



Australian Government
Inspector-General of Taxation

Review into the Australian Taxation Office's administration of valuation matters

A report to the Assistant Treasurer

Inspector-General of Taxation

September 2014

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30 September 2014

Senator the Hon Mathias Cormann
Acting Assistant Treasurer
Parliament House
Canberra ACT 2600

Dear Minister,

Review into the Australian Taxation Office's (ATO) administration of valuation matters

I am pleased to present you with my report of the above review. Valuation requirements in tax laws and their administration has been a persistent concern raised by a range of taxpayers.

I have made three recommendations for the Government's consideration. They seek to limit the need to conduct valuations particularly for small businesses. They include requiring valuations only where it has the 'highest net benefit', providing shortcuts or safe harbours as an alternative to conducting fresh and full valuations and tapering the eligibility criteria for tax concessions.

I have also made nine recommendations to the ATO, with almost all of which the ATO has agreed. They are largely aimed at preventing disputes from arising by, for example, the ATO adopting a more transparent and proportionate approach to challenging taxpayer valuations and allowing some divergence in valuations where they are purely attributable to the differing professional judgement of each party's valuer.

I am grateful for the support, contribution and willingness of those who provided their time, expertise and experience in the conduct of this review.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'Ali Noroozi', written over a horizontal line.

Ali Noroozi
Inspector-General of Taxation

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EXECUTIVE SUMMARY

The Inspector-General of Taxation's (IGT) review into the Australian Taxation Office's (ATO) administration of valuation matters was prompted by concerns raised by taxpayers, tax professionals and their representative bodies about the increasing role of valuations in tax law and their associated compliance costs.

There are inherent difficulties associated with valuations, such as their subjective nature, the use of ranges and the potentially prohibitive costs of obtaining them. Minor changes in valuations may also have a disproportionate tax effect where, for example, the eligibility for a concession is dependent on not exceeding certain thresholds. These difficulties, combined with the taxpayers' burden of proof where the ATO challenges their valuation, increase the potential for increased uncertainty, disputation and costs for both taxpayers and the ATO alike.

The IGT has made certain recommendations for the Government's consideration. These recommendations include requiring valuations only where it has the 'highest net benefit', providing shortcuts or safe harbours as an alternative to conducting fresh and full valuations and tapering the eligibility criteria for tax concessions.

The above are bolstered by further recommendations to the ATO to develop administrative safe harbours as well as providing additional tools to assist small businesses determine their eligibility for CGT concessions through the maximum net asset value test.

The ATO's processes for identifying valuation risks and engaging valuation expertise was also identified as an area requiring improvement, particularly given the Australian Valuation Office's closure. As a result, the IGT has made several recommendations aimed at promoting a more transparent and proportionate approach to testing and challenging taxpayer valuations. Specifically, the IGT has recommended that the ATO:

- risk assess taxpayers' instructions to valuers during pre-lodgement processes;
- develop a preliminary risk assessment process as a less costly and less formal alternative to a valuation critique;
- use legal and valuation expertise to assist in issue identification, information gathering and instructing valuers as well as staff training;
- revise its standard template for instructing valuers;
- allow taxpayers to access the ATO's instructions to its valuers; and
- only use publically available information or information that can be disclosed to the taxpayer in arriving at its market valuations.

The IGT has also recommended that the ATO improve and promote the Market Valuation Private Ruling system, which can offer taxpayers with greater certainty, as well as provide more detailed guidance on the application of valuation related penalties.

Disputes between taxpayers and the ATO may be purely attributable to the differing professional judgement of each party's valuer. In these circumstances, given the nature of the self assessment regime, the IGT is of the view that the taxpayer's valuation should be accepted notwithstanding that it is not exactly the same as the ATO's valuation. Accordingly, the IGT has recommended that the ATO provide guidance to its compliance officers to assist them in determining when to accept a taxpayer's valuation.

The IGT's previous *review into the ATO's use of early and alternative dispute resolution (ADR review)* contained many recommendations aimed at avoiding or resolving disputes, including some aimed at valuation disputes. Given the scope of the *ADR review*, in this review, recommendations aimed at dispute resolution are limited to the ATO promoting the use of facilitated expert conferencing, joint appointment of valuers and joint instruction of separate valuers by such means as updating its relevant guidance material.

