is the real and not a hypothetical owner, the circumstances of the deemed sale are the real circumstances obtaining at the time specified in the claim, there are no imposed assumptions as to the facts pertaining to the sale, and its likely costs are taken into consideration.

9 The taxpayers accepted that the provisions of section 24(2)(c), allowing an earlier time than that of the actual claim to be specified as the time when the shares had become of negligible value, does not permit account to be taken of information which was not and could not have been available at the specified time. But they submitted that information which had come to light after the event, and which could have been obtained at the specified date, could be taken into account to show that the circumstances at the time were such that the asset in question would not have had any value at that point, because the later-discovered information would have become apparent in any attempt to sell the asset.

10 This conclusion, it is said, derives from the amendment to section 24 made by the Finance Act 1996 to deal with the issue illustrated by the decision of Vinelott J in *Williams v Bullivant* [1983] STC 107. In that case, a concessionary practice published in a press statement by the Inland Revenue on 13 March 1975 allowed negligible value claims to be made no later than two years after the end of the tax year in which the asset had become of negligible value and by reference to a date specified in that tax year. Vinelott J appears to have accepted, *obiter*, that the effect of the concession was to permit the taxpayer, on discovering information which had been available at a prior date but was not appreciated then, to rely on that information in support of a negligible value claim by reference to that date if he made the claim within the two years following. It was submitted, moreover, that the case illustrated that the ‘becoming of negligible value’ referred to in section 24(2) could as much refer to a situation which had developed as to an event which had occurred.

11 On the central issue of the meaning of the term ‘value’ in subsection (2), the taxpayers’ arguments were as follows.

12 First, that it was clearly significant that parliament had not used the term ‘market value’ at all, but had used the simple term ‘value’ three times in the subsection. By contrast, ‘market value’ was used in subsection (3) to provide that where a loss or destruction, or negligible value, claim in respect of a building was made the land on which it stood would, independently, be deemed to be sold and reacquired for its then market value. Parliament, it was said, had used different language in the two subsections and must therefore have intended a different meaning in each. The thesis that the omission of a reference to the market in subsection (2) was accidental was not sustainable; different words used in two subsections of the same section must have been intended to mean different things. If the draftsman of section 24(2) had intended to lock-in to the provisions of sections 272 and 273, he would have done so clearly and explicitly.

13 In support of that submission, Mr Prosser relied on observations in the House of Lords in *Stanton v. Drayton Commercial Investment Co Ltd,* reported at 55 TC 286. In that case, it was necessary to establish the base value for capital gains tax of assets which had been acquired for an agreed and quantified price which was to be satisfied by the issue of shares in the taxpayer company, the quantified and agreed price being superior to the market value of the shares upon their allotment. It was held that the agreed and quantified price was the base value of the assets rather than the market value of the shares when issued in payment for them.

14 The base value of the assets in question was to be determined in accordance with Schedule 6, paragraph 4(1)(a), of the Finance Act 1965 which was as follows:-

> (1) Subject to the following provisions of this Schedule, the sums allowable as a deduction from the consideration in the computation

> under this Schedule of the gain accruing to a person on the disposal of an asset shall be restricted to-
>
> (a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition ...

15 Dealing with the question of the value of the consideration, Lord Fraser observed (at page 317):

> The next step is to ascertain the value of that consideration. The argument for the Crown, which was accepted by Vinelott J, was that "value" in paragraph 4(1)(a) of Sch 6 to the Finance Act 1965 meant "market value" and might be different from the price agreed between the parties. It was said that the value of consideration was something to be determined by reference to an objective standard, and not by reference to the cost to a particular party. I was at first attracted by this argument. But further reflection has convinced me that it is erroneous for two reasons. First, as a matter of pure construction of paragraph 4(1)(a), I see no indication that value is used as meaning market value. The paragraph is part of the general provisions for computing the amount of gain accruing on the disposal of an asset in the ordinary case – see s22(9) of the Act.
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> It is to be contrasted with section 22(4) of the Act which makes provision for some special cases, including the case where a person acquires an asset "otherwise than by way of a bargain made at arm's length and in particular where he acquires it by way of gift …". Section 22(4) provides that the acquisition of such an asset shall be deemed to be for a consideration equal to the "market value" of the asset, and the obvious reason is that no agreed value, arrived at by an arm's length transaction, is available. But in the ordinary case under paragraph 4(1)(*a*) such a value is available - namely the price agreed between the parties. Consequently there is no need to look to the market value, and no need to read in the word "market" before "value" where Parliament has not seen fit to use it.
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> Further, the deduction permitted by paragraph 4(1)(*a*) includes "the incidental costs *to him* [the taxpayer] of the acquisition" (emphasis added). The words that I have emphasised show that, at least so far as the costs of acquisition are concerned, it is the costs to the particular taxpayer that are relevant, and they are some indication that the value of the consideration given by him is to be calculated on the same basis.

16 Mr Prosser's argument built on this linguistic conclusion flowing from the difference of wording in subsections (2) and (3) by addressing what he said

was the purpose or policy of the section taken as a whole. Subsection (1) deems a disposal to have occurred where, in the circumstances of loss or destruction, no actual disposal can have taken place because of the fact of the destruction etc. By contrast, subsection (2) deals with the case where, although an actual disposal would not be impossible, it would be very difficult and it would be unreasonable to expect the taxpayer to undertake it simply to crystallise his loss; it may not be a permanent loss, but it is a loss which at that time has certainly occurred.

17 There is therefore a deemed disposal and reacquisition in subsection (2), but only a deemed disposal with no reacquisition in subsection (1). There is thus no need for the purposes of subsection (2) to postulate any particular catastrophe in regard to the asset, merely that it has reached a point at which it makes no sense to attempt an actual disposal to trigger a loss, and there is the fall back of the deemed reacquisition as longstop safeguard for the revenue in case the value of the asset revives subsequently.

18 Mr Prosser submitted that in addition to that, or consistently with that approach, the notion of negligible value for subsection (2) takes account of the likely costs of an actual disposal; so that if it is clear that such costs would be likely to match or exceed any consideration that might be obtained for the asset, that is a further factor is determining whether the asset is of negligible value. That is because on a normal disposal the costs of the disposal are deductible from the consideration obtained and there would again be no point in obliging the taxpayer to incur costs which would eat up the sale price of the asset and produce a nil, or virtually nil, result simply to crystallise a real loss which really existed. The policy of the subsection is therefore to take account of the situation and make provision for it.

19 Faced with the objection that section 38(4) provides in terms that any provision in this Act introducing the assumption that assets are sold and immediately reacquired shall not imply that any expenditure is incurred as incidental to the sale or reacquisition, Mr Prosser's answer is that section

38(4) applies to the deemed disposal and reacquisition, but not to the concept of negligible value which is a distinct matter preceding the deemed disposal and reacquisition.

20 Rejecting the construction which would require ‘negligible value’ in subsection (2) to be read as ‘negligible market value’, Mr Prosser contended for a subjective assessment of value, with the expression effectively meaning ‘value to the owner’. Thus, the test would be whether the asset in question had value to its owner. In *Stanton v. Drayton* the House of Lords had rejected the Crown’s contention in that situation that there had to be an objective test or standard in all circumstances. There the parties had, at arm’s length and fully commercially, agreed a specific price for assets but had agreed that that price should be satisfied by the issue of shares; as it happened, the shares when issued had a market value lower than the agreed price, but the (higher) agreed price was held to be the acquisition cost nonetheless. So, for section 24(2), the value of the same asset could be different for different persons in different circumstances - though in each set of circumstances there would be matters of fact capable of proof or disproof.

21 The suggestion, urged by the Crown, that a subjective approach would mean that a particular person’s inability for example to sell an asset would lead to its having no value, or having a negligible value, was answered according to Mr Prosser by looking at what other means of extracting value from the asset existed – such as drawing income from it, or by discounting a future sale value by reference to the time which would have to elapse before the sale could take place. A person who could not sell shares in a company without the other shareholders’ consent would not necessarily have a valueless asset – he would normally have an asset which would produce income, and only in the exceptional event of the shareholding never being likely to produce income and never being possible to sell could it be said that the asset’s value had become negligible. There need be no event or incident that brought about the situation contemplated by subsection (2), since the subsection itself envisaged only that

such a situation existed and it mattered not how or why that situation had come to be.

22 Mr Prosser emphasised the likely purpose of section 24(2), saying that although it might not be essential to the operation of the tax it was, like section 23, an example of where parliament had seen fit to take a realistic view of the taxpayer's position. Section 22 deems there to be a disposal of an asset if the owner derives a capital sum from it, but section 23 allows that disposal to be disregarded, but cancels the deemed disposal in section 22 if the capital sum is wholly applied in restoration of the asset and the taxpayer so elects. For the coherence of the tax, as a necessity of its operation, the allowance made possible by section 23 is not a strict necessity. The tax could operate without it. But parliament has seen fit to introduce a degree of flexibility to this extent. The same is then true of section 24(2): it is a flexibility – we referred to it in discussion of the matter as a 'fiscal tenderness' – towards the taxpayer which is, as it were, a relief from the strict application of the tax.

23 In that context it would be very unlikely that the draftsman of section 24(2) intended to factor in the criteria of sections 272 and 273 without having said so. If that had been the intention, there would have been no awkwardness in doing it, though he might have chosen a different order of words to avoid the clumsiness of the phrase 'negligible market value'. It would be less likely still that the draftsman intended to incorporate all the judicial learning about valuation in the estate duty and capital gains tax cases since 1894, but without the statutory modifications now in the legislation, the other option if any concept of market value had been intended.

24 The most obvious and the most practical construction of the phrase negligible value was – as Mr Gibbon observed with regard to the section generally – that it was dealing with a practical and commonsense area of the legislation and was therefore not intended to tie in the complications and subtleties of the various valuation provisions. In Mr Prosser's submission, 'value' here meant value to the taxpayer, not in the sense that the value was

what the taxpayer thought it was, but in the sense that the notion was tied to the actual facts obtaining at the time for the actual taxpayer concerned. The analogy was with the share option cases such as *Abbott v. Philbin* [1961] AC 352 and *Heaton v. Bell* [1970] AC 728 where the issue had been: what is the value to the taxpayer himself of this benefit? Mr Prosser made plain that he cited these cases as illustrations of comparable situations, and not as authorities bearing on the legislation before us.

25 Mr Prosser argued that the capital gains tax legislation overall has recourse to the concept of market value where cases arise in which a transaction involving an asset does not fairly reflect what happens in the real world, and the legislation therefore substitutes market value. Apart from that, however, the general rule is that capital gains tax operates by reference to what is actually paid or obtained. Section 24(2) does the same in the sense that that is the test implied as the condition of the negligible value claim being successfully made. It looks to see the net amount that the taxpayer could obtain at the relevant moment for his asset.

26 Consistently with this, the value to be taken for the purposes of section 24(2) must be net of costs. Capital gains tax has effect in relation to net gains, not gross amounts, and there could be no justification for departing from that general principle in this instance to produce what would be a fictitious and artificial result. Section 38(4) and its disregard of the costs of disposal bites on the deemed disposal and reacquisition, but not on the prior test of negligible value.

27 Some argument was advanced on the basis of observations made by this tribunal in *Marks v. HMRC* [2011] UKFTT 221 (TC), a decision of Judge Avery Jones and Ms O'Neill. In that case, the issues concerned the knowledge that a prospective purchaser should be regarded as having, sections 272 and 273 being in point. This was on the basis that Mr Prosser's primary contention about the meaning of value in the subsection was wrong and that reference should be made to the statutory provisions on market value in

section 272 and 273. On that basis, Mr Prosser sought to emphasise that *Marks* was not authority for saying that information reasonably required by the hypothetical purchaser is not confined to what the seller actually knows, in spite of remarks at the end of paragraph 31 which might be taken as suggesting the contrary. The test is: is the information reasonably required by the purchaser, (whether or not it is in fact known to the seller)?

28 Following on from that, Mr Prosser emphasised as well that if section 273 were to be in play, the section does not require that the prospective purchaser should be content with documentary evidence only, but would be entitled to dig deeper and make oral enquiries and investigations; he is not hypothesised as being confined to what is on paper, but is free if the circumstances make it appropriate to construct his own estimate of the assets' worth and prepare his own management accounts or balance sheet if they are otherwise lacking. If local visits to wherever the assets were located were to be needed, they could also be envisaged as taking place and the results of them as being taken into account by the purchaser.

Submissions on the law for the Crown

29 For the Crown, Mr Gibbon urged us to see section 24(2) in the context of subsection (1) and to approach it as providing for the exceptional and catastrophic instance of an asset becoming in effect extinct, albeit that shares in a limited company cannot – short of liquidation - be ownerless or simply vanish into thin air, so that some provision must be made for them broadly equivalent to that in subsection (1) for assets which are actually destroyed and cease to exist. Becoming of negligible value would, on that basis, be the equivalent to the asset's having been destroyed and the position must be believed to have become irredeemable – subject only to the remote possibility that in an exceptional case the asset might recover its value.

30 Mr Gibbon therefore submitted that the test of negligible value is absolute and not relative; as we have seen, the parties were in agreement on this point.

He also went on to assert that the negligible value should be nil, or close to nil, pointing out that the claims in this case were all that the value of the shares had been reduced to nil. The possibility that the value may not have been entirely extinguished was “inimical” to the making of a negligible value claim because any monetary value would not be “negligible”.

31 Mr Gibbon argued that this position was required by the policy of the legislation for these reasons:

(i) what was not known at the time cannot be taken into account: see the well-known example of the painting thought at the relevant time to be by an old master but later discovered to be by a forger, given by Plowman J in *Re Lynall* 47 TC 375, at 381; the later acquired knowledge is not relevant to the earlier valuation. But we understood Mr Gibbon to accept that later acquired knowledge which was available at the time, and would have been required then by the prospective purchaser, could be taken into account.

(ii) the subjectivity of Mr Prosser’s approach would produce unacceptable anomalies: for example, a seller who faced higher selling costs than another seller in the same position because of particular terms on which the first seller dealt with his stockbroker; a shareholder in a profitable company who could not sell his shares without the consent of the others. These people, depending on their individual circumstances, would have assets differently valued although they were the same assets; the same result could occur in respect of different blocks of shares in a company, where a small block might be more readily saleable than a larger one.

(iii) Moreover, much would depend on the evidence which the taxpayer himself chose to put forward, so that there would be an unpredictable and uneven applicable of the rules, which ought to be the same for everyone. A subjective approach focussing on the value to the owner alone meant that excessively vague and uncertain criteria of value would inevitably result. In particular, it would not be possible as a practical matter to identify a hypothetical arm's length price for an asset if recourse were not had to the concept of market value.

(iv) The real choice for the tribunal was between applying the broad market value concept in section 272, and applying the same concept refined in accordance with section 273. In that context, the taxpayers' argument that the difference of wording between subsections (2) and (3) must imply a difference of meaning receives little support from the example of *Stanton v. Drayton* on which Mr Prosser relied. The case was not authority for a strict rule that differences of wording between sections must import differences of meaning, since it turned on the unrelated issue of whether - given the existence of an actual bargain made at arm's length - it was still appropriate to imply a reference to the market value test.

