Valuation of Unquoted Shares

Capital Acquisitions Tax Manual Part 21

This document should be read in conjunction with section 27 of the CATCA 2003.

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Note: This manual is currently subject to review and may not reflect up-to-date position. Most recent version.

Revenue
Cáin agus Custaim na hÉireann
Irish Tax and Customs

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21.1 Introduction

As part of its compliance function, Revenue values unquoted shares which are held in private or public companies which are not listed /quoted on a Stock Exchange.

21.2 Aims of Valuation

- To ensure that valuations submitted in respect of unquoted shares reflect the open market values.
- To deter evasion and avoidance by detecting under-valuations and taking appropriate action.

21.3 Valuation of Shares

Valuation is not an exact science. The value of a shareholding depends on many factors - the nature/size of the shareholding passing, profitability of the business and its future prospects in the marketplace at the time of the transaction.

When valuing shares in unquoted companies for tax purposes, the shares passing must be valued on the basis of a hypothetical sale in a hypothetical open market between a hypothetical willing vendor and a hypothetical willing purchaser.

Depending on the nature of the company's business, different valuation methodologies may be employed.

21.4 Valuation Based on Earnings

Trading and manufacturing companies are normally valued on the basis of a multiple of their maintainable after-tax profits. This multiple is known as the price earnings ratio. The multiple used may vary depending on the particular industry in which the company is engaged.

The appropriate multiple is normally selected by reference to a quoted company/companies in the same industry. Financial information in respect of quoted companies is published regularly in the national newspapers. The results of these companies are analysed in relation to their trading performance and the prices at which their shares are sold are expressed as a multiple of their after-tax profits

When a suitable quoted company has been identified, the normal practice is to use the multiple of after-tax profits appropriate to that quoted company, less a discount of 20% to compensate for the lack of access to the market which a quote on the stock exchange provides, i.e. if the multiple of after-tax profits for the quoted company is 10, the appropriate multiple for an unquoted company would be 8, but this may be further reduced if the unquoted company is a relatively small one.

Example

Company's after-tax profits	€250,000
Price Earnings Ratio (say)	8
Value of Company	€2,000,000

This is known as the Earnings method of valuation and most companies are valued on this basis.

If a company has retained profits or assets of any sort not immediately required for the purpose of its trade, the value of all such assets would normally be added to the company's earnings value.

21.5 Valuation Based on Assets

Investment holding or property holding companies are normally valued on the basis of their net assets value. The values shown on the Balance Sheet for property or investments may not normally represent their true value. It is generally necessary therefore to obtain up-to-date values as at valuation date for these assets and substitute market value for book value on the Balance Sheet when carrying out a valuation.

21.6 Valuations Based on Turnover Fees or Commissions

Companies which own or operate Licensed Premises or Restaurants or whose business is in the services sector, such as Insurance Brokers, Quantity Surveyors, Architectural Practices, Consulting Engineers, Legal etc. are normally valued on the basis of a multiple of their turnover, fees or commissions.

21.7 Control of a Company

Where a company is a "company controlled by the donee or successor", section 27 of the Capital Acquisitions Tax Consolidation Act 2003 provides that the shares must be valued on the basis that the owner is deemed to have control of the company. The combined shareholdings of the donee or successor and his or her relatives (and of the trustees of any settlement whose objects include the donee or successor or relatives of the donee or successor) are taken into account both for the purpose of ascertaining whether or not the company is controlled and for the purpose of measuring the extent of the control.

21.8 Definition of Control

Control under section 27 is defined and covers voting control (direct or indirect).

Control is recognised as:

- the capacity to exercise the power of a board of directors,

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- the right to receive more than half of total dividends,
- an interest in the shares of the company representing half or more of the total nominal value of the shares of the company,
- the powers of a board of directors of the company,
- powers of a governing director of the company,
- the power to nominate a majority of the directors of the company or a governing director thereof,
- the power to veto the appointment of a director of the company or powers of a like nature.

21.9 Explanatory Note on Relatives

"Relative of the donee or successor" as defined by section 2(4) of the Capital Acquisitions Tax Consolidation Act 2003 includes—

a) the spouse;

b) the mother, father, children, uncles and aunts;

c) brothers, sisters, nephews, nieces, grandchildren, great-grandchildren, first cousins and their children;

d) spouses of those mentioned at (b) and (c);

e) grandparents.

21.10 Effects of Control

Under these provisions, shares in companies that are owned by an individual or by relatives of an individual, are to be valued as a proportionate part of the entire shareholding in the company held by that individual and relatives of that individual.

21.11 Different Classes of Shares

Section 27 also provides that where different classes of shares exist, each class of share must be valued in the light of the advantages and disadvantages that attach to them.

Valuation examples of controlled companies illustrating the effect where there are more than one class of shares with different rights.

Controlled Company .... Issued Share Capital 100 Ordinary €1.00 shares all shares pari passu.

Company worth	€20,000
Value of 1 share	€20,000 x 1
	100
	= €200 per share

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Controlled Company .... Issued Share Capital 80 Ordinary €1.00 shares and 20 A Ordinary Voting Shares. Other than voting rights, all shares pari passu. (Voting shares are allocated a premium value equivalent to 15% of the value of the company to reflect the power which attaches to them.)

Company worth €20,000

A shares voting premium €3,000

Balance for distribution between voting and non-voting shares €17,000

Valuation of Ordinary Shares

$\frac{\text{€}17,000 \times 80}{100} = \frac{\text{€}13,600}{80}$ = €170 per Ordinary Share

Valuation of A Ordinary Shares

$\frac{\text{€}17,000 \times 20}{100}$ + Voting Premium €3,000

Value of one A Ordinary Voting Shares

$\frac{\text{€}170 \times 20 + \text{Voting Premium } \text{€}3,000}{20}$ = €170 + €150 = €320 per share

Difference in value therefore: Ordinary Non-Voting Shares €170 per share

Voting A Ordinary Shares €320 per share

Value of Voting Rights therefore = €150 per share.

21.12 Size of Shareholding

The size of the shareholding passing reflects the amount of control that a shareholder can exercise on the running of a company and the value of a particular shareholding is normally discounted to reflect the advantages/disadvantages attaching to same.

A 75% – 100% shareholder has full control over all matters affecting the company, including the power to wind it up.

A 51% – 74% shareholder has the power (control) to do all things except wind the company up.

A 50% shareholder needs the support of another shareholder to pass an ordinary resolution.

21.13 Majority Shareholding/Influential Minority Shareholding

21.13.1 Holdings of 50% and above

Value by reference to the value of the whole company less a suitable discount, e.g.

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75%+	Nil discount or perhaps 5% at most
50% + 1	10 – 15%
50%	20 – 30%
25% + 1	35 – 40%

21.13.2 Minority Shareholding

Up to 25% – value by reference to dividends if a realistic level of dividend is being paid. If no dividend, look at discounted earnings with a discount range of 50% – 70%, as these are influential minority holdings.

21.14 Stages in Valuation

1. Calculate the value of the entire company.
2. Value the shareholding passing.
3. Discount gross value to reflect size of shareholding passing, taking account of the deemed control provisions of Section 27 of the Capital Acquisitions Tax Consolidation Act 2003.

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