



**The Institute of
Chartered Accountants
in Australia**

10 March 2008

Ms Janet Keogh
The Australian Taxation Office

By email: Janet.Keogh@ato.gov.au

Dear Madam,

Consultation for Market Valuation Guidelines

Thank you for the opportunity for the Institute of Chartered Accountants in Australia (the "Institute") to provide comments on the Australian Taxation Office's revised Market Valuation Guidelines ("the Guidelines").

This response includes comments received from the Business Valuation Special Interest Group (BVSIG) of the Institute and members of the Institute's Tax Technical Committee, which is comprised of people at the Big 4 accounting firms.

The comments are set out in the following Appendices:

- A: General comments on the application and relevance of the Market Valuation Guidelines
- B: Specific comments regarding the wording in the Guidelines

We would be pleased to discuss any of our responses in more detail. Should you have any questions in relation to the matters discussed in the attached document, please contact John Gibson, Chair, BVSIG on +61 2 9248 4616.

Yours faithfully

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Appendix A: General comments on the application and relevance of the Market Valuation Guidelines

The purpose of the Guidelines, to whom it applies and the provisions of the various taxing acts for which it is intended to be applicable (or not applicable) should be clarified. Overall, in our view the Guidelines are overly lengthy and its intention to advise the reader of “the standards expected by the Tax Office” could be achieved more effectively and concisely.

The Guidelines provide little utility

The Guidelines could be a much shorter document. It should cater to the expert or the ordinary taxpayer effectively, but addressing both in the one document is a difficult task. The Guidelines provide insufficient information for the expert but sufficient information to overwhelm the novice. Accordingly, the attempt to provide comprehensive Guidelines, catering to all users and outcomes in the tax environment diminishes the Guidelines’ utility.

It is unclear whom or what the Guidelines applies to

The title makes the Guidelines specific to market valuation for tax purposes, the identified audience being “Valuers” (page 1). The Guidelines stated purpose is “to help anyone involved in a valuation process for tax purposes”, without exception (page 3).

The Guidelines do not apply to convertible notes (page 32) and do not appear to apply to the valuation of derivatives, although a reader will not become aware of this until pages 31 and 37. Such exclusions should be explicit and be stated at the beginning of the Guidelines.

Diverting between expert topics such as ‘special value’ and ‘highest and best use’ and generalist topics such as ‘Definition of market value’, shows the Guidelines being directed at both experts and ordinary taxpayers, making it harder to read and employ than it would be if the audience were separated.

The Guidelines do not balance compliance costs and potential tax risk

The Guidelines fail to appropriately balance the costs of compliance associated with preparing valuation reports as described in the Guidelines and potential tax risk. The third paragraph of Part D and the introductory paragraphs in Part F on page 57 are a long way from providing taxpayers with sufficient comfort in this respect. The approach taken in the Guidelines will impose a significant and costly compliance burden that will impact disproportionately on SMEs, micro-businesses and individuals.

The Guidelines would benefit by adopting principles of prudent business management which have been accepted by the ATO in the context of preparing transfer pricing documentation for purposes of Australia’s transfer pricing rules (see TR 98/11).

Consistency between the Guidelines and taxation rulings

In reference to page 3, following first paragraph ...”professional valuers”: We recommend insertion of the following to clarify the status of the Guidelines:

“In general, where a view expressed in these Guidelines is inconsistent with a view expressed in a taxation ruling, taxation determination or the Consolidation Reference Manual, to the extent of the inconsistency the view expressed in the taxation ruling etc is to be treated as the Tax Office’s view. However where these Guidelines expresses a view that is specific to a particular subject matter, for example in Appendix 2 of this Guidelines regarding the valuation of real estate, and the Consolidation Reference Manual or the non-binding explanation in taxation ruling or taxation determination has

expressed a less specific view, the more detailed commentary in these Guidelines should be treated as representing the Tax Office's view to the extent of any inconsistency."

Terminology, structure and size

The Guidelines seem too focused on valuations of land

Pages 20-25 (Part B: Real Property, Plant and Equipment), pages 77- 85 (Appendix 2) and pages 86-110 (Appendix 3) relate to valuations of real property while pages 20-25 (Part B: Real Property, Plant and Equipment) and pages 111-116 (Appendix 4) relate to valuations of plant and equipment. On the other hand, pages 26-43 (Part C: Business Valuations) relates to business valuations and valuations of securities and intangibles for which there is no accompanying appendix.