(v) A further difficulty in the way of reading value in subsections (2) and (3) of section 24 differently would be that, whereas the land of a building claimed to be of negligible value was deemed to be disposed of and reacquired at market value, the building standing on it would, on Mr Prosser's thesis, be treated by reference to a different valuation basis. The result would be asymmetrical and improbable.

(vi) Not to have regard either to the statutory tests of market value, or those developed by the courts between the time of the Finance Act 1894 and the Finance Act 1973, would be unjustified. Wherever the question of value or worth in relation to any thing had arisen, the courts or parliament had always looked to or applied an objective standard. Parliament cannot have intended that the process of building up the valuation criteria to be applied which the courts and the legislation have accomplished over the past 100 years should start all over again in this particular context. One or the other of these streams of learning about valuation must have been intended to be relied on.

(vii) In the estate duty case of *Battle v. CIR* [1980] STC 86, an issue before the court concerned the valuation of shares in a company acquired in consideration of a gift of stock to the company. Balcombe J held (at page 90(h-j) that the shares were required by the legislation applicable to be valued by reference to a sale in the open market but, even if that were not the case, since the assets gifted in exchange for the shares were themselves required to be thus valued the shares should be valued in the same way, as there would otherwise be no true basis for a comparison between the values of the shares and the gifted assets which was required to be made. Balcombe J added that:-

> In any event, in default of some other method of valuation being expressly provided, 'worth' will normally be determined by reference to the open market: see *McIlquham v. Taylor* [1895] 1 Ch 53 at 63-64 per Lindley LJ and *Attorney General v. Jameson* [1905] 2 IR 218 at 239 per Holmes LJ.

(viii) Mr Gibbon then recalled the various principles which had been established by the courts regarding valuation: that the hypothetical vendor is anonymous, *IRC v. Clay* [1914] 3 KB 466, at 473; that the sale also is hypothetical, *Duke of Buccleuch v. IRC* [1976] 506, at 543 per Lord Guest; that there is a willing vendor and a willing purchaser, *Clay* at 478; that proper marketing and exposure of the asset is to be assumed, *Buccleuch* at 525A-B, per Lord Reid; that the potential purchaser is prudent, *Findlay's Trustees v. CIR* (1938) ATC 437, at 440; that the potential purchaser's enquiries would depend on the circumstances, *Lynall* at 698E per Lord Morris; that the common law open market approach did not require confidential information to be made available, whereas section 273 does: *Caton's Administrators v. Couch* [1995] STC (SCD) 34 at 49h-50c, per Sp Cmsr Brice.

32 Mr Gibbon argued that the reason that subsection (2) did not refer to market value was that shares of effectively no worth, ones whose value had been irredeemably lost, would not have any market value and therefore there would be little sense in making reference to value in such terms; if the shares did have a market value, that indicated that the value was not negligible and that the section did not apply.

33 Put another way, there would have been an awkwardness in the draftsman referring to something which could not properly be said to exist, namely an asset whose value in the open market was negligible because, by definition, there was in that event effectively no market for it. Subsection (2) therefore referred to negligible value, without more, to indicate that it was referring to something which the market would not value; whether there was or was not a market value for the asset was relevant to deciding whether or not it had become of negligible value, because there was no other adequate yardstick which could be applied to test the matter.

34 In that perspective, the deemed disposal and reacquisition is not an option for the taxpayer who chooses to claim negligible value on the basis that the asset has become useless to him personally, with the Revenue safeguarded in the long run if the asset revives; rather it is a longstop for the exceptional case in which an asset which has lost its value does - contrary to all expectations – come back to revive. Put another way, the section is not designed as an option for bed and breakfasting shares to offset other gains which are taxable. The deeming provision is a necessary adjunct where an asset has not been definitively extinguished, as will often be the case for example with shares whose existence lingers on throughout the period of a liquidation, well after they have become valueless. Without the reacquisition provision the shares would, after they had been declared of negligible value, enter a limbo outside the scope of the tax altogether – a result that cannot have been intended.

35 In estimating whether the level of negligible value had been reached, the Crown's submissions insisted upon the relevance of section 38(4) in excluding

any consideration of the costs of disposal. The wording used in that provision and the wording used in section 24(2) was identical: "sold and immediately reacquired"; in the circumstances, the application of the rule that costs could not be taken into account could not be resisted.

36 In his written submissions, Mr Gibbon had referred to the requirement that an asset "had become of negligible value" as referring to an "event" terminating or effectively terminating the existence of an asset, but in oral submissions he clarified this, explaining that while there might well be a process leading up to negligible value the wording of the section envisaged that a point had been reached at which something had happened, a state of affairs had come into existence or been reached, and in that sense an event had occurred.

37 Turning to the question of the publicity that should be hypothesised for any sale in the open market, Mr Gibbon submitted that both *Buccleuch* and *Marks* are authority for the proposition that only the material that was available at the time could be hypothesised as forming part of the publicity that would have been advanced, and that it should not be assumed that accounts not in existence would have been prepared. To the extent that expert evidence was based on a misapprehension of that point, it was wrongly based, and Mr Gibbon made particular reference to the expert evidence of Mr Eamer – see below – in particular at paragraphs 15.3-5 and 16.3-4 of his statement.

38 The point is made clearly by the tribunal in *Marks*, at paragraph 31 where it is said:-

> Mr Gibbon contended that only information actually available was assumed to be provided. We agree with Mr Gibbon. It is inherent in the hypothesis that the information is available to be supplied. The assumption relates to the information that [the purchaser] might reasonably require if he were proposing to purchase the asset from a willing vendor by private treaty and at arm's length.

39 Finally, Mr Gibbon pointed out that if it were correct that the reference to value in section 24(2) did bring into play the statutory provisions, it was open

to us to conclude that section 272 alone – importing in effect the judge-made law on valuation – should be applied. Referring to section 273, Mr Gibbon submitted, would add a certain artificiality from a context which did not apply in this case - an artificial further introduction of information to get round the problem raised by the decision which prompted the enactment of section 273, namely *Re Lynall* [1972] AC 680. In other words, as we understood it, Mr Gibbon was leaving open the option of holding that we could apply section 272 without applying section 273 also, or of holding that the two sections applied together as though they had been referred to specifically.

40 After the conclusion of the hearing, our attention fell on a first instance decision relating to section 24, *Harper v HMRC* [2009] UKFTT 382 (TC) which had not been cited in argument, and we accordingly invited the parties' comments on it in their written closing submissions. In that case, the taxpayer had made a claim for loss relief under section 574 of the Income and Corporation Taxes Act 1988, which was in turn based on the fact that he claimed allowable capital losses by virtue of the operation of section 24; it was agreed that shares in respect of which he made the claim were of negligible value at the date of the claim, 5 April 2004.

41 The taxpayer had made injections of money, in return for shares, in a company called HMS President (1918) Ltd: he claimed that the shares were, at their issue, worth at least what he paid for them, namely £149,890 (for shares allotted in June 2002) and £250,000 (for shares allotted in December 2003). The Crown considered that the shares were of negligible value as at the date of allotment, and therefore had not "become" of negligible value by 5 April 2004. The appeal was argued between non-counsel representatives at a short hearing and was principally decided on limited facts and consideration of whether Mr Harper had discharged the burden of proof.

42 Neither party referred to any authority on the meaning of "negligible value" but it was noted that according to HMRC's internal guidance it meant "worth

next to nothing", which the tribunal regarded as a correct interpretation of the legislation. The taxpayer's argument assumed that whether the shares were originally of value was to be assessed by reference to sections 272 and 273. There is no explicit reference to HMRC's submissions on the relevance of sections 272 and 273, but the tribunal noted that those provisions "do not seem to be controversial" - see [17].

43 The tribunal found, at [26]-[29], that the money injected in June 2002 "was not made by way of investment in a thriving company, but in order to keep the company afloat", and also found that the company was "in considerable financial difficulty by that stage". Further, that it was "impossible to conclude that the company was solvent and that its shares had any value" at December 2003: and it was concluded that it was "more likely than not" that the cash injection then "was made, on this occasion as in June 2002, in an ultimately unsuccessful attempt to save the company and escape the prospect that the creditors would call on [the taxpayer's] personal guarantees". Moreover, it was held that there was "no reliable evidence from which we could properly conclude that the company had a positive value, reflected in its shares, at either of those dates, still less evidence from which we might have come to a conclusion about what that value might have been".

44 Both parties to this appeal submitted that *Harper* was a decision on its own facts, which contained no detailed consideration of the law and provided no material assistance to the tribunal in deciding the legal and factual questions in this appeal.

Conclusions on the law

45 We accept the logic of the Crown's argument that section 24 should in principle be read as a whole, and that it is not appropriate to interpret each subsection independently unless there is a very clear indication that that is what parliament intended. We see no such indication. It is in our view

entirely reasonable to postulate that parliament intended section 24 to deal with a group of very similar though not identical situations in which assets effectively cease to exist.

46 Subsection (1) can only be read in that way. Subsection (2) deals with cases which are virtually identical to those in subsection (1) but where the asset is still formally in existence, though as good as dead. Subsection (3) concludes the range of situations addressed by dealing with the special case of a building which is either destroyed or has become of negligible value (both possibilities are contemplated) but where the site of the building retains – as one would expect – a substantial value. It is important to note that subsection (3) in effect qualifies subsections (1) and (2) rather adds to them, leaving it even more evident that the first two subsections should be read together and not apart, and avoiding the anomaly of different criteria being applicable in subsection (3) to the building and its site.

47 In those circumstances, to speak of an asset which has become of negligible value as having a market value makes no sense. The very fact that it has no market value is why it is said to be of negligible value; if the asset has a market value, then its value cannot be negligible. That it may nonetheless have a subjective value to its owner is beside the point: an item of sentimental value to a person may well be nearly priceless as far as that person is concerned, but it would be quite unworkable for the tax base to depend on the accident of personal attachment to an asset rather than upon a value evidenced by an actual or hypothesised arm’s length transaction.

48 The test of eligibility for a claim under section 24(2) is therefore: does this asset have a market value? If the answer is no, a claim may in principle be made; if the answer is yes, no claim under this provision is appropriate. The draftsman had accordingly no need to specify whether the word ‘value’ in the phrase ‘negligible value’ meant ‘market value’ – or some other type of value - because the reference is to a situation in which there is no objective value. It was rightly accepted by both parties that ‘negligible value’ meant ‘worth next

to nothing'; and although it is at first sight odd for a claim for 'negligible' value to be set at nil, it is quite consistent with an approach to the issue which accepts that nil and negligible are so close as to make no difference.

49 It follows that the criteria in sections 272 and 273 must be applicable for the purpose of ascertaining whether a claim falls within section 24(2) or whether it fails *in limine*. We accept the argument that parliament cannot have intended the tribunals and courts to embark upon a fresh course of investigation into a novel and nebulous concept of value when there are clear and well understood rules within the tax code in question, or that it has been left unclear since 1965 when this section was first enacted whether section 272 alone should be in play or whether both these sections are relevant. Section 273 is in terms appended to section 272, and we see no ground for excluding its possible application.

50 Various other conclusions follow. Thus, bearing mind the possibility admitted by subsection (2)(b) of making negligible value claims two years in arrear, it is apparent that information relevant to the earlier time thus permitted to be used which is discovered after that date may be taken into account, but only if it was in fact available at the relevant time and the prospective purchaser would reasonably have requested it. Following *Marks*, we accept therefore that accounts not in existence at the relevant time are not to be treated as having been created at that time, even if they came into existence subsequently and contained information available at the time.

51 Further, since the issue is whether the asset in question had a market value or not, the likely costs of disposal must be taken into account in the usual way it is found that there is a gross market value. The fact that section 38(4) requires no account to be taken of expenditure incidental to the deemed sale and re-acquisition is irrelevant, since that notional transaction takes place after the prior question of whether the asset is of negligible value or not has been dealt with. There cannot be a conflation of the condition precedent to a claim being made and the consequence of its having been being made.

52 Lastly, we have regard to valuable summary of the characteristics of the market to be hypothesised given by Hoffman LJ in the inheritance tax case of *IRC v Gray* [1994] STC 360 at 372:

> The hypothetical vendor is an anonymous but reasonable vendor, who goes about the sale as a prudent man of business, negotiating seriously without giving the impression of being either over-anxious or unduly reluctant. The hypothetical buyer is slightly less anonymous. He too is assumed to have behaved reasonably, making proper inquiries about the property and not appearing too eager to buy. But he also reflects reality in that he embodies whatever was actually the demand for that property at the relevant time.
>
> It cannot be too strongly emphasised that although the sale is hypothetical, there is nothing hypothetical about the open market in which it is supposed to have taken place. 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.

The factual evidence

53 The evidence before us consisted of a substantial volume of documentation. In addition to this there was the written and oral evidence of each of the three taxpayers themselves, the like from Mr Simon Miesegaes - at the time the finance director of InterX Plc, and from four expert witnesses: for the taxpayers, Messrs Badri Nathan and Keith Eamer, and for the Crown Messrs Jerzy Wielechowski and Christopher Glover.

54 Counsel for the Crown aptly described as a “dense thicket” the evidence which the appeal has produced. The findings which follow are therefore necessarily a digest of this extensive material, much of which appeared to us to have a very limited connection with the issue under appeal. We have therefore stated only what we consider to be the salient facts, omitting reference to many nuances of recollection that were debated except where they have a definite relevance to the central question we have to resolve. We were assisted by detailed post-hearing submissions on the factual evidence from both counsel.

55 Very unfortunately, Diligenti’s records are much less than complete, and in consequence precise figures are often unavailable and the figures there are from various sources do not always tally; where we have quoted figures about Diligenti below, they are those which seemed to us to be the best attested. The tribunal’s task would have been much easier if the ‘D’ report on the company made to the then Department of Trade and Industry had been available; neither party, however, sought the issue of a summons to obtain it and it is indeed probable that such a summons would in any event have been resisted by the Department on the ground of public interest immunity.

56 Much of the business testified to had also been recorded in documentary form, generally in minutes of board meetings, memoranda to the board or in formal presentations. This type of documentary evidence, especially the board minutes, is known when it is prepared to be potentially available to a wider readership, and is therefore apt to be expressed in formal and sometimes terse language - and, on occasion, in terms which are designed to gloss over or avoid issues which have been divisive or sensitive at a meeting or otherwise. While this tendency is a matter of general observation it was also clearly apparent from the evidence we heard, in particular that of Mr Miesegaes who

was responsible for most of the board minutes we saw, and Mr Nathan whose experience as a seasoned investor looking at target companies was in point.[1]

57 Against this background, we regarded all the factual witnesses as honest and credible, doing their best to recall accurately events ten or more years ago and the context of them. We would reject any suggestion – though none was made explicitly - that any of the witnesses was apt to gloss the factual record to assist his case. Where differences of emphasis or meaning appeared between the company minutes and the lengthy oral evidence - which was of course tested by thorough cross-examinations - we have accepted the latter, save where we explicitly indicate the contrary.

