

The Newsletter from The Network of Independent Forensic Accountants

## PICTURE YOUR FORENSIC ACCOUNTANT IN THE HOT TUB... **...AND ASK YOURSELF HOW YOU FEEL ABOUT THE MENTAL IMAGE YOU HAVE CONJURED UP.**

It seems likely that the giving of concurrent evidence by expert witnesses, so-called 'Hot-tubbing', is likely to become ever more common, not least because the experience of the courts is that it saves considerable judicial time and, as the Ministry of Justice is all too keenly aware, time is money.

Instructing solicitors therefore need to give some thought to how they think proposed expert witnesses are likely to perform in the Hot-tub. Cross-examination can be a daunting prospect for some but those who are likely to perform best in the Hot-tub will need very particular character traits.

The traditional scenario in which a lawyer cross-examines a forensic accountant pits an expert in one discipline (law) against an expert in another (accountancy). There is therefore always the prospect that the accountant will be able to bamboozle whoever is cross-examining him or her. Such a scenario is unlikely in the Hot-tub in which accountant is pitted against accountant.

By giving evidence simultaneously, direct comparisons will inevitably be drawn between two opposing experts and whichever is able to give the most cogent and convincing evidence is likely to overshadow his or her counterpart.

Hot-tubbing may therefore appear to be a less formal and more relaxed format than traditional cross-examination but experts who let down their guard will do so at their peril. The key, as ever, is to ensure that you choose an expert on whom you can rely to master the evidence and deliver a persuasive unbiased opinion founded solidly on the facts<sup>1</sup>.

1. NIIFA members have received training in the giving of concurrent evidence.

### Also in this issue:

#### **CHIMERA ON THE SPRINGBOARD**

Uncertainty surrounds company valuations in the divorce courts.

#### **MESHER ORDER OR DEFERRED CHARGE?**

Understanding the very different tax treatments of the two.

#### **CAN THE DARK CLOUD OF INSOLVENCY EVER HAVE A SILVER LINING?**

Opportunities to pursue claims that could not otherwise be funded.

#### **PLACING A VALUE ON FREE TIME**

A complex issue that is often overlooked in loss of earnings claims.



# THE CHIMERA ON THE SPRINGBOARD

**The divorce courts have long been sceptical of the accuracy of private company valuations but recent judgments give rise to more uncertainty than ever.**

Moylan J<sup>1</sup> described the ostensible accuracy of private company valuations as being no more than a chimera whose purpose was to assist the court ‘in testing the fairness of the proposed outcome’. His view is shared by many judges and even the most robust forensic accountant would undoubtedly accept that the exercise of valuing shares in a family business for the purposes of matrimonial ancillary relief proceedings is an inexact science.

That inexactitude has been exacerbated by the widely reported case of Jones v Jones<sup>2</sup> which introduces a new degree of uncertainty by means of the so-called ‘springboard effect’.

## The facts

The case of Jones and Jones concerned a couple whose total assets at the date of trial amounted to approximately £25million representing, in effect, the proceeds of the sale, in 2007, of the husband’s business.

Forensic accountants for both parties agreed that the value of the business at the date of the marriage, in 1996, had been £2million.

## The decision

The court held that a deduction ought to be made from the available pool of £25million to reflect the value that the husband brought to the marriage, namely the value of the company in 1996.

One might have thought that that would have caused the court to deduct £2million from £25million to arrive at a figure of £23million to be shared equally between the parties. However that was not the approach adopted.

Instead the court declined to accept the valuation of £2million because it considered that it failed to take into account the latent potential of the business to which it referred as the ‘springboard effect’. Accordingly, in a calculation that was by the court’s own admission ‘arbitrary’, it ascribed a value of £9million to the company at the date of the marriage. It then

deducted this figure from the pool of £25million, concluding that the matrimonial property amounted to £16million, of which the wife was entitled to 50% (£8million) by application of the sharing principle.

## The implications

The court’s approach creates unwelcome uncertainty for both family lawyers and forensic accountants who assist them.

Clearly it is now more important than ever for consideration to be given, not only to the value of family companies at the date of divorce but also at the time of the marriage. Furthermore it seems that it is necessary to apply a degree of hindsight to the valuation at the time of marriage.