The Guidelines should avoid the selective use of statutory and accounting definitions

In a number of places, the Guidelines selectively use statutory definitions from a particular taxing act or various accounting definitions and suggests these are generally applicable for all tax purposes (e.g. the definition of security on page 31, the definition of intangible asset on page 39). In our view this selective approach should be avoided.

Other definitions of value not recognised

AASB 3 Business Combinations provides the following definition of fair value:

"The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction."

Since valuers are often undertaking valuations for both taxation and accounting purposes, it would be helpful to acknowledge the definition of value in AASB 3 and confirm that generally, market value is equivalent to fair value.

There is considerable overlap between Parts C and E in relation to intangible assets

There is considerable overlap between the discussion on valuing a business in Part C and the discussion on valuing intangible assets in Part C and the discussion on valuing underlying assets in Part E. A case could be made for incorporating Part E into Part C. In many cases, the disposal of a business will include the transfer of intangible assets and the need will arise to allocate value between the various assets underlying the business.

Valuers & valuation processes

The Guidelines' risk matrix should apply to review processes of the ATO

Page 17 states: "Except for the most straightforward valuation processes, a market value ascertained by a person without formal valuation qualifications may be considered a greater risk than one derived by a suitable qualified person." Notwithstanding this, page 27, in relation to various methods of valuing a business, security or intangible asset, advises that "These methods are often applied within the Tax Office to derive or assess a market value." To ensure the integrity of valuations, the Guidelines' risk matrix should equally apply to internal valuation processes of the ATO.

Review should be based on stronger grounds than an ATO officer doubting the integrity of a value

Page 60 of the Guidelines advises that “If we doubt the integrity of the value to be allocated it will be necessary to examine that transaction and its basis. If it is based on a valuation, the risks associated with specific market valuations will be considered. If it is not based on a valuation or there is no statutory requirement for a market value to be determined, the basis on which it has been determined will need to be examined in the context of the legislation and factual circumstances.” It may be alarming for readers to be advised that a full review could be launched because the ATO doubts the integrity of a value, given all valuation is a subjective / judgement anyway.

The Guidelines allow for a determination that a market value is acceptable before any review of that valuation

Page 57 of the Guidelines states: “If we identify a sufficient tax risk we may examine the valuation process risk. This is generally done by valuers. They determine whether a market value is acceptable and review the valuation process if necessary, to see if it complies with accepted valuation industry practice.” This idea could be expressed better such that the review of the valuation process is undertaken before any determination that a market value is acceptable.

The Guidelines does not clarify when a valuer has ‘significant experience’

In relation to a significant holding of listed shares, page 35 explains that “A valuer with significant experience may be required to assess the applicability and quantum of any discount or premium”. It is unclear how, and by whom, ‘significant experience’ is measured.

Not all transfers of intangible assets as that term is used in the Guidelines will give rise to CGT events

The discussion on intangible assets in Parts C and E (in particular the Step-by-Step Guidelines for the allocation of value on pages 54-55) should consider that transfers of intangible assets, as that term is used in the Guidelines, may not give rise to CGT events for purposes of the ITAA 1997 (for example ‘know-how’ is not a CGT asset - see paragraph 101 of TR 1999/16 and TD 2000/33). This is only briefly and indirectly acknowledged at the end of the examples of intangible assets extracted from AASB 3 included at the bottom of page 40.

It is unclear if the Guidelines applies for establishing an ‘arm’s length’ value for transfer pricing

On page 15 the Guidelines, under the heading ‘Arm’s length value and transfer pricing’ states that establishing a market value for something is distinguishable from transfer pricing. The logical conclusion to be drawn from this latter statement is that the Guidelines are not intended to apply for establishing an arm’s length value for the purposes of Australia’s transfer pricing rules.

If the Guidelines are not intended to apply for establishing an arm’s length value for purposes of Australia’s transfer pricing rules, then this should be stated explicitly. If, on the other hand, the Guidelines are intended to apply for establishing an arm’s length value for purposes of Australia’s transfer pricing rules, then changes should be made to reflect the matters referred to on page 15 under the heading ‘Arm’s length value and transfer pricing’.