58 A specific reflection on the reliability of the oral evidence of Mr Simon Barker was made in submissions by the Crown in closing. It was said that Mr Barker himself acknowledged that he found the questioning on certain issues upsetting and that he tended at times to become emotional about matters put to him. It was submitted that "what triggered the upset was the mismatch between his absolutely firm recollection and what the documents incontrovertibly showed". That is not our conclusion. Our judgment of the matter is that such distress or vexation as Mr Barker, a non-practising chartered account, evinced during the course of some four days in the witness box was caused by the recollection of how – as will be seen below – he had been worsted in business by men in whom he had placed a high degree of confidence and trust, and the painful recollection of how his own judgment had at times been deficient.

[1] That people are apt to present matters in a particular context was, indeed, underlined by Crown counsel's submission in regard to a challenge to the independence of an expert witness. Submitting that the right test was whether the witness had given an honest view, not whether he would have said the same if instructed by the other side, Mr Gibbon QC wrote that "an expert witness might feel himself constrained to avoid (if possible) expressing adverse views about the person responsible for paying his professional fees".

59 A similar reflection was made in respect of the evidence of Mr Miesegaes where his oral evidence was in some degree at variance with the written records, again almost always in board minutes or board level documents. In this case, it was suggested by the Crown that there had been “an understandable blurring of his recollection over the last decade”. Our judgment of Mr Miesegaes, also a chartered accountant, is that he was a careful, honest and accurate witness who had no interest himself in the success or otherwise of this appeal, and whose frankness in relation to matters was at times at the expense of his own professional pride. We had no hesitation in accepting Mr Miesegaes’s account of events and the reasons for which they occurred, even where there was shown to be a difference of detail or emphasis between his account and either the documentary record or the evidence of Mr Barker.

60 Overall, where we do not indicate to the contrary in relation to the facts recounted hereafter, we have found them proved on the balance of probabilities. Our findings with regard to the often conflicting expert evidence appear from the reasoning given under the heading ‘conclusions’ following it. It was common ground that the burden of proof in this appeal lay on the taxpayers.

Background

61 The appellants were shareholders in a public company originally called Ideal Hardware Limited but which, by stages, became Ideal Hardware Plc and then InterX Plc. It is as InterX Plc that we are concerned with it, and we refer to the company as ‘InterX’. The three appellants had a long business association behind them and, at least in the context of the events to be related here, it was Mr Barker who took the lead role and upon whom the other two clearly relied throughout.

62 On 19 December 2000, each of the appellants subscribed for 11,000 ordinary shares of £0.01 at par, with a premium of £303.0203 per share, in a

company called Diligenti Limited ('Diligenti'); the total cost to each person was thus £3,333,333 or £10,000,000 between the three of them. The Crown accepts that the shares thus subscribed had a value at the time they were issued, albeit that it is also accepted that the investment they represented was made into a company with a portfolio of loss-making investments. How that came about was as follows.

63 Ideal Hardware Limited had been established in 1987 as an IT distribution business and it was floated on the London Stock Exchange in 1994, becoming a public company. In 1998, the company was renamed InterX to coincide with a move into non-distribution activities, the distribution activities having been assigned to related companies. One of those was a start-up software company called Cromwell Media Limited, in which InterX had a 33.3% stake acquired in 1997, and which had an innovative software product known as BladeRunner in which high hopes for its profitability were entertained. In 1999, BladeRunner was being used to launch a new online IT information service at www.itnetwork.com and by the end of 1999 InterX had taken the decision to sell its distribution business to concentrate its efforts on its network software and information businesses. Another such company was called IT Network.

64 InterX therefore acquired the remaining shares in Cromwell Media Limited in March 2000, making it a wholly owned subsidiary. At the same time, InterX raised new capital of some £54,000,000 at £34 per share on the stock market, issuing Listing Particulars describing its new course of development in software and its proposed acquisitions for that purpose, in particular of a company called PharmWeb. The purpose of buying PharmWeb was to use it as the vehicle to construct what was called an "electronic Oxo Tower", a vision of an information tool for the life sciences industry based on the ground-breaking 'BladeRunner' product now acquired by InterX. This is described further below.

65 In the course of that exercise, the three appellants received some £10,000,000 each for the disposal of part of their shareholdings at £34 a share (though only a month later InterX's shares were being traded at no more than £16 each). As part and parcel of the capital issue, a new director joined the board in April 2000, a Mr Philip Crawford, who was said to have had a successful career as chief executive of Oracle Corporation, one of the world's largest and most successful business software companies. The sale of InterX's distribution business was completed in July 2000 and Mr Crawford became InterX's chief executive officer in August 2000.

The origins of Diligenti

66 For the acquisition of PharmWeb, announced in the Listing Particulars, some £20M was required. Its acquisition was intended to provide a platform for developing "the IT Network business model within the global pharmaceutical industry". During the negotiations to acquire PharmWeb, the appellant Mr Barker was introduced to two persons who were to play a crucial role in the establishment, running and eventual demise of Diligenti. These two persons were Mr Neil Stafford and Mr Christopher Spanoudakis. Mr Stafford had been a global business director at Monsanto. Mr Spanoudakis was a partner at PriceWaterhouseCoopers in corporate finance and was acting on behalf of PharmWeb; he had been voted "Rainmaker of the Year" from 1998 to 2000 by the Sunday Times and Mercury Asset Management. Mr Barker later said of him that InterX believed that "if anyone could raise further funds, he would be able to". Mr Wickes commented of them both that they "talked a very good game".

67 The germ of the idea for Diligenti emerged during the PharmWeb negotiations in discussions between Mr Barker and these two men, and already by late March 2000 the board of InterX had agreed to take them on with very substantial remuneration packages which were described as "extremely expensive for both the company and the settling individuals ... but were necessary to secure these quality individuals". The three appellants made

some £500,000 worth of personal contributions to the remuneration package in the form of trusts of InterX shares set up for Messrs Stafford and Spanoudakis, and between them they were also to have salaries of £450,000, share options worth £350,000 and a 'Golden Hello' of £250,000 for Mr Stafford and £416,000 for Mr Spanoudakis. But Mr Barker regarded them as having the vision and the contacts to promote the name of Diligenti, to identify the right partners and potential targets, to negotiate acquisitions and to raise money.

68 In hindsight, it could be said to have been a move in the wrong direction at the wrong time. It was in March 2000 that the dotcom bubble burst and when, almost overnight, flotations, fundraisings, new launches and IPOs came to a halt. Mr Miesegaes indeed recalled, because it coincided with another event he particularly remembered, that the NASDAQ had begun to fall on 10 March and, suddenly, there had been a downslide.

69 When, only a month after capital had been raised to acquire PharmWeb, the acquisition had to be abandoned because of defects in its title to intellectual property rights, Mr Stafford continued to inspire Mr Barker with a vision for the life sciences industry – nutrition, health and agriculture - bigger than that which had been inherent in the business of PharmWeb, namely to set up an "electronic information backbone" for the industry, the "electronic Oxo Tower" which would be a point of reference showing the company's BladeRunner software in action; this software allowed users of it to track in detail what was happening on their websites, and therefore to refine or target the marketing of their products better and obtain an important commercial advantage by doing so. A BladeRunner licence cost £350,000, and a further £1-2M had to be expended to operate it in conjunction with a purchaser's existing website.

70 But this was the direction InterX wanted go in and, with £20M now spare because of the failure of the PharmWeb acquisition, Messrs Stafford and Spanoudakis succeeded in persuading Mr Barker and his colleagues that they could, with the support of InterX, deliver the vision in the form of Diligenti.

Mr Barker's evidence, which we accept, was that InterX's support for this was based upon the proposition that the new business would purchase a BladeRunner licence and effectively become a showpiece for the technology, encouraging others in the life sciences sector to follow suit and purchase licences to use themselves, or by forming partnerships with Diligenti.

71 In May 2000, Messrs Stafford and Spanoudakis presented InterX with the Diligenti Business Plan. It stated the purpose of the company as being "a world-wide partner to the life sciences industry building on core skills in technology, informatics and science to develop knowledge based solutions that integrate technology with key commercial skills", though no explicit mention was made of the BladeRunner software. The object however was to integrate the diverse businesses acquired to achieve synergies "in the infrastructure, content, value proposition and customer relationships that are not available" to the businesses individually.

72 The plan set out five objectives to be met by December 2001: more than $50M in sales, break-even in income, 250+ employees, positive cashflow by second quarter of 2001 and profitability by third quarter of 2001. None of these objectives was to be met. The ultimate flotation of Dilgenti by the fourth quarter of 2002 was seen as the "number one option". By May 2000 the dot.com market had already peaked and the fallout was happening but, undeterred by that, the plan was approved. Diligenti itself was incorporated on 7 June 2000, with some 250,000 shares allotted to Messrs Stafford and Spanoudakis subscribed at par (i.e. at one penny per share).

73 The approval of the Diligenti plan was subject only to InterX securing an overdraft facility from its bankers of £20M to provide the £30M overall cover which was needed, which was not expected to be a problem. In the event it was a problem, and the overdraft was refused. It had been decided in principle on 12 June that Mr Crawford would become InterX's Chief Executive Officer in August following the sea change in the Group's strategy from being an IT distribution company to being a software provider, focussing in the immediate

future on BladeRunner. But in the absence of the £20M overdraft, the question then arose whether to proceed with the Diligenti project.

74 There were two options: A to abandon the Diligenti proposals, and B to proceed with them investing £4M and making available some short-term working loan capital pending further financing. InterX's internal analysis showed that option A would cost about £5M in lost expenses and there would be the loss also of three "guaranteed" BladeRunner licence sales to Diligenti and the likelihood of three further sales to it; InterX would lose out on a significant opportunity to promote its technology on a global scale. Option B, on the other hand, contemplated an investment of £4M in the equity of Diligenti and a short-term working capital facility of £16M, plus the purchase by Diligenti of "a minimum of three BladeRunner licences within the first 12 months, subject to 'best price' and having the cash to do it". At the end of June 2000, option B was adopted.

75 Before the Funding Agreements were made, however, InterX's auditors Arthur Andersen prepared a report of that company's working capital needs, a requirement before the necessary circular to shareholders explaining the developments which was to be issued on 18 July. This of course included reference to the Diligenti financing proposals and it estimated that Diligenti would by the end of 2001 need £10M more than the amount InterX was putting into it in order to repay InterX's loan. InterX itself could ultimately not supply that additional need, since the auditors required to be satisfied that InterX's maximum exposure to Diligenti would not exceed £10M.

76 The three appellants therefore undertook informally to InterX and the auditors that they themselves would supply the further capital needed if, despite their then expectations to the contrary, funding could not be found elsewhere. The informal undertaking was not made the subject of a written agreement for fear of falling foul of Stock Exchange regulations. As was to be the case in regard to third party funding, it was understood that if further funds were invested by the appellants InterX would be entitled to the repayment of

an equivalent amount of its own debt - mirroring the "pull through" provision in the Funding Agreement described below.

77 It was important to InterX that Diligenti should be an associated company rather than a subsidiary and InterX therefore agreed to fund Diligenti as to £4M by way of equity (which, with a premium for the shares, would give InterX 150,000 shares) and as to £16M by way of loan, equalling the total of £20M originally intended for the PharmWeb acquisition.

78 This loan was to be a short-term loan and was the subject of a formal Funding Agreement made on 18 July 2000; it was repayable by 31 December 2001 at the latest and was secured by a fixed and floating charge over all Diligenti's assets. As indicated, it was provided that if third party funding was obtained before then, InterX's debt would be repaid to the same extent, a provision described as the "pull-through", which also applied if there was a change of control.[2] Initially, InterX's intention was to invest £4M as equity and £8M as a loan, with a further £8M loan to follow if the business went well. A first version of the Funding Agreement was executed on that basis on 14 July. Mr Spanoudakis however, finding this agreement signed by Mr Stafford, insisted that it be revised up to £16M at once, and he signed the revised version which was dated 18 July.

79 The Funding Agreement provided that the debt element was convertible at InterX's option into 250,000 shares at a steadily increasing cost per share, so that the exercise of the option up to 31 December 2000 would cost InterX £64 a share, up to 30 June 2001 £100 a share, and up to 31 December 2001 £200 a share. Thus, InterX could acquire voting control of Dilgenti, but only at a cost which would be justified if the company's performance were to be highly successful. Meanwhile, a six weekly or monthly financial report to InterX was required to be made by Diligenti, though these reports were never in fact made, and InterX did not enforce the obligation.

[2] 'control' was as defined in section 416 of the Income and Corporation Taxes Act 1988.

80 The position of Messrs Stafford and Spanoudakis on the other hand was made almost unassailable: the articles provided that in any resolution to remove a director, they would be entitled to one vote more than was capable of being cast by the other shareholders. Transfers of shares were subject to a right of pre-emption on the part of existing shareholders at a price determined by the auditors, with no minority discount permitted; subject to that, shares might be traded freely but only at the determined price or above.

81 The articles also provided that if the sale was to a purchaser who was a "person who carries on or who is interested in a business which operates within the life sciences support industries", it could only be made with the consent of Messrs Stafford and Spanoudakis. In the same vein, these two gentlemen were entitled to appoint a majority of the board of directors, whether or not they held a majority of the shares; they thus had, for one penny a share, acquired virtual control of the company. InterX, which had contributed in effect the entire working capital of the company was entitled only to appoint one director, and could not outvote Messrs Stafford and Spanoudakis either on the board or in the shareholders' meeting.

82 Given the previous emphasis on the central importance of Diligenti using the BladeRunner technology, the Funding Agreement was strangely drafted in regard to that question: clause 14.10 obliged Diligenti not, without InterX's consent (not to be unreasonably withheld), to "purchase software competitive to the Lender's BladeRunner application platform, such software to be purchased at no greater than market competitive rates evidence of which to be provided by the Lender to the Borrower on request". Although Mr Barker regarded the use of BladeRunner by Diligenti as "crucial" it is unclear whether this should be read as a positive obligation to buy BladeRunner (albeit cast as a negative covenant) or simply as an obligation not to buy competing products - of which a detailed list then followed.

83 The obscurity of the drafting might simply have been the result of the haste with which the transaction was concluded against the deadline of 18 July for the issue of InterX's circular to shareholders, but Mr Barker's explanation of the matter was that it was the result of hard negotiation by Mr Spanoudakis. As has been seen, a previous version of the Funding Agreement, signed by Mr Stafford, had been executed on 14 July committing InterX to only £8M of loan; but, following frantic negotiations, the 18 July agreement signed this time by Mr Spanoudakis was substituted with the InterX loan now at £16M, and with what Mr Barker described as "this absolutely pathetic commitment with regards to technology".

84 Mr Spanoudakis knew that InterX were up against a deadline with regard to the issue of a circular to shareholders[3] required by the Stock Exchange's regulations explaining the disposal of InterX's distribution business, what was happening with the £20M which had been raised to acquire PharmWeb and the investment in Diligenti. This circular was duly issued on 18 July, the day after the revised Funding Agreement was actually signed (though it was dated 18 July), and Mr Spanoudakis had known that InterX were desperate to settle the Diligenti documents by then.