It seems that the question for the forensic accountant is no longer ‘what would a prospective purchaser have been likely to pay to acquire the business at the time of the marriage?’. The answer to that question in the

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Jones case was £2million and it was this answer that the courts rejected.

Instead the question that the forensic accountant or advising lawyer seems to need to consider is now “what would a prospective purchaser have been likely to pay to acquire the business at the time of the marriage *if he had known that, by the time of the divorce, it would have become worth £X?*”

As if that were not sufficiently fraught with uncertainty, the position is further complicated by the need to uplift the value so derived to reflect its economic growth during the marriage. In the Jones case this was done by applying the relevant FTSE Index for the sector in which the business operated.

1 *H v H* [2008] EWHC 935 (Fam), [2008] 2 FLR 2092

2 *Jones v Jones* [2011] EWCA Civ 41



# CAN THE DARK CLOUD OF INSOLVENCY EVER HAVE A SILVER LINING?

**Success fees and insurance premiums will continue to be recoverable in insolvency proceedings until April 2015 which may give rise to opportunities to pursue claims that could not otherwise be funded.**

The Legal Aid, Sentencing and Punishment of Offenders Act 2012 received Royal Assent on 1 May 2012 and the Government has already announced that the provisions relating to civil litigation funding costs will come into force in April 2013, subject to two exceptions. The first is in relation to mesothelioma cases. The second is the so-called 'Insolvency carve-out' that exempts insolvency proceedings until April 2015.

This means that, until April 2015, success fees under conditional fee agreements ('CFA') and after-the-event insurance premiums will remain recoverable by the successful party to litigation.

Clearly it would never be commercially justifiable (even if it were morally acceptable) to contrive an artificial insolvency simply to benefit from the terms of the carve-out. However it is sometimes the case that prospective Claimants, especially those with professional negligence claims, find themselves close to financial ruin.

Such Claimants, who are on the cusp of insolvency, may find it worthwhile considering whether they might be able to benefit from the carve-out.

Even then, it may not be straightforward to engage the carve-out. A voluntary arrangement is typically the least invasive insolvency procedure but it seems unlikely that the carve-out will apply unless it is the insolvency practitioner (as opposed to the debtor) who acts as Claimant. This may mean that causes of action have to be assigned from debtor to voluntary arrangement supervisor and that, in itself, can be fraught with difficulty.

Many Claimants have relatively modest claims of less than £100k. CFAs may be the only affordable way to fund these claims but may be unattractive if, as is likely, they result in Claimants facing the prospect that much if not all of the spoils of victory are likely to be absorbed by irrecoverable legal costs.

For those with few assets other than a strong claim (that cannot otherwise be funded), insolvency proceedings may be an option that solicitors advising prospective Claimants need to consider. Then perhaps rule out, if only to ensure that they have given comprehensive and best advice.

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# MESHER ORDER OR DEFERRED CHARGE - WHY IT MATTERS WHICH YOU CHOOSE

The tax treatment that flows from a Mesher Order in matrimonial ancillary relief proceedings is very different to that which flows from a deferred charge.



As family lawyers know, it is often the case that the terms of a divorce will allow one spouse to occupy the former matrimonial home ('FMH') pending a sale at some specified future date, such as the eighteenth birthday of a youngest child. These terms are typically achieved by means of a so-called Mesher Order or a deferred charge.

A Mesher Order does not affect the underlying ownership of the FMH. It merely excludes the absent spouse from occupying it until its sale by creating a trust in which the former husband and wife are settlors and in which the occupying spouse is a beneficiary.

For tax purposes there are two periods to consider, as follows:

- The First Period, from the date of acquisition to the date of the court order; and
- The Second Period, from the date of the court order to the date specified for the FMH to be sold.

The tax treatment of a Mesher Order is favourable.

In relation to the First Period, the transfer into trust will qualify for principal private residence relief



## MESHER ORDER OR DEFERRED CHARGE - continued...

('PPRR') from Capital Gains Tax ('CGT'). As long as the FMH was occupied throughout the period of ownership (prior to the separation) and is transferred into trust within three years of the absent spouse moving out, the whole of the gain will be covered by PPRR.