Appendix B: Specific comments regarding the wording in the Guidelines

Reference	Paragraph	Comments
Part A	Page 2	paragraph two – spelling appendixes should be appendices.
Part A	Page 4	para , 2change “what is required” to read “what is expected”...
Part A	Page 13,	second last paragraph containing bullet points, refer to 3rd bullet”associated with the (delete “land” and replace with “asset being valued, in the specific case, land.”)
Part A	Page 14,	first para , rather than ‘The Law’ the sentence should read “Subdivision 960-S of the ITAA 1997” also provides, in determining.....
Part A	page 14	second last paragraph, the last word ‘Australian’. This sentence appears to be incomplete.
Part A	Page 15	Amend “Valuers are sometime required to assess value using different approaches (or standards of value). In this regard it would be useful to provide comment as to how “market value” differs (if at all) from the definition of “fair value” contained in AASB 3 Business Combinations.
Part A	Page 15	‘Where (insert “directly”) comparable arm’s length sales data is available, (insert “(eg in a market for a commodity product)”) this is generally considered the most appropriate methodology. Where a market exists for an asset, that market is widely considered to be the best evidence of market value (insert “of the asset traded in the market.”)
Part A	Page 15	Refer to page 15, under the heading HYPOTHETICAL MARKET...”If there is no market (insert “for the asset being valued”) the courts have held that the valuer must assume a market”
Part A	Page 15	“The market value is the (delete “value” and replace with “price”)and sellers would (insert “negotiate” and delete “arrive at”).
Part A	Page 16	Refer to page 16, first paragraph ‘The hypothetical market approachparagraph 44 states: Comment : This is not a very good reference as it appears to relate more to a “special condition” rather than the appropriateness of assuming a hypothetical market.
Part A	Page 16	Refer to page 16, under the heading Special Value, last sentence in the paragraph....the special value (delete “may” and replace with “is likely”) to be reflected in the market value.
Part A	Page 16	Refer to page 16, under the heading Prospective Market Values in rulings, third sentence, “Those events may affect the market prior to the (delete “valuation date” and replace with “future date for which the market value is determined”) resulting in market values
Part A	Page 17	Who may undertake a market valuation – it would be helpful for the ATO to refer to specific additional qualifications such as FINSIA, or membership of the BVSIG and other advanced finance qualifications.
Part A	Page 17	Refer to page 17, under the heading “Who may UNDERTAKE a market valuation?” refer to last sentence of paragraph 1, “The Government has announced that valuations conducted by members of an approved professional association will avoid any cost of Tax Office review of that valuation. Comment: Clarification is required regarding the meaning of the expression “approved professional association”.

Reference	Paragraph	Comments
Part A	Page 18	Instructing the Valuer – it is more common practice for the scope of work to be agreed and documented in the engagement letter. Written instructions are rarely provided. This practice should be allowed for.
Part A	Page 18	Refer to page 18: The bolded, capitalised comment at top of the page may not be the ATO's. Comment: The statement "personal integrity and competence are fundamental requirements" is subjective and not capable of objective verification.
Part B	Page 22	Replacement Cost: The statement that valuations for financial reporting "may be based on applying arbitrary depreciation rates related more to accounting policy than to market analysis" is (hopefully) inaccurate. Valuations for financial reporting require the valuer to determine a market or fair value. If the DRC approach is used, then the assumptions made by the valuer in respect of effective lives, residual values and depreciation profiles should all be such that they result in a reasonable market value being determined. Otherwise such a valuation would not be consistent with IVSC and AV&PSB standards and guidance. A properly conducted valuation on the basis of fair market value for financial reporting purposes should therefore be entirely consistent with a market valuation for tax purposes.
Part B	Page 24	Valuations of Plant and Equipment, para 2. The statement in respect of impairment and componentization suggests that these matters are covered in the real property part of the Guidelines, however there do not appear to be any further references. Absent such clarification, it might be better to remove this paragraph.
Part B	Page 24	Valuations of Plant and Equipment, para 3. The statement in respect of leasehold improvements is confusing (i.e. it was difficult to understand what the ATO requires). Certainly, if a DRC approach is adopted, then the effective life adopted for leasehold improvements should have regard to the term of the lease. However leasehold improvements are only one category of assets whose effective life may be limited by external factors (e.g. the life of mine improvements will be limited by the life of the mine). This doesn't appear to be what this paragraph is saying though. Suggest this paragraph should either be re-worked to provide greater clarity or deleted.
Part B	Page 25	The references to valuation "methods" and "methodologies" should be to "approach" and "approaches". There are a number of methods within each of the approaches. Refer IVSC 9.1
Part B	Page 27	There are three main approaches to valuation, not several, as follows: <ul style="list-style-type: none"> • Market • Income • Cost / asset based The probabilistic valuation approach would be used under one of these approaches (e.g. Monte Carlo analysis in a discounted cash flow approach), and is not a separate method as such. This has further implications for pages 27, 28, 33 and 42.
Part C	Page 28	The reference to 'thin capitalisation' under the heading 'Tax context examples' should include a footnote acknowledging the transitional rules relating to intangibles valuation contained in s820-45(1).