85 Mr Barker conceded that this was his explanation of events rather than his actual recollection of them, and an obstacle to it is that the relevant clause was in the same terms in the superseded agreement of 14 July. Contrariwise, it must also be noted that Mr Barker always felt that he had a clear oral commitment from Messrs Stafford and Spanoudakis that they would use BladeRunner, that it was part of the vision that they had shared when they had joined InterX and that they would still make good on that understanding.

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[3] The circular was duly issued on 18 July and stated that "InterX will work with Diligenti to migrate Diligenti's acquired businesses onto a technology platform incorporating InterX's BladeRunner product".

86 We therefore make no finding about why clause 14.10 was expressed in the way it was, but we note that the lack of clarity about the place of BladeRunner in Diligenti's operations was to give rise to further tensions in the months to come. Indeed, almost at once discomfort about how matters had been left began to surface: the board minutes of InterX for 20 July record that "it is important to continue to press Diligenti to ensure the appropriate licence sales are made". In the meantime, the Funding Agreement committed Diligenti to undertake a technology review by InterX Technology regarding the need for "a complete technology platform" for not less than £25,000.

87 A similar uncertainty was created by the drafting of clause 20.2 in the Funding Agreement. After providing for the usual fixed and floating charge over the company's assets it was specified additionally that: "The Borrower shall provide such further security in respect of the Facility as the Lender may at its absolute discretion request when the amount drawn down under the Facility which has not been repaid exceeds £8M". The uncertainty of the obligation thus created evidently calls into question its enforceability and, indeed, the board of InterX decided on 14 December 2000 that "if the additional security phrase was, in fact, meaningless, given that InterX has a fixed and floating charge over the assets of Diligenti, then the phrase should be removed". The minutes of the same board meeting noted that "any feeling of moral commitment from Simon Barker and James Wickes in relation to giving any guarantee on any part of the loan on a personal basis was formally 'removed' ".

88 Messrs Barker and Wickes thought that clause 20.2 did not refer to their position and that the "guarantee" referred to in the December minutes was a promise by them to invest £10M personally to bring the total available to Diligenti to £30M if needed and, possibly, to give InterX assurance that with the operation of the "pull-through" its total loan exposure would not exceed £10M. The evidence of Mr Simon Miesegaes, however, indicates that the clause was part of an effort to circumvent what were believed to be Stock Exchange objections to a commitment by the appellants to invest £10M in

Diligenti if required to do so; but it was also the case that Mr John Hancox, a non-executive director of InterX, had been adamant that there should be something in writing to reflect the appellants' commitment.

89 Mr Miesegaes told us that if the record had shown a contractually or legally binding commitment by the appellants to invest £10M in Diligenti that could have been regarded by the Stock Exchange as a 'related party transaction', which would have brought its own complications, so the appellants' commitment was presented as an offer of providing 'security' for InterX's loan but without further detail being written down. This commitment was at times also referred to in the evidence as a "guarantee", as an "undertaking" and as "underwriting". In any event, when the December 2000 investment which is the subject of this appeal was made Mr Miesegaes said that Mr Barker wanted clause 20.2 withdrawn and – in so far as it might affect them also – so did the Diligenti management. As we have seen, it was withdrawn. We accept Mr Miesegaes's evidence as the probable explanation of what clause 20.2 was intended to cover.

The first six months

90 Much evidence was given about the steps which it was understood that the Diligenti management were taking through the course of the next six months. Acquisitions of businesses were certainly being made.[4] In September, Diligenti took a 34% stake[5] for $1.5M in EasyChem Inc, an online chemical distribution and data business in the United States and the UK; also in September, Diligenti bought 100% ownership of ClinNet Solutions Inc for $12M, a company providing online news and healthcare information to professionals in the United States, 100% ownership of Q-Global Limited for $0.75M, a software data collection and data mining business relating to agrochemicals, and in October 100% ownership of Club Medical Sarl, a

[4] It seems that all the acquisitions apart from HESc were at least identified before the formal incorporation of Dilgenti in June 2000.

[5] Raised to 100% by the start of 2001.

company providing online news and healthcare information to professionals in France; lastly, it acquired in November a 51% rising to 68% stake in a health and wellness company in the United States which became known as 'HESc' for $10M.[6]

91 The minutes of the InterX board for 21 September 2000 recorded that Diligenti's turnover in the current financial year was expected to be in the region of $50M, but in the event it was as Mr Barker put it "nowhere near" that figure – in fact it was less than £15M. No Chief Financial Officer was ever appointed by Diligenti, and there was no equivalent until InterX's CFO Mr Simon Miesegaes stepped in to try and rescue the situation in August the following year. The tension over BladeRunner also surfaced, with the minutes recording that the investment in Diligenti "had originally been made with a view to securing BladeRunner licences into Diligenti's leveraged investments. It was agreed that if licences were not going to be sold to Diligenti it might not be appropriate for InterX to continue investing".

92 In October, it was recorded that Diligenti's current 'burn rate' (i.e. the rate at which cash was being spent without a corresponding inflow) was £500,000 a month but the expectation was that it would become cashflow positive "in the next twelve months". It never did. The sale of a BladeRunner licence to Diligenti was reported to be near, following an earlier report that Diligenti had prepared a proposal for the use of the integrated BladeRunner system.

93 A report and presentation by the Diligenti management to the board of InterX in November 2000 stated that key management positions within these companies had, where necessary, been filled and that "the group is now focussed on integration of all business activities, as well as continuing to aggressively grow revenues", the total of which for 2001 was projected to be $56.77M. Mention was made of the use of BladeRunner to deliver "premium

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[6] The 68% level was not attained until May 2001. The company subsequently changed its named to 'Exemplar'; to avoid confusion, we refer to it throughout by its original name of HESc.

revenue opportunities" and to the need in 2001 for a common technology platform to be established, with $3M being identified as the cost.

94 No effort was spared in painting an optimistic picture of Diligenti's position. Thus with regard to HESc, the best of the investments Diligenti had made, it said "New 3M contract in place with revenue potential of $100M in 2001", giving the impression that such a sum might be obtained that year. In the same presentation, another figure was given with the statement "3M contract nationwide roll-out starts 1 January. Revenue opportunity upwards $50M." The revenue projections for 2001 were however shown elsewhere as $35M, suggesting a very speculative character to the figures; in the event, revenues for 2001 were less than $20M; for the first three months of 2001 they were $1.764M, $1.674M and $1.904M with losses for the same three months of $402,000, $581,000 and $954,000. The 3M contract claimed to be "in place" had not been made and nothing of its kind was to be made until June 2001, and what actually emerged in terms of revenue from 3M in 2001 was of the order of $500,000.

95 The presentation included detailed and very optimistic projections for each of the subsidiaries and it concluded with an example of what Mr Barker was later to describe as "brochureware": "Our business model and vision is unique, our capabilities are unparalleled, the market conditions are outstanding, Diligenti will return significant capital value and strategic opportunities to InterX shareholders". It ended: "Our expected outcome from this meeting is to waive the 'sweep' loan term". Apparently this meant that Diligenti wanted InterX to waive the obligation under the Funding Agreement that any new investment would trigger a repayment of the same amount to InterX, and they had in mind in particular the expected investment by the three appellants.

96 The presentation was "well received" by the board and the appellants had at that point been largely content to believe that the supposedly exceptional men that they had hired were best left to do what they said they were doing, and to leave them on a loose rein. Mr Barker, who acted as the leader of the

three, commented in evidence: “What was understood at base level was that a conservative, prudent budget for HESc for 2001 was $35M and what was understood was that it was going to start on 1 January. What was also understood was this could be the biggest thing since sliced bread. But we prepared a prudent conservative budget. So I was expecting, on the basis of this, on the basis of this I am making decisions as to invest in the company, was I expecting more than just a few hundreds of thousands revenue on the 3M contract commencing whenever it was later in the year, the answer is most definitely ‘yes’. How many, I don’t know, but it was in the tens of millions.” And he told us: “I was a complete believer in it”.

97 A rather more hesitant and at times sceptical view was often taken by the chairman Mr Richard Jewson, and by Mr Philip Crawford, the CEO, and Mr John Hancox, a non-executive director who was chairman of the audit committee; Mr Crawford’s attitude was clearly influenced by Diligenti’s lack of enthusiasm to buy BladeRunner licences, and he is recorded as complaining of it regularly. Outside, the mood in relation to the sector was severely pessimistic. The Daily Telegraph of 25 November, for example, said: “At beginning of the year, the markets were prepared to believe anything, provided it ended with .com. Now the cash has run out, and almost every e-commerce company from the largest to the smallest is feeling the squeeze. At this rate, only a handful of pure internet companies will survive beyond Christmas. ... Philip Crawford, chief executive of the software group InterX, describes the current market mood as pretty grim”.

98 Approaching the end of 2000, Diligenti had received from InterX some 16M[7] in total and had made a number of acquisitions, but they were, overall, loss-making and projections showed that it was clear that further funding to the tune of $15M or £10M would be needed. Mr Barker himself commented that “the internet market was collapsing [in May 2000]” but, faced with the continued assurances from Messrs Stafford and Spanoudakis in November

[7] £4M in equity and £12M in loan.

2000 that all was well, and that 2001 would be a profitable year, and wishing the two men to concentrate on the development of the business rather than to be preoccupied in raising funds, the three taxpayers honoured their commitment to InterX of six months earlier and made the investment totalling £10M in the 33,000 shares of Diligenti which has led to this appeal.

99 Some sort of effort was made to establish a share price which could be said to be at arm's length, but no due diligence was done and Mr Barker commented that "it was a quick 'we think that's probably a fair value'". A negotiation took place between Mr Barker and Mr Spanoudakis in which a deal was struck: the share price would be based on calculations which valued Diligenti's business at around £120M. ING Barings, Arthur Andersen and Allen & Overy reviewed it, (ING Barings had attended the presentation by the Diligenti management in November) and agreed that it seemed to be a reasonable value, and the matter was endorsed by the board of InterX.

100 The shares thus issued on 19 December 2000 gave each appellant a holding of 2.49% of Diligenti's share capital. Diligenti had therefore secured funding totalling £30M, but the Funding Agreement with InterX made the previous July was amended to provide that a sum equivalent to that invested by the appellants - £10M - was to be repayable to InterX by 30 June 2001, the remaining £16M still being due back to InterX by 31 December 2001 or the receipt of earlier outside funding. A further consequence of the investment was that Mr Barker became a member of the board of Diligenti. While this investment was being concluded, InterX's share price (which had been as high as £40 in March 2000) had fallen to £8.20, and was to fall to £1.015 by 5 April 2001, a decline of some 88% since the point of the appellants' investment.

101 The circumstances indicate that there may well not have been any other source of funding for Diligenti available. Although the investment by the appellants was presented as allowing the Diligenti management to concentrate on the business rather to be diverted into the effort of fund raising, InterX itself had been under pressure from its bankers: on 12 June 2000, when the

working capital report prepared by Arthur Andersen for the board of InterX was considered it was recorded that "neither NatWest nor Barclays had been prepared to provide a working capital facility to the Group. Accordingly, it was necessary for the board to prioritise the working capital available." The initial plan had been to invest some £28M in Diligenti but, as a result of InterX's bank refusing it a loan of £20M, the entire project with regard to Diligenti was put in jeopardy. It will be recalled that it was following this that the taxpayers' undertaking referred to above was given to the board of InterX to put in £10M if no-one else could be found to do so.

102 In September 2000, at the request of NatWest, the board of InterX authorised guarantees to be given by the company in respect of its banking liabilities. There is no indication that the possibility of raising the necessary funds for Diligenti elsewhere had been considered a serious option, though Mr Barker was still "peeved" at having to find the money himself: because of the £10M he had made from the sale of InterX shares in March 2000, Mr Barker was facing a personal tax liability of some £3.3M already, and having to find another such sum was not improving his cashflow position when he was also engaged in building a house. On the eve of the investment in Diligenti, the board minutes of InterX record: "The board was grateful to [the appellants] for providing funds to enable Diligenti to pursue its strategic objectives and enabling the board of Diligenti not to be forced into a fundraising exercise at this critical stage of the company's development".

103 Mr Hancox, the independent director and chairman of the audit committee, resigned at this meeting, but not before making what Mr Miesegaes recalls were "a whole load of comments about what needed to be done in relation to holding Diligenti to account". Mr Hancox, whose background was at Charterhouse in investment, took the view that subsidiary companies in the United States were often difficult to control and he seems to have been very much of a 'hawk' in regard to Diligenti.

The crisis at InterX

104 Over the Christmas recess of 2000, Mr Barker reflected on the progress InterX had made since its decision six months earlier to change from being a hardware distributor to concentrating on software, and he was not pleased with what he concluded. In particular, Mr Barker wrote himself a presentation which he called the 'wake up and smell the coffee' presentation, which analysed where InterX stood from a technology perspective; it showed that InterX had had essentially the same number of customers at the start of the last year as it had at the end, and that there was virtually no market for the products they were trying to sell, principally BladeRunner.

105 The technology was simply too expensive at £350,000[8] plus a £1-2M implementation cost.[9] Under pressure, Diligenti had purchased a licence for BladeRunner in November 2000 at the discounted price of £300,000, but they never made use of it - though it seems that they did pay for it. The new CEO Mr Crawford was, in Mr Barker's view, not equal to coming to terms with the situation and developing a new strategy to deal with it. Moreover, there was a degree of friction between the two men, and indeed between Mr Crawford and others at InterX. At the same time, pressure was being put on Diligenti to make a repayment to InterX of at least part of their loan. According to Mr Barker, InterX needed "major, major changes".

106 Matters came to a head at the board meeting on 13 February 2001 when Mr Barker, and two others including InterX's CFO Mr Simon Miesegaes, said they were minded to resign; after discussion it was agreed that Mr Crawford should resign and that Mr Barker should succeed him as CEO. A new strategy for InterX was thus of urgency, together with a plan to handle the market reaction to Philip Crawford's sudden departure. The market reaction was bad: InterX shares fell 57% at once and by 5 April they had fallen over half as

[8] The price is variously given as £350,000 or £400,000.

[9] BladeRunner had to be reduced to a simplified and less expensive version by InterX and was then marketed in the summer of 2001 as 'Net 2020'.

much again; on 15 February the Guardian described InterX's plans as "in [10]tatters"; the Financial Times said that analysts believed that there could be a bid for the company, and by 16 March the paper was expressing the view that "InterX is in a terrible mess" and recommended "sell down to the net cash balance".[11]

107 On 22 March, Mr Stafford said in a formal written report to the board of InterX on Diligenti's progress that the company "has continued its good start" and had "rapidly moved to close and integrate [its acquisitions] into our unique business model" and proceeded in the same optimistic and confident tone to conclude: "We thank you for your confidence in Diligenti and its people and hope that you will continue to support and follow the development of the company". It was simply noted that the report was reviewed and that Diligenti was trading satisfactorily; in regard to an "exit route" from that company, it was suggested that it could perhaps sell 24%[12] of its holding in HESc to repay InterX's loan, but the loan would be repaid by the end of December 2001.

