NIFA NEWS ISSUE 39

The Newsletter from The Network of Independent Forensic Accountants

When is an expert witness not an expert?

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When is an expert witness not an expert?

The answer, according to the lessons learned after the collapse of a fraud trial, is that an expert witness is not an expert if the entire basis of his expertise comes from simply having once watched a documentary on the subject.

Andrew Ager had given evidence on Carbon Credits in more than 20 fraud trials before admitting in Southwark Crown Court that he had never read a book on the subject and had no formal qualifications. The case collapsed when Mr Ager admitted that he had cut and pasted the same evidence into reports for several different cases.

In closing the case, the judge said: "Andrew Ager is not an expert of suitable calibre. He had little or no understanding of the duties of an expert. He had received no training and attended no courses. He has no academic qualifications. His work has never been peer-reviewed."

The judge's comments raise an important question about what qualifies someone to give expert witness testimony and whether some form of accreditation should be required.

Some have suggested that a Register of Expert Witnesses should be created, listing only those experts who have proved themselves to be competent, suitably qualified and cognisant of the role and duties of an expert witness. However, in the writer's opinion, such a Register might not achieve the desired objective for several reasons.

"Misleading evidence"

Firstly, a Register would do nothing to prevent that problems can arise when expert witnesses who may be eminently qualified to opine on issues within their field of experience stray onto matters outside their expertise. The most infamous example of this arose in the case of the paediatrician Sir Roy Meadows who was discredited after giving misleading evidence in a field of statistics in which he was not qualified.

> *“It would be a great pity if such individuals were precluded from being able to give opinion evidence simply because they did not appear on a Register of approved expert witnesses.”*

Secondly, although a Register might play a role for those who practice in the fields of accountancy, surveying or medicine and who regularly give expert evidence, it is important to recognise that the court regularly seeks a professional opinion from those whose expertise is in more obscure subjects. For example, a barrister known to the writer once commented that the most impressive expert evidence he had ever heard was given by an expert in the field of paper manufacture. The expert in question was able to provide articulate, helpful and relevant evidence about how paper is made. He had never given expert evidence before and was unlikely ever to have to give expert evidence again.

It would be a great pity if such individuals were precluded from being able to give opinion evidence simply because they did not appear on a Register of approved expert witnesses.

Indeed, if the requirements to be listed in a Register, were the same as those required for membership of such esteemed bodies as the Academy of Experts or the Expert Witness Institute, Mr Ager might well have been able to satisfy them. He did not profess to belong to any particular professional body and the fact that he had acted in previous cases might have enabled him to have obtained a reference from instructing solicitors.

Another problem is the need to identify which of the ever-increasing number of Registers of expert witnesses should be recognised by the courts. There are currently no standard criteria for eligibility to be included on various Registers. Some subject experts to far more scrutiny than others. This makes it very difficult for those looking for experts to know on which Registers they should rely. Worse still, the Registers that are willing to list anyone in return for payment of a fee, risk giving purported experts credibility that they may not deserve.

The Criminal and Civil Procedure Rules require that instructing solicitors make experts aware of their duties but perhaps what is needed is an amendment that places upon them a positive obligation to test and challenge the experts they instruct, so as to enable them to form their own independent assessment as to their qualification and suitability to opine on the issues in question.

Tax alerts

When there's no place like home

The recent tax tribunal case of Yechiel[1] is one about which all family lawyers should be aware. It suggests the Principal Private Residence Relief is becoming harder to claim.

Mr Yechiel bought a house in 2007 and obtained planning consent to extend it in March 2008. In August that year he got married but the marriage was short-lived.

In April 2011 he moved into the house where he remained until December 2011 when he moved back to live with his parents. The house was sold the following year.

Despite the fact that he undisputedly lived in the property for some months and paid council tax, HMRC successfully challenged his claim for Principal Private Residence Relief on the grounds that his occupation lacked the relevant "quality"!

It appears that the tribunal was influenced by Mr Yechiel's admission that he went to his parents' house for meals and took his laundry there, although he did eat takeaways at the property. HMRC also argued that it was relevant that he had used only a small amount of electricity, notwithstanding that his occupation was during the summer months.

The tribunal concluded that *"as well as occupation (which clearly happened) and intention to occupy for a time with a reasonable degree of permanence (about which the point seems to be finely balanced), 'quality' is determined by what the appellant actually did in the house. We consider that to have a quality of residence, the occupation of the house should constitute not only sleeping, but also periods of 'living', being cooking, eating a meal sitting down, and generally spending some periods of leisure there."*

The moral of this case is that Principal Private Residence Relief can no longer be taken for granted.