Reference	Paragraph	Comments
Part C	Page 31	Refer to page 31, centre page bullet points Comment: “Probabilistic” is a sub-set of the income approach, rather than a discreet approach. It should not be listed as a separate approach.
Part C	Page 32	Refer to page 32, under heading Income. The income-based approach (insert “is used to assess” and delete “derives”). Comment: The word derives implies a degree of mathematical precision that is not justified. It fails to recognise the degree of judgement inherent in many market valuations prepared for the purposes.
Part C	Page 32	On page 32, delete the heading “Probabilistic” and move the two paragraphs “The probabilistic approach...” and “Probabilistic approaches are often”... up so that they appear after the final paragraph under the “Income” heading before the “Asset” heading. Comment: This is because the probabilistic approach is a sub-set of the income approach, rather than a separate approach.
Part C	Page 32	In the paragraph beginning “The probabilistic approach is (insert “an example of an income based approach”) often used to derive a valuation
Part C	Page 32	Refer to page 32, under the heading Tax Context Examples, first paragraph. The methods described above comprise only the first step in (insert “assessing” and delete “deriving”) the value of an item.
Part C	Page 32	Refer to bottom of page 32, the sentence before bullet points “.....of different scenarios, (delete “including”).
Part C	Page 33	Refer to page 33, last paragraph, These factors include (but are not limited to): second last bullet point can be removed. Comment: This is covered in the point appearing immediately below regarding “the nature of the business”.
Part C	Page 34	Refer to page 34, final bullet point, “at the company (insert “/ business ”) level. Comment - This list combines required disclosures with factors to be considered. Revise as appropriate.
Part C	Page 34	The footnote reading “For reasons not necessarily limited to the effects of liquidity and/or volatility” is opaque.
Part C	Page 37	Refer to page 37, under the heading Valuation Approaches, “cost-based and probabilistic approaches” delete ‘ and probabilistic ’
Part C	Page 37	The reference to a “qualified person” is cross referenced to 139FG which may state that a qualified person is a “Registered Company Auditor”.
Part C	Page 39	Refer to page 39, under heading Hybrid Securities, second paragraph after voting rights, (insert “, dividend rights ”)
Part C	Page 40	Refer to page 40, 3rd last paragraph from bottom of page “Where a traded preference share.....is used (insert “as a benchmark in assessing the market value of a debt instrument” and delete “as the basis for benchmarking to debt”).
Part C	Page 42	Refer to page 42, “effect” in the 3rd last paragraph should read “ affect ”. Refer to page 42, second last paragraph “Where debt has been issued (insert “ by ”) an Australian subsidiary.....