108 On 27 March 2001, InterX announced the results of a strategic review which Mr Barker as the new Chief Executive had undertaken following Mr Crawford's departure. A major change was that InterX would cease to market BladeRunner but develop products based on the BladeRunner platform capable of easy and prompt implementation. In addition to its direct sales, InterX would henceforth engage significant numbers of partners such as resellers, system integrators and consultants, management consultancies, complementary software vendors, infrastructure providers and internet service providers. Mr Miesegaes testified that nobody thought that this change would affect the value of Diligenti.

[11] By March 2001 InterX's cash balance was some £26M.

[12] The figure was probably suggested to leave Diligenti with an overall 51% control of HESc.

109 There was indeed no mention of Diligenti and the implication was that it would no longer be relied upon as a main shop window for InterX's products. As regards Diligenti's health, however, the implication was if anything positive: no adverse comment was made, and the review contained detailed cashflow projections for the whole business which did not identify any problems with Diligenti. The public announcement of the strategic review indicated that it had involved "an appraisal of all areas of [InterX's] marketplace, assets and business principles", implying that nothing had been found wanting which did not figure in the review's proposals.

Diligenti adrift

110 Diligenti's projections for 2001 had shown a peak cashflow requirement for some $25.6M in September of that year and the need for $15M more than the appellants had invested, but in the light of what was happening there was no intention on the part of InterX to give Diligenti any more money; indeed the opposite was the case, with InterX still hoping that its loan would be repaid out of fundraising by Diligenti: the board minutes of InterX for 17 January show Mr Barker being requested to explore ways an early redemption of the loan together with a sale of the InterX shareholding.

111 Given the situation at InterX, the loose rein on which Diligenti had been held in 2000 became, in the early months of 2001, looser still. Mr Barker's evidence was that he did not have any discussions with the Diligenti management around this time and simply said to them "I'm rather tied up at the moment, just do the best you can"; his evidence to us was that he "did not look at any detail with regard to Diligenti trading activity until when we started looking at the accounts in August/September time, 2001". The same was the case for Mr Miesegaes whose involvement with Diligenti to the end of March 2001 was "minimal"; he did not have the time to attend to it and also deal with the crisis at InterX: "[Diligenti] has got a PriceWaterhouseCoopers partner as one of the top ten. You must be able to park that and rely on them to get that business up and running". A major strategy review was taking

place at InterX and numerous redundancies were being made in an effort to restore the company to profitability and to regain the confidence of investors. Such information as reached InterX about Diligenti was what the management of that company offered in generalised and optimistic terms.

112 The result at the time was that Diligenti's progress continued to be reported in the board minutes of InterX favourably. On 22 February, it was noted that "Diligenti continues to perform ahead of its targets" and on 22 March that Diligenti was "trading satisfactorily" and that the loan would be repaid by the end of December 2001; perhaps the repayment could come from a sale of some of Diligenti's interest in HESc, the last US company Diligenti had bought and the most promising of them, not least since some of its shares (Diligenti did not own all the shares) were publicly traded on NASDAQ's 'pink sheets' and were thus relatively liquid. But Mr Barker commented in evidence that, already at this point, "I suspect we probably knew that we that we weren't going to get our money back at the end of June".

113 It was later discovered however that the reality was very different and that the management had consistently failed to inform InterX about the true state of affairs at Diligenti. Mr Barker's comment was that "the business that was represented [in the Diligenti management presentation] in November 2000 was not the business that was the real business". Examples of this were numerous: the various businesses acquired by Diligenti had not been (and were not to be) integrated, either financially or technologically, in spite of claims to the contrary, and very serious errors in financial reporting were being made; a contract with 14,000 farm suppliers of Danish bacon never happened; a "strategic alliance" with Cambridge university to "ensure that we are at the forefront of innovation" turned out to be a promise of sponsorship for a research student in human genomics which never happened. Substantial revenue opportunities were promised from business with Tesco, Royal & Sun Alliance, Danish Crown and Novartis, but none of them materialised.

114 Mr Miesegaes commented too that when he was investigating matters closely in the summer of 2001 he would find that "you got a nice piece of gloss on top from Mr Stafford which is, 'yeah, we are right in with Tesco and Tesco think we are the best thing since sliced bread', and you think 'gosh, that's a real nugget, that's great'; and then you dig and find that there's nothing written with Tesco". Mr Miesegaes's comment on the Diligenti management, Neil Stafford and Chris Spanoudakis, expressed a strong feeling of exasperation; for him they were "the Big Time Charlies trying to create this business without rolling their sleeves up and doing the detail and seeing: what have we got here and how are we going to deal with it?" At the end of his evidence, Mr Miesegaes was asked why these two highly rated men had ultimately failed: he replied that he did not judge them to be dishonest but they had had no previous experience of running a business; what was needed was practical people and their problems were "denial [of the mounting crisis] and incompetency and absence of executive management".

115 Mr Barker, after he had later discovered what had really been happening, described much of what the Diligenti management were reporting as "brochureware" – in other words, unreliable exaggerations, optimistic projections and general sales talk, rather than hard facts. In particular, the revenue projections for the best of Diligenti's acquisitions, HESc, were wildly optimistic. In that regard, Mr Miesegaes said that it was not until he had gone out to the United States in the summer of 2001 that "I suddenly realised that there is nothing – it doesn't really exist" – with the exception of the business carried on by HESc - "the only revenues we had were in [HESc] and that was losing money hand over fist".

116 The obscurity which surrounded the real position at Diligenti had other repercussions. For the purpose of valuing share options in Diligenti, it was necessary for tax purposes to place a value on the shares in the context of the enterprise management incentive scheme for two new employees, who were to have options for 750 shares each. PriceWaterhouseCoopers accordingly wrote to HMRC on 30 January 2001, admitting that there no financial statements

available but proposing a share price of £26.66, discounted by reference to the smallness of the holdings and the decline in internet-related stocks to arrive at £13. That price was accepted by HMRC.

117 A similar request was made on 30 May 2001, but for approved options again for small holdings. There were still no financial statements, but there were consolidated management account details to 31 March and the appellants' investment of December 2000 (which had not been recognised in the earlier request) now there to go by, and a price of £285 per share was proposed. The Revenue were surprised by the value of £303 per share arising from the December investment and expected a greater discount, but finally agreed £285. Mr Miesegaes confirmed that he was not approached in either case and that, as far as he was aware, there was no question of any due diligence having been done in relation to these valuations.

118 At the end of March 2001, reliable figures for revenue were not available: "you might" commented Mr Miesegaes "have been given something, but it would not have been a piece of paper you would have had any confidence in. ... In terms of getting to the true financial position I would have needed a crack team of people to come in and I would [..] have sent in a PWC or KPMG with international exposure saying I want you in every subsidiary tomorrow, I want to know that position, I want it in a week; and it costs hundreds of thousands of pounds to do, that but that is what you would do".[13]

[13] The report by Messrs Miesegaes and Carter on HESc in October 2001 noted however that "all the financial information that an executive team could need to make financially sound business decisions has been available since March 2001." This was the sole exception.

119 On the basis of information available at the time (but much of it only confirmed later) it is known that the Diligenti group's burn rate in the first three months of 2001 was £1.706M in January, £2.182M in February and £0.955M in March.[14] The figures for the best company, HESc, for the three months showed net losses of $402,000, $581,000 and $954,000. Turnover was 34% below forecast. By 31 March, £13.8M of the InterX loan had been drawn down leaving somewhat more than £2.8M left to come, and there were cash balances of just over £5M; but, at the cash burn rate since the start of 2001, Diligenti would run out of cash by 30 June (when it would also have to find the £10M needed to make its first repayment to InterX). There was no adequate accounting system in place at Diligenti, and there would not be one until Mr Miesegaes had time to take the situation under control in the spring and summer of that year; before that, the management accounts, such as they were, were being produced on a spreadsheet model driven by the bank statements and were a long way behind.

120 The position of Diligenti's other subsidiaries were worse than the overall picture suggested. Despite a forecast in November 2000 of revenue of £1.4M for the first half of 2001, ClinNet's actual revenues were just £172,372 with a loss of £629,045. EasyChem's turnover had been forecast at £13.5M in November 2000 based on having secured a valuable contract with Novartis, but it had not in fact done so; its losses for the first half of 2001 exceeded £800,000. Club Medical in France appeared to be scarcely functioning at all. Q Global's actual turnover for 2001 was a mere £21,000, less than 1% of forecast. The exact picture for each of the subsidiaries up to 5 April 2001 would have been available then but only, it is clear, after significant research.

[14] Another source gives the figures for February as £2.022M and for March as £1.257M.

Diligenti's problems come into the open

121 By 18 May, Mr Barker was still reporting to the board of InterX that he was "satisfied" with Diligenti's progress, but his information remained dependent on what the Diligenti management chose to tell him and he was becoming aware that they were in fact behind targets. Messrs Stafford and Spanoudakis were claiming that they were pursuing a number of funding options, among them one from a large American company, to raise between $21M and $45M. Mr Barker said that, by May 2001, he realised that he was "not giving Diligenti the time I needed to" and asked Mr Miesegaes to get more involved. From then on till September or October that year, Mr Miesegaes and his team began to investigate Diligenti's finances ever more thoroughly, going out to the United States to do so and producing management accounts in August.

122 The first stop was Diligenti's offices to examine with its financial controller Mr Tim Gardiner each accounting unit and the group structure overall. It was a complex group with a number of companies in the United States and France whose financial reporting needed to be integrated but had not been, and without group systems for the treatment of associated companies, subsidiary companies, goodwill, dates of acquisition, revenue and profit and loss analysis and foreign currency movements. The financial accounting at all levels was weak. The burn rate of the various subsidiaries, essential to gauge whether a company was trading profitably, could not have been discovered without going to each set of local bank statements. Mr Miesegaes considered that that Mr Gardiner, though "very, very honest" was out of his depth. Such elementary matters as having a 'Bible' of the acquisition documents for each subsidiary had not been attended to.

123 Apart from the systemic failures in financial control, Mr Miesegaes discovered specific examples of serious mistakes being made. Thus, in the original balance sheet for 31 March 2001 the liability to InterX of £13.8 M (including interest) was shown as a long term liability, whereas it was

repayable by 31 December 2001 at the latest (and £10M of it potentially by 30 June) and a proper accounting treatment of it would have been to classify it as a current liability. The treatment of goodwill was another example: stated at 31 October 2000 to be £9.2M, it increased at 30 November 2000 to £14.6M and by 31 January 2001 to £15.6M, following two major acquisitions. But by 28 February 2001 goodwill had inexplicably risen to £20.6M without any further acquisitions to justify it, and had to be reduced again by nearly £5M to £15.8M, where it remained.

124 No accounting policy had been formulated in respect of writing off and impairment of goodwill at a time when businesses in the internet sector were continuing to fall sharply. Other examples of bad accounting were found, as in the treatment of minority interests where errors of up to three quarters of a million pounds took place. As for foreign currency movements, Mr Miesegaes's view was that Diligenti's financial controller "never fully understood" how to deal with the issues. Overall, it remained impossible to know what the real financial position of Diligenti was at any single point in time.

125 The position was not helped by a less than cooperative attitude on the part of Mr Stafford and Mr Spanoudakis who were, Mr Miesegaes found, "very protective of their environment and what they were doing and they didn't want somebody to upset their status quo". This factor and the need not to provoke an open contest with the Diligenti management, was in particular responsible for the hopeful tone which Mr Miesegaes adopted in his report that autumn on the possibility of saving HESc. As bad as the accounting failures was that Diligenti had no Chief Technical Officer, so that the task of meshing together the technologies in the group was neglected; in effect, each member operated much as a stand-alone.

126 By 30 June Diligenti's cash balances had reduced to £2.7M and by July, Mr Barker and Mr Miesegaes had become increasingly concerned at the timeliness and accuracy of the financial information emanating from Diligenti

which was “bleeding cash at an alarming rate” and they had evidently given up hope of any repayment being made by the end of June. Further fundraising was now becoming urgent and it appears that Diligenti was already in touch with Deloitte & Touche about it and that it had been recognised that the “pull-through” could not be exercised at the same time. Mr Barker’s comment was that “if they are out there fundraising, to have the major investor, in terms of cash investor, pulling money out is the death knell of any successful fundraising venture”. Mr Miesegaes said the same: “investors don’t like putting money in if somebody is sucking it straight out, you know, because they think ‘Do they know something I don’t know?’ ”.

127 On 13 July, Mr Miesegaes commented to Diligenti that with cash at the end of May at £2.7M and further funds due from InterX of about £3M, the company had enough cash until the end of September, but that by August or September Diligenti might be starting to trade while insolvent. Mr Miesegaes’s concerns had grown and he minuted Mr Spanoudakis that he thought Diligenti’s financial controller seemed not to know what the financial numbers he was producing meant, that he was making some basic errors and was probably overloaded with a weak team under him; Mr Miesegaes urged that cashflow forecasts should now be prepared at least weekly and adverted to the need to be aware of the danger of trading while insolvent.

128 In August, Mr Barker had “stopped any inclination to believe what they were telling me”. Optimism about fundraising, however, continued to be expressed by Diligenti. On 7 August Mr Miesegaes was appointed to the board of Diligenti; the minutes of the meeting noted that Deloitte & Touche were appointed for the fundraising exercise. They were said to be “extremely positive” about the prospects for fundraising and thought it would be complete by the middle of October, based on a valuation of Diligenti of some $250M. This was fed through to InterX two days later as a prospect of raising $21M to $45M on a valuation of $250M to $500M; the board considered making provision against the non-repayment of the loan, but decided that it would be premature to do so.

129 Mr Barker told us that he believed that this was not “an accurate representation of the state of the company or the state of the fundraising process” and that the report from Diligenti “had been overegged to get to the conclusion” that InterX had little to worry about and that there was a “deliberate misrepresentation”. It may have been: the information given to InterX was certainly of the unjustifiably optimistic sort consistently reported by Diligenti, but the Diligenti management were not before the tribunal and we do not feel able to make a finding that there was a deliberate misrepresentation.

130 Mr Miesegaes in the autumn made several trips to the United States with a colleague Mr Paul Carter to visit the various Diligenti owned businesses there in Parsippany, New Jersey, Kansas and Sarasota. These were all loss-making businesses burning large amounts of cash and with no sense of belonging to or operating as part of a single group. Mr Miesegaes found that their executives had little or no confidence in Messrs Stafford and Spanoudakis and were relieved to see people taking a serious interest in what was happening; even the Chief Executive Officer of HESc reacted in this way – the business was merely “ticking over”, in contrast to Neil Stafford’s forecasts of a huge jump in turnover.