In relation to the Second Period, on a subsequent sale of the FMH, there is a deemed disposal by the trustees at market value. By virtue of the fact that a beneficiary of the trust has occupied the FMH as his or her main residence, the trustees can claim PPRR on the deemed disposal.

This situation can be contrasted with that which arises in the case of a deferred charge. Under the terms of a deferred charge the ownership of the property is transferred in full to the occupying spouse. This can be for a fixed sum but is more usually for a fixed percentage of the market value of the FMH at the end of the Second Period. A charge is registered against the FMH to secure the interest of the absent spouse.

In this situation there are two disposals, as follows:

- At the end of the First Period there is a deemed disposal of a half share of the FMH by the absent spouse; and then
- At the end of the Second Period there is a disposal of the charge which is treated as a separate asset for CGT purposes.

The deemed disposal proceeds in relation to the first of these disposals will be the amount secured by the charge. If the charge secures a fixed sum, then the disposal proceeds are deemed to be that sum. Alternatively, if the charge secures a percentage of future value, the rule of *Marren v Ingles* [1980 STC 500] applies and the disposal proceeds are deemed to be the current value of the right to receive an as-yet unascertainable future sum. This allows the time value of money and future uncertainty to be taken into account in the calculation of the amount secured by the charge.

Under a deferred charge, a husband is entitled to 50% of the property.

- His half share of the FMH originally cost £50K
- The right to receive 50% of the proceeds is valued at £200K at the end of the First Period.
- The FMH is sold at the end of the Second Period on the cessation of the charge for £600K.

### Disposal 1 – end of First Period

	£
Deemed proceeds	200K
Cost	(50K)
Gain covered by PPRR	150K

### Disposal 2 – end of Second Period

	£
Actual proceeds	300K
Less: Deemed cost (above)	(200K)
Taxable gain (no PPRR)	100K

In either case, PPRR is available on the first disposal in much the same way as it is for the transfer into trust under a Mesher Order.

The problem arises at the end of the Second Period, when the charge is released.

Tax becomes payable if the value of the asset secured by the charge at the end of the Second Period exceeds the value attributed to it at the end of the First Period (see the example above).

As can be seen, a Mesher Order and a deferred charge are taxed very differently and the consequences of opting for one in preference to the other needs to be carefully understood.

## NIFA WELCOMES TWO NEW MEMBERS:

**Kate Hart**  
Roffe Swayne, Godalming, Surrey.

**Michelle Fisher**  
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## PLACING A VALUE ON FREE TIME IN LOSS OF EARNINGS CASES

**Calculating loss of earnings claims for the self-employed is never easy but the concept of 'free time' adds an additional complexity and one that can easily be overlooked.**

Consider a self-employed consultant who claims compensation for loss of earnings as a result of a personal injury. Suppose that the Claimant earned £30k pa before the accident and but has earned only £15k after the accident, as evidenced by accounting records.

On the face of it, the Claimant has a claim for loss of earnings based on a multiplicand of £15k using an appropriate multiplier from the Ogden Tables.

**However, it is sometimes the case that part of the reason for the fall in earnings is that the Claimant's injuries prevent him or her from attracting as much work after the accident as before it.**

This can mean that the Claimant is unable to devote him/herself full time to the business simply because there is insufficient work to fill the working week.

The Claimant, in these circumstances, may have a considerable amount of 'free time', which did not exist before the accident. This raises the question as to whether and, if so, to what extent, that free time ought to be taken into account for the purposes of the loss of earnings claim. Might it, for example, be open for the Defendant to argue that the Claimant's duty to mitigate any loss extends to having to find an additional source of income to occupy the free time that has arisen?

It may well be that the additional income is deemed only to be paid at national minimum wage rates but it could still make a significant difference to the overall quantum of a claim.

As a first step, it would seem to be prudent for the terms of any instructions to forensic accountants to include not only an assessment of financial loss but also an assessment as to whether the accident has given rise to 'free time' for the Claimant. If it has, the arguments as to how it should be treated can then begin.