Reference	Paragraph	Comments
Part C	Page 42	The reference to 'transfer pricing' under the heading 'Tax context examples' should be deleted. It is not correct in law for the ATO to say that it requires taxpayers to adopt market value for intangible assets for purposes of Australia's transfer pricing rules as these rules use arm's length value and not market value as has been acknowledged on page 15.
Part D	Page 46	Refer to page 46, paragraph 5, "For the purpose of this Guidelines.....of Australian (delete " federal tax ") Comment – It is the Australian law relating to these assets that must be applied, not a sub-set of the law (e.g. Australian law relating to copyright or trademarks must be applied in the valuation of these assets even though that law is not "federal tax" law).
Part D	Page 46	Page 46 - Under the heading "Valuing intangible assets...." First paragraph – "income- based, (insert " and cost-based " approaches and delete "and probabilistic")
Part D	Page 47	Refer to page 47 bullet point 5 "(that is, under (delete "the separability and / or contractual / legal criteria" and insert " Australian law. ") Comment: It is Australian law that is relevant, not an accounting standard.
Part D	Page 47	Refer to page 47 under heading "Valuing goodwill" first paragraph last sentence, (delete "equity of the" so that it reads "and the valuation (market value) of the business. ")
Part D	Page 47	Page 47 - Second paragraph same heading (delete " of equity "). Page 47 - Comment about "Valuing goodwill" section: The current wording is insufficient. It fails to do justice to this important topic. Please refer to the section entitled "Valuing Goodwill" for suggested wording.
Part D	Page 49	Refer to page 49, 4th paragraph "If there is no documentation or evidence about the valuation process, (insert " we will not be able to accept that " the value..., delete "does not establish" and insert " is an appropriate assessment of " market value.) Refer to page 50, heading 'Description of Asset'. Insert after the existing last sentence " The description of the asset should reflect the character of the asset under Australian law ".
Part D	Page 49	It is not common practice for the client to provide written instructions to the valuer. The more common practice is for the valuer to confirm the instructions via an engagement letter.
Part D	Page 50	Working papers. The second sentence of the third paragraph overstates the record keeping requirements of s262A of the ITAA 1936. Specifically, paragraph 262A(2)(b) does not require that a valuation report must provide sufficient information to allow the valuation to be replicated by another valuer. It only requires that documents be kept containing particulars of any estimate or calculation made by a person and particulars showing the basis on which and the method by which, the estimate or calculation was made. The record keeping requirements of other tax laws may be different.
Part D	Page 50	The lack of detail in a valuation report may go to risk assessment as described in Part F but it does not of itself result in a valuation report not satisfying the record keeping provisions of, for example, s262A.

Reference	Paragraph	Comments
Part D	Page 50	Disclaimers and indemnities: the requirements to explain the effect of any disclaimers and indemnities is problematic and impractical. Disclaimers are a common inclusion in virtually all valuation reports, and often include indemnities. Further, professional indemnity legislation has recently been introduced in most states in Australia.
Part D	Page 51	Refer to page 51, heading 'Reasoning for Methodologies used', second paragraph "...where a market (insert "for the asset being valued") exists...
Part D	Page 54	Refer to page 54, heading 'Working papers' last paragraph. The end of the final sentence should read "the documentation and additional records should be relatively few".
Part D	Page 56	Refer to page 56, last paragraph, last sentence of the page "...used to calculate (insert "the value of") goodwill, and that goodwill.....".
Part D	Page 57	Comments on the valuation of various asset categories, but in order to calculate a residual the relevant liabilities also need to be addressed. Items worthy of guidance include deferred tax balances, inter-company debts and guarantees
Part D	Page 57	Refer to page 57, paragraph 3, 'a step by step Guidelines.....may be found at page 55'. Comment – the page reference may need to change.
Part D	Page 57	Refer to page 57, point 6 '....that the business (delete "was not profitable" and replace with "does not generate economic profit").
Part D	Page 61	Refer to page 61, heading 'Valuation process risk' 4th bullet point - Insert 'in' following "on")
Part D	Page 65	Refer to page 65, 3rd paragraph delete 'scrutiny' as the word is repeated twice.
Part D	Page 69	The reference to a "qualified person" is cross referenced to 139FG which may state that a qualified person is a "Registered Company Auditor".
Part F	Table 1	(Risk matrix for quality of the valuation process and documentation) extends over more than 2 pages, is repetitious and too detailed. There are clear similarities with the table in paragraph 4.26 of TR 98/11. A higher-level one-page risk matrix would be of more value.
	Table 2	(Risk matrix for allocations of value – see Part E: Valuing underlying assets) is similarly repetitious and too detailed. Again, a higher-level one-page risk matrix would be of more value.
Part G, Appendix 1	Table 1	The references to arm's length value and TR 97/20 on page 70 should be removed as they relate to arm's length value and not market value – see general comments above.
	Table 2	Reference to transfer pricing on page 75 should be removed as the transfer pricing provisions in Division 13 of the ITAA 1936 deal with arm's length value and not market value – see general comments above. The inclusion in Appendix 1 of a list of relevant ATO rulings is useful. However, greater care could be taken in regard to the items in various tables, to ensure that only items relevant to Appendix 1 are shown the first table and so on.