131 By the autumn HESc itself was on the verge of bankruptcy, with a turnover of about \$18M (rather than the \$60M forecast) and “bleeding cash at hundreds of dollars a month”. On 13 September the Diligenti board noted that the fundraising was “not going particularly well”, the possibility of direct investment into HESc by way of convertible promissory notes by the appellants totalling £1.5M was discussed, and Mr Barker was very encouraged that Messrs Stafford and Spanoudakis expressed themselves willing to invest £250,000 each. But on 18 September, Mr Barker was telling the board that it “did not have the financial information available to it to be able to make any decision as to how the business should be run over the next two to three months or whether in fact the business should be closed down immediately in

order to avoid further losses being incurred at a time when the company could be technically insolvent".

132 The matter was reported to the board of InterX the next day and Mr Barker was authorised to tell Diligenti that they had lost the confidence of InterX; there was now a need for InterX to get "materially involved" in the business of Diligenti. By October, the Diligenti management admitted that they could not repay the InterX loan by December 2001 – the original longstop date – but with the new funding expected it would now be in the first half of 2002. Since HESc was the only one of the businesses that seemed to have any prospects, Mr Miesegaes and Mr Carter prepared a report specifically about it at the beginning of October in which they said "We believe in the future success of the Exemplar[15] business".

133 Mr Miesegaes was pressed hard in cross-examination on why he had given a positive tone to this report and he conceded that he had been desperate to salvage something from the wreck of Diligenti, and had been in denial himself that HESc also was effectively past recovery and that his judgment had failed him. HESc was still losing cash; additional funding was needed even to pay the October salaries; the shares had been downgraded from the NASDAQ Bulletin Board to its Pink Sheets, due to non-compliance with statutory reporting to the Securities and Exchange Commission; the net loss in the eight months to 31 August 2001 was $5.148M[16]; the aged debtors were now at some 26% of the book; and the company would struggle to meet $20M of revenue for 2001 ($100M had been forecast at the November 2000 presentation to the InterX board).

[15] HESc had by then changed its name to 'Exemplar'.

[16] Including $402,000, $581,000 & $954,000 in January, February and March 2001.

134 Nonetheless, new funding for HESc was recommended. The report was put to the board of Diligenti on 17 October. Mr Spanoudakis who chaired the meeting announced that he had not himself read it, saying that “he was unsure to whom it was addressed”. Nonetheless, practical decisions were taken on an examination of it, including the recruitment of a chief financial officer, the updating of the statutory returns due to the Securities and Exchange Commission, the payment Deloitte & Touche as auditors and – bizarrely - a clear attempt to exclude InterX participation on the board for the future. And it was agreed to seek more funding since the September results showed a loss of over $700,000. Messrs Barker, Harper and Wickes subsequently invested about £500,000[17] each in convertible promissory notes issued by HESc in December 2001; Messrs Stafford and Spanoudakis did not invest either in HESc or in Diligenti.

Diligenti’s insolvency

135 The beginning of the end came in January 2002. At a board meeting of Diligenti on 8 January 2002 Mr Stafford formally stated that the fundraising activities in relation to all the business except HESc “had not been successful and that there were no further prospects that might reverse this situation in the near future”. Apart from the case with HESc,[18] there were insufficient funds to continue the loss-making activities of the Diligenti group without further investment. In view of InterX’s position as a secured creditor and a significant shareholder, it was agreed that Diligenti should now provide “detailed access” to its financial and management information and the winding up of all loss-making activities was commenced.

136 In a formal letter dated 29 January 2002 from InterX to Diligenti, the latter were informed that “following an analysis of Diligenti’s financial information and discussion with our legal advisers, we have concluded that

[17] $705,000.

[18] HESc had completed its own fundraising in December 2001 which had secured its immediate future, but it did not provide scope for the repayment of the Diligenti loans.

Diligenti is insolvent, at least on a cashflow basis and possibly also on a balance sheet basis” and a Creditors’ Voluntary Arrangement – a ‘CVA’ – was proposed. It was estimated that the preferred creditors would receive payment in full, though unsecured creditors would receive nothing. On 7 March, the board of Diligenti approved the adoption of a CVA.

137 Mr Barker summed up the effect of the Diligenti venture in these terms: “Rather than using the money invested in the business to deliver the original vision of Diligenti, the money had been badly invested in loss-making business without any attempt at integration and inappropriate expense accounts. Worse, the original vision of Diligenti had not even been validated. £30M was gone with almost nothing to show for it.” Thus, the “electronic Oxo Tower” concept had not been made good, and there was therefore nothing there which could be used to attract an investor’s interest, even despite the financial state of the company. According to Mr Barker, the CVA had been the only fair option at the time: if Diligenti had gone straight into administration and had simply been shut down, none of the creditors would have got anything.

Expert witnesses

138 We received evidence from four expert witnesses: for the taxpayers, Messrs Badri Nathan and Keith Eamer, and for the Crown Messrs Jerzy Wielechowski and Christopher Glover. Inevitably, criticisms were made by opposing counsel of the qualifications or reliability of the witnesses on matters of detail, and where the objections seemed to us of major importance we have reflected them in our conclusions. Overall, we were materially assisted by the expert evidence given.

The expert evidence - *Mr Nathan*

139 The first expert to give evidence was Mr Badri Nathan, who had been asked to brief Mr Keith Eamer, the second expert witness, on the factual context of the valuation. Both were instructed on behalf of the taxpayers.

140 Mr Nathan held a BS degree in electrical engineering and computer science from the University of Colorado and an MBA degree from the Wharton School of the University of Pennsylvania. Principally, his expertise relevant to the appeal had been gained (i) at Amadeus Capital Partners in London from 1998 to 2001, where Mr Nathan managed a portfolio of companies focussing on communications and software technologies; he described Amadeus as one of the top venture capital funds; and (ii) at Texas Pacific Group from 2001 to 2003, described as the largest or second largest investor globally in venture capital including private equity, where he was a general partner and the European managing partner. Mr Nathan declared that he was a business colleague of both Mr Barker and Mr Harper, he knew Mr Wickes socially, and he said he had volunteered his services in this appeal unpaid.

141 Doubt was cast on Mr Nathan's suitability as an expert witness in two respects: first, since 2003 he had been carrying on a debt factoring business dealing in distressed debts bought from banks, and thus had been out of the sector for some time and, secondly, he had never before been an expert witness before a court or tribunal, or had had any experience of fiscal valuation. In addition, it was submitted that care was needed in regard to Mr Nathan's evidence in view of his close connection with the appellants.

142 Nonetheless, Mr Nathan could speak on the basis of his experience as a venture capitalist, as a high net worth individual investor himself and as having worked alongside such investors, particularly in start-ups, during the 2000-2001 period; much of his evidence was pertinent to the issues and drawn from knowledge of events in the periods concerned. Having seen him in the witness box and under cross-examination, we found no reason to doubt Mr Nathan's honesty or his independence of mind.

143 In terms of a market overview for this sector Mr Nathan's evidence was that at the end of 2000 the market had crashed: the NASDAQ composite index (the primary public market for companies in the technology and life sciences

sector) went from a peak in excess of 5,000 in March 2000 to less than 2,000 in March 2001, and continued to drop during that year; between 1 January and 5 April 2001, it fell 30%. That led to a collapse in the availability of venture capital funding, creating 'orphan' companies where the lead investor found himself unable to support ongoing funding requirements. Given the size of the holdings – 2.49% of the issued capital – there would have been no ready market for the appellants' shares in the first quarter of 2001.

144 The fact that these very small holdings would offer no prospect of real influence, let alone control of the company, meant that they would be particularly unattractive to an investor of any sort. Taken together with (a) the fact of Diligenti's negative cashflow, (b) the June 2001 deadline for repayment of £10M to InterX, and (c) the troubled state of the major creditor InterX (apparent from their share price, if nothing else), indicating that they were unlikely to be a long-term funder, the only prospective purchasers would be friends and family of the vendors buying for non-commercial reasons, or people who might possibly buy the shares as a speculation without knowing what was really going on.

145 On the matter of fundraising, Mr Nathan was categorical. In regard to the looming repayment due under the "pull-through" on 30 June, he was asked if a statement by InterX that they were not expecting payment then would make a difference. Mr Nathan's reply was: "If [InterX] were willing to give me a legal undertaking to extend the loan or cancel it then that would be different. But I wouldn't, without comfort that it was going to be there, no new investor would come in. I can't imagine me coming in knowing that the money could be pulled out, I would want to get some sort of agreement, binding agreement, that basically they waived their rights to call the loan".

146 Turning to the specifics of Diligenti, Mr Nathan said that any investor would be unimpressed by Mr Spanoudakis's background as a 'rainmaker': his comment on Mr Spanoudakis was "He was a fund raiser for an accounting firm. That doesn't give him any credibility in terms of running a start up or

running a corporation" - a view which, we note, was consistent with Mr Miesegaes's assessment of why Diligenti had failed. Due diligence on the part of a venture capital fund would certainly be rigorous and reveal the unhappy state of affairs described above; in so far as a private, high net worth, individual was concerned the due diligence might well not be so detailed but such a person would be much more affected by the prevailing negative sentiment towards the sector and the end result would therefore be much the same.

147 The favourable or optimistic statements in the various board minutes would be treated with scepticism since a cautious investor would only expect to see positive comments in such a place – companies knew that board minutes were open to inspection and generally took care accordingly. (The same would, on this basis, we think be true of Mr Miesegaes's October 2001 report on HESc.) Management expressed optimism would not be significant either: Mr Nathan concluded "you literally have to prise their fingers off [the business] at the very last moment because they will be trying until the day that they come in, the receivers come in, because they are trying to keep it alive somehow, but a more sane investor, a more dispassionate person will look at it and say that it's not going to be possible". If Diligenti had never been able to meet any of its previous forecasts there would be little or no confidence that it would do so going forward.

148 We note that Mr Nathan, in spite of the fact of his present close association with the appellants, did not recoil from describing Mr Barker's attitude in regard to his dealings with Diligenti as not "prudent".

The expert evidence – Mr Eamer

149 The second expert witness, who to a very limited extent built upon the evidence of Mr Nathan, was Mr Keith Eamer.

150 Mr Eamer held a BA degree in law from the University of Kent at Canterbury, had worked in the Capital Taxes Office of the Inland Revenue

between 1974 and 1988, including five years in its Share Valuation Division; then between 1988 and 1989 as a share valuation manager at Coopers & Lybrand, between 1989 and 1999 in the same capacity at Moores Rowland, and from 1999 to 2009 as Director of Business valuations at BDO Stoy Hayward following their merger with Moores Rowland. Mr Eamer was a founder member and former council member of the Society of Share and Business Valuers, a founder member of the Expert Witness Institute, a member of the Society of Trust and Estate Practitioners, a Fellow of the Royal Institute of Chartered Surveyors and the editor or co-author of four editions of *Practical Share Valuation* as well as the author of many articles on share valuation in professional journals.

151 Mr Eamer's evidence considered the basis on which Diligenti had been established, compared the forecasts with the position at 5 April 2001 and the value of Diligenti's investments then, reviewed market conditions at that date and the cash position at that point, and examined in detail the position with regard to each of Diligenti's businesses. It was noted that the investment made by the appellants effectively resulted from the absence of any alternative source of funding, and the crisis at InterX in early 2001 and the falls in its share price were then examined and the conclusion reached that the market capitalisation of InterX at 5 April put the value of its equity in Diligenti at nil.

152 Mr Eamer, as Mr Nathan had done, noted the sharp decline in the NASDAQ index over the 12 months to 5 April 2001 and added that a similar pattern was shown by the London Stock Exchange TechMARK index over that period, declining from 5,718 at the beginning to 1,764 at 5 April 2001.

153 On due diligence, Mr Eamer agreed that a potential purchaser of the shares would have examined the price paid by Diligenti for each of its investments, considered how the value might have changed in the meantime due to market conditions and the progress each had made by comparison with their forecasts in November 2000. In particular, a potential purchaser would look at the additional intangible value of £118M added by the appellants'

investment and questioned whether it still had substance in the light of the failure of the BladeRunner project, together with Diligenti's failure to implement any form of integration across its investments; and he would note that the investment in December 2000 had been determined by Diligenti's need for funds and did not necessarily equate to the price that would have been paid at the time for existing holdings of that size.

154 Mr Eamer's evidence continued that by 5 April 2001 Diligenti had been unable to secure any further funding; that any that was secured would have to be used to repay the first instalment of £10M due to InterX on 30 June (and although InterX might have given up hope of getting their money then, that fact would either not get through to a purchaser or he would be inclined to discount it); that the value of all the companies owned by Diligenti with the exception of HESc was nil, and that HESc's goodwill would be no more than £1M. The net asset deficit in Diligenti's balance sheet at that date would therefore be £9.452M. At 5 April, it was clear – both generally, and from InterX's own strategy announcement on 27 March - that the BladeRunner technology could not now be expected to bring value to any of Diligenti's operations and that Diligenti had not adopted any other form of IT integration.

155 Concluding that the value of each of the appellants' shareholdings at 5 April was worth no more than £1, Mr Eamer summarised his opinion as follows: (i) any additional intangible value that had been due to prospects for the BladeRunner technology had disappeared since the sidelining of that by InterX in March 2001, (ii) market values for the types of investment made by Diligenti had had fallen dramatically since they were made, (iii) the forecasts for the first quarter of 2001 had fallen well short, (iv) the 'enterprise value' of InterX at 5 April showed that the market put no value on InterX's investment in Diligenti, and (v) Diligenti was running out of cash and had little prospect of finding new sources.

156 Mr Eamer reviewed the criteria applicable for valuations on the basis of section 272 alone, or on the basis of section 272 and 273, and reached the same conclusion on either approach.

The expert evidence – Mr Wielechowski

157 Evidence for the Crown was given by Mr Jerzy Wielechowski and Mr Christopher Glover.

158 Mr Wielechowski, prior to his retirement in 2001, was for thirty years a member of the London Stock Exchange, whose examinations he had passed; he had spent nearly ten years in the seventies as an investment analyst working within the stockbroking division of Phillips & Drew, then twenty years in institutional fund management with Phillips & Drew Fund Management (latterly UBS Asset Management) which was responsible for managing over £50bn of assets by 2000, and he became a director in 1986 and Head of Corporate Governance in 1996. Mr Wielechowski made it clear that his experience as an investment analyst was with quoted companies and that he had had no experience with unquoted technology stocks.

159 Since 2001, Mr Wielechowski has been a part-time adviser to and a member of the Supervisory Board of Sterling Strategic Value, described as an investment fund in Switzerland specialising in corporate governance opportunities in SMEs in the United Kingdom and elsewhere in Europe.

160 Mr Wielechowski's evidence was prepared on the basis of his responses to four questions. The first question was: to what extent would adverse contemporary market sentiment existing at the valuation date, following the decline since the highpoint of the dot.com bubble in 2000, have affected the market for shares in Diligenti?