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[1] Yechiel [2018] UKFTT 0683 (TC)

Changes to Entrepreneurs' Relief

The Finance Bill 2019 introduced changes to the rules governing Entrepreneurs' Relief.

Firstly, shares have to have been held for two years prior to the disposal whereas previously they needed only to have been held for one year.

Secondly, as before a shareholder must hold at least 5% of the ordinary share capital and votes of the company (test 1) but, now in addition, s/he must also be 'beneficially entitled to' either:

- 5% of profits (dividends), and assets available for distribution to equity holders on a winding up of the company (test 2); or
- 5% of the sale proceeds had the whole of the ordinary share capital of the company been sold on the day of the disposal (test 3).

In order to qualify for Entrepreneurs' Relief shareholders must satisfy either tests 1 and 2 or tests 1 and 3.

A fair day's pay for a fair day's work

Often a key factor in a company valuation is the assessment of an open market rate of remuneration for its directors. Such assessments can be contentious and fraught with uncertainty.

The vast majority of director shareholders in family-owned businesses remunerate themselves by means of dividends for tax-planning purposes. Such dividends include an element of quasi-remuneration and represents a reward for their labour, as directors. However, they will often also include an element that represents a return on their investments as shareholders.

Business valuation theory dictates that, for the purposes of assessing the likely future maintainable earnings of a company, the valuer should deduct a notional cost of management equating to the remuneration that would be payable to the directors if they were not shareholders. The estimation of these directors' salaries is far from straightforward.

An appropriate starting point is an assessment of the roles and responsibilities of the directors and the level of skills and qualifications that they require. Typically, directors of larger businesses command higher salaries than directors of smaller businesses.

In the writer's opinion the most reliable yardstick will be the salary paid to those actually employed by the company at the next tier of management immediately below the shareholder-directors, including non-shareholder directors or senior managers. The valuer can use such salaries as a starting point and add to them a premium to reflect the additional seniority commensurate with the role undertaken by the owners.

"A degree of caution"

However, in many cases there are few if any senior staff and an alternative approach needs to be found. In those cases the best source of information can often be surveys of directors remuneration such as that published by Croner but these have to be treated with a degree of caution because sample sizes can often be small and companies within the sample may not be comparable with the company being valued. That said, in the absence of other benchmarks, such surveys at least provide a measure of objectivity.

For smaller companies the Annual Survey of Hours and Earnings published by the Office of National Statistics can sometimes also be a useful guide.

Some valuers seek to rely on published advertisements but these are notoriously unreliable and can even be misleading if the advertised roles are not comparable with those undertaken by the director shareholders.

One of the factors that makes the assessment of an open market rate of remuneration so difficult is that company owner-managers often work very long hours and have a level of devotion to their businesses that are rarely found in even the most loyal employees. It is therefore vitally important that the business valuer gets a good understanding as to the precise role undertaken by each director and the number of hours each work that are devoted to the business.

Terminal value

A recent judgment in the Family Courts in the case of FW and FH[1] has cast doubt on the applicability of the traditional use of Discounted Cash Flows in company valuations.

The case involved the valuation of a family company in the context of a divorce. Two accountancy experts gave evidence, one for the husband and one for the wife. Both applied the discounted cash flow approach to valuing the business. This involves:

i. Consideration of a cash flow forecast;
ii. The application of a discount to the cash flows to reflect their inherent risk; and
iii. The calculation of a terminal value, representing the discounted value of the cash flows from the end of the period for which the cash flow has been prepared into the future.

In this case the cash flow forecast had been prepared for a five year period to 2023.

The judge observed that *"Taking a terminal value allows one to build in the value of the likely future cashflow after 2023, as when the company is sold it will have an infrastructure in place and projects in progress that will not yet have flowed into the profit stream but nevertheless will be of significant value to the purchaser."*

One of the experts calculated a terminal value but the other did not do so, arguing instead that the history of the business did not allow for an assumption of a stable and sure future profit stream which would be essential for a notional purchaser to be willing to pay a terminal value.

The judge concluded that the volatility of the business did not permit any accurate basis upon which a terminal value could be assumed and therefore disregarded it in its entirety.

[1] [2019] EWHC 1338 (Fam)

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