161 In regard to this, Mr Wielechowski conceded that he knew no more than any interested reader of the newspapers and financial publications would know. He noted, however, that the NASDAQ index had peaked on 10 March

2000 at 5,048 and fell to a low of 1,114 in October 2002; in between, there were periods of "great volatility" but also "volatile periods during which there are opportunities to make money as well as lose it"; undoubtedly the bursting of the bubble would have had a negative effect on attitude to Diligenti's shares; from the start of the year to 5 April 2001 the 30% fall in the index resulted in people getting much more cautious, worried and even frightened. In its favour, however, would be the fact that the company was not a "pure play dot.com", since its acquisitions were not essentially high-tech but publishing and service operations in the life sciences sector. It was more of a roll-up of existing businesses than a start up in the usual sense. In particular, the prospects of HESc were "presumably not solely dependent on growth via the internet".

162 The second question was: how would a prospective purchaser of a 2.52% holding in Diligenti view InterX's interest in Diligenti and the loan facility? The key features were that InterX was the largest shareholder after management and the holder of a £16M convertible loan facility. A prospective purchaser would take account of the fact that InterX was unwilling – indeed unable – to commit any funding to Diligenti beyond that provided for in the Funding Agreement. But the purchaser would also take account of InterX's second quarter results issued on 7 March 2001 showing the loan drawdown increased from £9.9M to £13.3M, and its Strategic Review in March 2001 which made no mention of Diligenti. In the absence of adverse comment on Diligenti, it might reasonably be assumed that all was well; that, and the fact that InterX still had a cash holding of £26M in March 2001, would suggest to an investor that there had been no material change in InterX's ability and intention to continue its financial support – the drawdown indeed suggested that the two companies were "hugging each other even closer", which would be reassuring to an investor.

163 The third question asked what InterX's reporting obligations to the City were in so far as the value of its investment in Diligenti was concerned. Here Mr Wielechowski believed that the then current Listing Rules obliged the

directors of InterX to announce to the Stock Exchange at the earliest opportunity any information they had concerning a possible major diminution in the value of their investment. Mr Wielechowski was not explicit about whether he thought that obligation had been complied with or not in March/April 2001, though we infer that he thought it had.

164 The fourth question was: what conclusions can be drawn about the value of Diligenti's shares from the stock market value of InterX's shares at the valuation date? Mr Wielechowski considered that the market value of a quoted parent company often fails to reflect the value of underlying assets and trades at a discount to net asset value, and it is indeed for that reason that investors often buy into quoted shares believing there to be a profit to be made accordingly. Mr Wielechowski's conclusion was that there would be no necessary connection between the market value of InterX and the value of Diligenti's shares. In particular, Diligenti's failure to sell any BladeRunner licences to third parties would not affect its valuation.

165 Mr Wielechowski was strongly critical of Mr Eamer's use of the concept of 'enterprise value' to conclude that Diligenti was valued at nil by the market. In Mr Wielechowski's view, that approach was intellectually incorrect: the assets of an owned or associated company should be valued first and then compared with the stock market value of the parent to see whether the latter was in fact an undervalue, having regard to the value of the parts. To do the exercise top down was, in Mr Wielechowski's view, to make it meaningless.

166 Nor was it easy to envisage that shares put at £303 each in December 2000, when the Appellants had invested, had become worthless by April 2001. When it was put to him that an investor might choose to put money into a company by way of equity, but without supposing that the shares were at that moment necessarily worth the money that was being invested, Mr Wielechowski replied that if someone asked what the shares were worth the "only answer you have got is that yesterday the shares were traded, were sold, and that seems to me the relevant thing". However, when Mr Wielechowski

was asked whether he thought InterX's failure subsequently to exercise their option under the Funding Agreement to convert their loan into shares at £64 in December 2000 – an obvious bargain compared with what the Appellants had paid – implied a lower value, he replied that he had not considered the point.

The expert evidence – Mr Glover

167 Mr Glover is a chartered accountant, holds a masters degree in International Banking and Financial Studies and has passed the Stock Exchange examinations; he is the author of *Valuation of Unquoted Companies*, now in its fifth edition, and of *The Valuation of Unquoted Shares* published by the Institute of Chartered Accountants in 2002. Mr Glover has practised as a share valuation specialist for the past 27 years and before that had over ten years' experience in share valuation as an investment analyst with stockbrokers Phillips & Drew and then, specialising exclusively in the valuation of unquoted shares, with Ernst & Young. Acting at various times for both taxpayers and the Revenue, Mr Glover has been an expert witness on matters of share valuation in courts in the United Kingdom, Ireland, Singapore, Austria and the Netherlands.

168 Mr Glover's evidence was that the open market value of a holding of each appellant's shares at 5 April 2001 was not less than £154,000 (£14.66 per share) "and may well have been considerably more". His report reviewed the origins of Diligenti, its financing, the activity of its subsidiaries, the forecasts for turnover and profit/loss, and the position at 5 April 2001 in so far as it could be ascertained by reference to information which would have been available at that time. Valuations on the basis of section 272 and 273, or 272 alone, or on the basis that the shares would be sold in an arm's length commercial transaction but with no presumption that the transaction would be in the open market, all reached the same conclusion.

169 Starting with the latest price put on the shares, the £303 paid by the appellants in December 2000, the prospective purchaser would make

searching enquiries into Diligenti; since there would be no audited accounts at the valuation date, the purchaser would require sight of Diligenti's management accounts, would wish to satisfy himself as to its future funding and would have made proper enquiry into each of the operating subsidiaries, analysing their financial statements, seeing their brochures and acquainting himself fully with their future plans. Very little, Mr Glover pointed out, is now known about the historic or prospective results of Diligenti's investments and there are no annual or management accounts for the various companies and no future trading projections beyond 2001. The due diligence would have involved six figure costs, including perhaps sending a team of accountants to the United States to examine the five subsidiaries - though the case would be different if the purchaser was willing to pay only a derisory, low price such as the £154,000 Mr Glover had arrived at, in which event he would make do with a much less thorough due diligence, or maybe even none at all.

170 In Mr Glover's view, the prospect of an ultimate flotation of Diligenti would have been the main attraction to a buyer of the small block of shares each appellant held. At 5 April, the company held cash reserves of over £5M and had yet to draw down a further £2.2M from InterX, so that it had actually or potentially at that date nearly £7.4M available to it. Both the InterX management and the Diligenti management were in March 2001 still adopting a bullish view of Diligenti's prospects, and expecting there to be no difficulty in Diligenti acquiring its next round of financing. That effectively neutralised the factor that £10M was repayable at the end of June, which there was no evidence that InterX was in fact going to require, and the rest by 31 December 2001. However, Mr Glover conceded that a third party providing renewed funding would not do so if it realised that it would just be pulled through to InterX. If the funding were to be done by way of the issue of preference shares, the same would be the case.

171 Citing post-valuation events which he claimed were admissible as throwing light on the situation at 5 April, Mr Glover drew attention to the value of £285 per share agreed by PriceWaterhouseCoopers with HMRC for

the purpose of the company's approved share option plan in June 2001, to InterX's accounts to 30 June 2001 having included a credit for an unrealised gain in respect of their shareholding in Diligenti[19] valuing the shares at £303.03, to InterX's directors seeing in August 2001 no need to make provision against the loan facility or the value of their equity, to their general satisfaction with Diligenti for at least three months after the valuation date, and to Deloitte & Touche's reported optimism in August 2001 about the prospective fundraising then being considered.

172 Mr Glover concluded that informed professional opinion at the time was that Diligenti's value was considerably in excess of its costs – over four times as much – and the company's shares must have been worth at least their balance sheet value: thus, the net assets and equity funds shown in the unaudited balance sheet as at 31 March 2001 were £6,189,000 which, given the 441,000 shares then in issue, produced a value per share of £14.03, or £154,330 for 11,000 shares; he rounded these figures down to £154,000 and £14 per share.

173 Noting again that "crucial information which prospective purchasers would have required is not now available" Mr Glover added: "It is of course possible that this missing information would show that at 5 April 2001 Diligenti's equity was worthless. But that this perception escaped the notice of Diligenti's directors, the directors of InterX, Arthur Andersen (InterX's auditors) and PWC (who valued Diligenti's shares in June 2001) all of whom had access to this information is, to my mind, highly unlikely."

174 In a supplementary report, Mr Glover strongly attacked Mr Eamer's valuation on the following principal grounds:

- the value of Diligenti's subsidiaries rested on their future prospects but without the detailed forecasts and projections available at the time those

[19] i.e. a notional disposal of the amount by which InterX's holding had diminished as a percentage of the whole following the appellants' subscription of 11,000 shares in December 2000.

prospects could not be assessed (or dismissed) and the approach was too "broad brush";

- the valuation reasoning adopted to conclude that the subsidiaries (apart from HESc) were worthless had not been disclosed;
- in regard to HESc, trades from NASDAQ's Pink Sheets on 4 and 6 April 2001 showed a market capitalisation of between $17.4M and $19.4M, and Diligenti's holding to be worth between $10.9M and $12.2M, whereas Mr Eamer had put it at $1.5M;
- it could not be assumed that Diligenti would not attract funding since no attempt had been made to secure it, and the directors of InterX were confident when meeting on 22 March 2001 that their loan would be repaid on time;
- there was no reason to suppose that the demise of BladeRunner in March 2001 would have any material effect on Diligenti's future prospects;
- although the notion of 'enterprise value' used by Mr Eamer had become a mainstream tool of investment appraisal, it had "no external stock market reality", and the average stock market participant could not have formed a view on the worth of Diligenti since there was no adequate information in the public domain for that purpose;
- there was a "fundamental flaw" in Mr Eamer's approach stemming from his failure to recognise that because so much information on Diligenti and its subsidiaries was not now available it was impossible to be precise about the value of its shares, and there was very little likelihood that by 5 April 2001 they had become worthless.

175 Mr Glover then modified or clarified some of his evidence in cross-examination. With regard to the PriceWaterhouseCoopers' valuation of £285 per share in June 2001, Mr Glover said that it would have been negligent of them not to have gone into the evidence supporting it and he would not expect

that, though he conceded that there were mistakes about Diligenti in their letters to HMRC, suggesting that they had not dug very deeply and that the management of Diligenti had in fact wanted a fairly high valuation reached. Pressed that he had not included a discount to reflect the small minority position of the shareholdings, Mr Glover replied that "technically" a minority discount would be appropriate; he appeared uncertain what the value should be but noted that everybody who looked at the situation at the time thought that Diligenti was a good investment. Mr Glover also noted that due diligences had been done before their acquisition by Arthur Andersen and PriceWaterhouseCoopers on the subsidiaries ClinNet and HESc.

176 Mr Glover also agreed that Diligenti's failure to reach its targets in the first quarter of 2001 would cause concern, in particular that HESc's performance was well below forecast, as would Diligenti's failure to provide a common technology platform integrating their five subsidiaries. Even so, HESc was the business with a clear promise; Mr Glover agreed that anyone wanting to invest in HESc would do so by buying its shares direct rather than buying Diligenti's shares, though he later opined that an investor "could conceivably see an investment in Diligenti as a cheap way into HESc".

177 There was some suggestion in Mr Glover's oral evidence of a personal dislike or disapproval of the appellants, in particular Mr Barker; that possibility was addressed in cross-examination and submissions, and we record that we do not consider that any personal feeling he might have had had any impact on the value of Mr Glover's evidence on the issues.

Conclusions

178 The absence of much contemporary material, especially in regard to Diligenti's subsidiaries, has been noted and undoubtedly hinders the resolution of the appeal. But the difficulty seems to us to be as broad as it is long: on the one hand, it makes it more difficult for the appellants to show the effect on the market of what would be reasonably requested and obtained by a prospective

purchaser and therefore to show that the value of the shares was probably negligible, and on the other it is the more difficult to show the probability that there must have been something there to support all the impressions and conclusions reached at the time that Diligenti's business group had significant value. For example, the fact that Diligenti was falling short of its targets might – or might not – have been susceptible of an adequate or at least a plausible explanation at 5 April 2001, but we just don't know.

179 A possible option for the funding of Diligenti in 2001 was acknowledged to be the issue of preference shares (though there is no evidence that this was actually considered). At first sight, such a development would appear to have negative implications for a holder of the ordinary shares both in terms of dividends and as regards distributions on insolvency; but it is also arguable that the effect on the equity would have been positive in establishing a better basis for growth and demonstrating confidence in the company, thus encouraging a prospective purchaser to view the appellants' shareholdings more favourably as regards their future prospects.

180 The claim by Mr Eamer to use the concept of 'enterprise value' to show that Diligenti was valued at nil by the market as of the valuation date is not convincing. As has been pointed out, such a 'top down' process is not adequate to value specific assets held by a quoted company, and much commercial activity takes place upon investors perceiving that an underlying asset or assets are indeed worth more than is suggested by the share price of a holding company.

181 It is said that an investor, seeking to acquire shares in HESc, might do so by acquiring shares in Diligenti, since the latter might be available at a substantial discount to the former, thus giving value to Diligenti shares. The suggestion is unrealistic because it does not admit the very real possibility that the shares in Diligenti might become worthless and – as indeed occurred – that the shareholders would receive nothing upon liquidation, whereupon the holder of them would retain no link-through to the value of HESc; anyone

desiring to hold HESc shares would acquire them direct and Diligenti's shares would not have been sought for that purpose.

182 Evidently, the tribunal's task in principle is to examine the position in relation to each of the appellants separately, albeit that in practice there is no reason to regard the valuation exercise as different for any of them. The range of potential purchasers appears to us to have consisted of two groups of persons.

183 Group one would be composed of an indeterminate number of high net worth individuals interested in a relatively speculative investment in the technology sector. That there were such persons can be inferred from the fact of the American and British indices of shares in the sector still showing a significant degree of investor activity; despite the heavy fall in the value of the stocks over the previous year, the sector was not by any means dead. We include in this group persons such as Mr Miesegaes and other senior officials of InterX and Diligenti, who were at least at one remove from the inner core of group two. Consistently with the evidence, we see it as unlikely that the range of buyers would include venture capital funds as such.

184 Group two would consist of the three appellants, Mr Stafford and Mr Spanoudakis, and InterX. They were the only persons likely to be willing to consider purchasing with a low level of due diligence.

185 The starting assumption for group one is that they would have regard to the price paid for the shares in December 2000 and would undertake due diligence with that in mind. We conclude that these principal considerations would therefore be taken into account by such a prospective purchaser of the shares at the valuation date, and that such a person would reasonably require, and have obtained before proceeding, the information following:-

(i) The role, or intended role, of BladeRunner in regard to Diligenti. This is much disputed. That it was an excellent piece of technology appears not to have been in doubt, but it was expensive and it required further costly and no doubt time-consuming implementation, which were among the reasons InterX abandoned sales of it in March 2001 and sought to market instead a slimmed down and less costly version that summer.

(ii) Was BladeRunner vital to the success of Diligenti, or did pressure to use it simply become a nuisance to the company - or was it never clearly part of their strategy? While we have accepted Mr Barker's recollection of the bargain he had made with Diligenti's management that BladeRunner was to be an important part of their strategy and that it was intended that Diligenti's use of it should serve as a shop window for InterX's product, it is also apparent that for reasons good or bad, honest or dishonest, Diligenti did not see it the same way, that it was at best lukewarm about BladeRunner and indeed that Diligenti made sure in the Funding Agreement that it could avoid being forced to take it up.

(iii) There was a mismatch between InterX's and Mr Barker's understanding of how BladeRunner would figure in Diligenti's business and Diligenti's own view of that matter. In so far as the value of Diligenti's shares at 5 April 2001 was concerned, however, the question was not particularly significant – BladeRunner had by then been effectively abandoned in its original form by InterX and it had not featured as a significant part of Diligenti's known forward planning or actual operations.

(iv) Was it relevant that the BladeRunner software was intended to occupy an important place in Diligenti's business? Our answer is no: that it never did occupy a very significant role in practice seems clear, and by March 2001 its overall significance in the technology market in its then existing form was minimal. The suggestion by Mr Eamer that the goodwill value of Diligenti of £118M had been eradicated by the failure of the BladeRunner project conflicts with the evidence that, although BladeRunner could have had a serious role to play in

Diligenti's businesses, in fact it never did either in terms of actual use or in terms of forward planning. But even if BladeRunner had been crucial to Diligenti, the licence it had acquired would have continued to be useable, since InterX maintained its support for established customers.

(v) On the other hand, it is apparent that Diligenti's failure to establish, or at least to have taken credible steps to establish, a common technology platform of any sort to integrate its subsidiaries' activities would have told against the value of its shares. Integration of the businesses was recognised in the company's own statements as an important objective, and in practical terms something to bring it about was a virtual necessity; but there was no evidence by April 2001 that progress had been made in doing so. This factor would also have reduced the attraction of the prospect of ultimate flotation.

(vi) The gradual discovery by Mr Miesegaes between May and September 2001 of the serious accounting and financial reporting failures at Diligenti reflect what would have been discovered by a potential purchaser undertaking due diligence of the kind suggested by the expert evidence. It would have had a profoundly negative impact on the perception by such a purchaser of the health and prospects of Diligenti, but it would not have been enough at 5 April 2001 to render a purchaser unwilling to proceed at any price at all. Information such as Mr Miesegaes unearthed would only have been obtained by a purchaser willing to pay a considerable price and to expend correspondingly substantial sums on due diligence, and the absence of easily digested financial statements could only have made a negative impression.

(vii) The unresolved difference between Messrs Eamer and Glover over the value of HESc, the only Diligenti asset for which there is external evidence of value, shows how difficult it would be to get to the bottom of matters. Mr Glover put the value of the HESc shares at between \$10.9M and \$12.2M, referring to actual trades on NASDAQ on 4 and 6 April 2001, whereas Mr Eamer put the value at \$1.5M.

(viii) The appellants strongly attacked Mr Glover's figure on the ground that the trades in question were of a very small number of shares - 6,700 and 5,100, when there were 39,700,000 shares in issue – but also on the ground that these trades were made on outdated information, as detailed accounting reports had not been filed since September 2000; and lastly on the ground that it was reckoned on a Diligenti holding of 62.7% when at the time their holding was only 51%, meaning Mr Glover's valuation should be \$8.9M even on his own assumptions. A potential purchaser would probably be more likely to accept something like that figure as realistic than the \$1.5M contended for by Mr Eamer. Such uncertainty in regard to the only asset with an externally attested value would have weighed against the value of the shares in Diligenti.

(ix) It has been noted that Mr Miesegaes's restating of the accounts led to the goodwill of Diligenti being shown at the end of March 2001 at some £15.8M. The appellants contested that amount on the basis that this figure, representing broadly the cost of acquisitions by Diligenti, should be reduced to £7.2M (Mr Glover's value of the holding in HESc) to reflect what they say was the net asset value of the company of £6.189M, which if reduced similarly produces a negative asset value of £2.49M. We consider that a prospective purchaser making enquiries at 5 April, however, would be more likely to accept the figure for goodwill which Mr Miesegaes in fact adopted in line with what was then perceived to be the case.

(x) The InterX strategic review released at the end of March 2001 would have been a significant source of information taken into account by a prospective purchaser, and it would have been seen as a source of comfort. InterX was just emerging from an exceptionally difficult period in which its separate existence was near to being in issue. Mr Barker, after ousting the former chief executive Mr Crawford in a boardroom coup, had undertaken a root and branch reassessment of everything that InterX was doing in order to rescue the company from its malaise and restore it to health.

(xi) A surgical knife was in use and if InterX's investment in Diligenti was at that point in serious trouble, let alone a total disaster, some indication of that fact would be expected. It is of limited importance for this purpose that matters at Diligenti were not as InterX thought them to be: a potential purchaser of the shares at 5 April 2001, especially if buying at a much reduced price and thus less inclined to extensive due diligence, would clearly have been importantly reassured by the fact of this radical reassessment having just taken place. That factor is underlined by the circumstance of the InterX board having received and been satisfied with a report from the chief executive of Diligenti as recently as 22 March 2001.

(xii) The optimism about fund raising expressed in the various board minutes and attributed to Deloitte & Touche well into the summer of 2001 must also tell against the notion that Diligenti's shares were of negligible value by the beginning of April. While it is true that these factors, including PriceWaterhouseCoopers' valuation of the shares for HMRC at the end of May, should be noted as occurring after the relevant valuation date they must indicate the likely reactions of those concerned to enquiries made by a purchaser at that date since they formed a continuum of perception which was well established. While it is also true that, if pressed, PriceWaterhouseCoopers for example would have had to concede that their view was not reached after any great enquiry or research, the general consensus of optimism would have reassured all but the most sceptical and cautious enquirers.

(xiii) The concern of the officers of InterX that they could be involved, through Diligenti, in the serious offence of trading while insolvent did not begin to manifest itself until Mr Miesegaes's email to Mr Spanoudakis of 13 July 2001, and was not finally recognised as being the case until the events of January 2002. Making every allowance for the tendency of those running a failing business to hang on until the last minute and to be, as it were, in denial about the gravity of their situation, it must follow that Diligenti would not have been perceived by a potential purchaser as being insolvent at the valuation date. In the absence of insolvency, there is a strong presumption that the equity in a company has not become valueless, unless there is some other compelling consideration to that effect.

(xiv) The salesmanship and negotiating skills of Messrs Stafford and Spanoudakis, who would be likely to be approached by a prospective purchaser, would have tended – if their impact on the appellants is anything to go by – to reassure and encourage, and to present a positive picture of Diligenti and its prospects. Taken together with Mr Barker's (at that time) positive view of the company this factor suggests that, even if the sale price at 5 April 2001 was a lot short of £303, it could nonetheless have been significant.

(xv) Although the cash position of Diligenti at 5 April 2001 appeared satisfactory, the rate of cash burn averaging £1.6M a month, and the evident funding requirements of Diligenti coming as soon as 30 June 2001, would be a matter of serious concern to a potential purchaser of the shares, particularly in view of the "pull-through" in InterX's favour, exercisable then and at any time before December 2001 when final repayment was due - which itself was a significant discouragement to potential investors. The purchaser would certainly seek information about how these funding requirements were to be satisfied.

(xvi) The depressed state of the market at large for technology shares by April 2001 would have meant that the population of potential purchasers was small but, on the evidence, it would nevertheless have existed even possibly for a loss-making start-up. However, in a rare instance of unanimity, the Crown's expert Mr Glover, the taxpayers' expert Mr Nathan, the chief executive officer of InterX Mr Barker and InterX's finance director Mr Miesegaes all agreed that an outside investor *would not have accepted the InterX pull-through being exercised and yet still have invested*. This was a fact of the market at a period in which investors were being very cautious and looking for signs of confidence and positive results, rather than taking the risk of finding themselves the last ones out in the event that the target for their investment failed.

(xvii) That factor, once established in the due diligence, would have operated to reduce the interested population of would-be investors still further. Any that were left would therefore have been led to enquire whether InterX would have been able to survive without the repayment of its loan and have agreed to waive the "pull through", at least until December 2001, thus allowing new funding to be a possibility. At the end of March 2001, despite being in a difficult situation requiring a radical turnaround in its fortunes, InterX did have a sizeable amount of cash on hand – some £26M – and was at least resigned to the prospect of receiving no repayment until the end of the year.

(xviii) The probability was that, if asked, InterX would have been willing in the interests of supporting Diligenti to give an assurance to a prospective purchaser of the shares that it would waive the "pull through" until December 2001 in the event of new funding being obtained. That said, it is very much a matter of speculation whether InterX would have been willing to go further in deferring its rights to repayment and we cannot say that it is probable that it would have done so. On the contrary, given that December 2001 was only nine months away from 5 April 2001, we conclude that any flexibility about exercising the “pull through” during that year would probably have gone no further and that the blocking effect of new funding for Diligenti would probably therefore have remained.

186 Notwithstanding the more positive factors in Diligenti’s favour noted above, the clear probability is that the blocking effect on new funding of InterX’s repayment rights would have reduced the population of willing and interested buyers in group one as at 5 April 2001 to nil.

187 Would the result be different in regard to the potential buyers in group two? It is clear that InterX, by at least December 2000, had no desire to invest more in Diligenti, and indeed that that attitude dated back essentially to the period of the Funding Agreement in July 2000. If the situation at InterX had not been so tense the position might just have been otherwise, but between December 2000 and 5 April 2001 the evidence is incontrovertible that the fortunes of InterX declined very sharply. Far from being in the market to make further investments at that date, the company was seeking the return of its loan to Diligenti as soon as it could be obtained without forcing the latter into crisis. InterX was not in the circumstances really a member of group two at all.

188 Next comes the Diligenti management, consisting of Mr Neil Stafford and Mr Christopher Spanoudakis. Plainly, they must have known more about the state of Diligenti’s affairs than any other prospective purchaser could know, so the question of due diligence would hardly have arisen. It is true that much of the evidence uncovered by Mr Miesegaes in the summer of 2001 was not explicitly stated in correct or orderly accounting form until he ensured that it was, but it is impossible to conceive that these two persons, experienced in management and accountancy as they were, would not be aware of the situation in their company and would not have faced up to it had they been about to part with any of their own money.

189 In the matter of fundraising, and how easy or difficult it would be, we can only echo the comment made by Mr Barker of Mr Spanoudakis when recruiting him that “if anyone could raise further funds, he would be able to”; he had not been ‘Rainmaker of the Year’ from 1998 to 2000 without acquiring a thorough knowledge of the dynamics of investment. The two men would have been well aware, despite their habitual claims of optimism, that successful fundraising for Diligenti was far from guaranteed and that any outside investment would seek to be at the expense of InterX’s “pull-through” rights, so that the factors discussed above in relation to group one would have been equally relevant.

190 Messrs Stafford and Spanoudakis had, moreover, a striking history of not risking their own money: the evidence shows that the only money they hazarded in the Diligenti venture (compared with the £30M put in by InterX and the appellants) was the cost of the 250,000 penny shares which gave them their majority control - £1,041.67 for Mr Spanoudakis and £1,458.33 for Mr Stafford. Some confirmation of their likely behaviour may be drawn from the events in September 2001 when they belatedly promised to invest £250,000 each, but never actually did so - even knowing by then that their company was in serious trouble.

191 It must be said that, given the very confident and forceful manner in which Messrs Stafford and Spanoudakis were accustomed to vaunt Diligenti’s prospects, it would have been difficult for them to explain a reluctance to buy a shareholding of the size we are considering. But notwithstanding their habitual bluster, and knowing what they did about Diligenti and what they would undoubtedly have known about the prospects for fundraising overall in the market at the time, we think the balance of probabilities is against seeing Mr Stafford and Mr Spanoudakis as willing buyers of the shares at 5 April 2001 at any price, however low.

192 The three appellants remain to be considered as prospective purchasers of each parcel of shares. We must start with the observation that at the valuation

date each of the appellants still thought highly of the target company's prospects, albeit that the evidence was that they were thinking about them very little since the immediate preoccupation was with InterX and its own future. But all three appellants gave evidence that they would be extremely cautious if, within four months of their having paid £3.3M for their shares, the equivalent parcel was offered to them for substantially less. Such an offer would invite closer attention to the condition of Diligenti and raise the question: what does the seller know that I don't know?

193 Questions were put to each of the factual witness about what their attitude would have been to an offer to them of one of the holdings in this appeal on 5 April 2001. It is in the nature of things difficult for anyone to answer a question of that sort ten years after the event, knowing what is known now, and having an obvious reason to prefer a response that will assist their case; the question more nearly invites a speculation rather than a recollection of fact, since the situation postulated did not occur. Nonetheless, it is possible with that caution in mind to make an estimate of what would have been likely to occur.

194 In the case of Mr Barker, the position was complicated by his being the chief executive of a public company. It would plainly be impossible for him to acquire a further tranche of Diligenti shares on 5 April at a price significantly lower than that he had paid four months earlier, in December 2000, without undermining InterX's published strategy: this is because the strategic review just published in March 2001 had sent the clear message that all was well with Diligenti, a company in which InterX had invested heavily; to purchase its shares at a heavy discount to the £303 per share at which he had bought so recently – or even the £26 at which InterX had invested the previous July - would suggest both that information about Diligenti had been suppressed and that matters were seriously amiss with it. And all the concerns which had been relevant to setting a share price in December 2000 would again have come into in play.

195 In addition to this, Mr Barker made it clear in his evidence that, believer in Diligenti though he still was at 5 April 2001, he did not have the funds available to match his December investment even if he had wanted to. (Nor did he in fact do so when the need for further funding became desperate in the autumn of 2001: in November, he and the other two appellants could only find £500,000 each to invest in HESc which they still regarded as having good prospects, but no more.) Even had Mr Barker been minded to seek a way to overcome the obstacles created by his position at InterX, he would, if confronted with an offer importantly below the December 2000 price, then inevitably have been drawn into a closer examination of affairs at Diligenti and have been led to the conclusions which we have postulated in the case of the investors in group one.

196 Mr Wickes and Mr Harper also gave evidence that they too did not have funds available to match the level of their December 2000 investments, and had no desire to invest in Diligenti further at any price. In view of their willingness to invest in HESc in November 2001 the latter statement might be taken with some reserve, but all three appellants affirmed credibly that in making investments they always acted together under the leadership of Mr Barker. That this was the pattern of action throughout – up to and including the November 2001 investment in HESc - and that Mr Wickes and Mr Harper's actual involvement in the Diligenti enterprise was, by comparison with Mr Barker's, very minimal emerges clearly from an overview of the evidence. We accept that they would not have acted independently of Mr Barker in making share purchases, even in the event of Diligenti shares being available at much reduced prices.

197 The three appellants, for these reasons, must also be reckoned on the balance of probabilities to be excluded from group two.

Decision

198 Our decision in the appeals is therefore that each of the appellants' shareholdings would in all probability have been unsaleable at 5 April 2001 in the open market in a sale by private treaty at arm's length. Their value therefore was, within the sense of that term as used in the statute, negligible. The appeals must therefore be allowed. The parties are at liberty to make an application with regard to costs within 30 days of the release of this Decision.

199 This document contains the 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 no 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.

Malachy Cornwell-Kelly
Tribunal Judge

RELEASE DATE: 5 October 2011