Overall, the report makes three recommendations to Government and nine recommendations to the ATO. The ATO has agreed to almost all nine recommendations.

LIST OF RECOMMENDATIONS

This section contains a complete list of the IGT recommendations from the other chapters of the report for summary reference.

RECOMMENDATION 3.1

The IGT recommends that, in designing tax laws, the Government consider:

- (a) requiring valuations only where the relevant regulation impact statement demonstrates that it would be of the 'highest net benefit'; and*
- (b) where valuation is required, provide safe harbours or allow the use of existing valuations obtained for other purposes such as accounting standards or as part of natural business systems.*

RECOMMENDATION 3.2

The IGT recommends that the Government consider consulting with small businesses and their representatives with a view to reducing the reliance on valuations to access the small business CGT concessions.

RECOMMENDATION 3.3

The IGT recommends that, where eligibility criteria for tax concessions or benefits require valuation, the Government should consider the use of tapering to avoid disproportionate outcomes that may arise due to minor differences in valuations.

RECOMMENDATION 4.1

The IGT recommends that the ATO:

- (a) continue consultation with stakeholders to develop and implement, where possible, administrative safe harbours that may reduce compliance costs associated with valuation; and*
- (b) develop and make publicly available a tool that provides an indication as to the eligibility of a taxpayer for the small business CGT concessions through the maximum net asset value test.*

RECOMMENDATION 4.2

The IGT recommends that the ATO:

- (a) continue to develop a strategy to identify the various valuation risks and the compliance action for mitigating those risks;*
- (b) where ATO compliance officers identify valuation risks:
 - i) as a first step, use valuers to undertake a 'preliminary risk assessment' to assess such risk;*
 - ii) agree or agree to disagree on relevant legal or factual issues; and*
 - iii) consider whether further action, such as commissioning a critique or a full valuation, is required, taking into account factors such as the cost associated with each option as compared to the disputed amount; and**
- (c) where a taxpayer's assessment is to be amended as a result of a critique or full valuation, provide the relevant details contained in the preliminary risk assessment, critique and/or full valuation to that taxpayer.*

RECOMMENDATION 4.3

The IGT recommends that the ATO:

- (a) in consultation with stakeholders, develop a standard template for instructing valuers; and*
- (b) where a material valuation risk is identified during pre-lodgement processes, conduct a risk assessment of the taxpayer's valuation instructions with a view to reaching agreement on the instructions and/or to jointly instructing an independent valuer.*

RECOMMENDATION 4.4

The IGT recommends that the ATO publish more detailed guidance on the application of penalties to valuation discrepancies.

RECOMMENDATION 4.5

The IGT recommends that the ATO use legal and valuation expertise, including external expertise, to:

- (a) assist in areas such as identifying issues, gathering information and instructing valuers; and*
- (b) provide training to staff to build capability for the long term.*

RECOMMENDATION 4.6

The IGT recommends that the ATO:

- (a) allow taxpayer access to its instructions to valuers; and*
- (b) only use publically available information or information that can be disclosed to the taxpayer in arriving at its market valuation.*

RECOMMENDATION 4.7

Where a valuation dispute is primarily due to the professional judgement of valuers engaged by each party, the IGT recommends that the ATO provide guidance to its staff on when they should accept the taxpayer's point estimate. Such guidance may provide a number of methods and when each may be appropriately used. Examples of these methods may include applying a 10 per cent tolerance to point estimates or obtaining an opinion from the ATO's valuer as to the reasonableness of the taxpayer's point estimate.

RECOMMENDATION 4.8

The IGT recommends that the ATO:

- (a) promote the availability of Market Valuation Private Rulings (MVPR);*
- (b) jointly appoint valuers with taxpayers for MVPR purposes and allow the taxpayer greater access to the valuer; and*
- (c) consider bearing some of the valuation costs of MVPR to reflect potential ATO savings.*

RECOMMENDATION 5.1

The IGT recommends that the ATO:

- (a) ensure that it facilitates taxpayer requests for expert valuer conferencing on competing valuations to reach a common understanding of inputs and methodologies used by each valuer, the resulting valuation and the reasons for it;*
- (b) make taxpayers aware that they can request expert valuer conferencing as mentioned at (a) above; and*
- (c) in its guidance relating to valuations, update the range of dispute resolution approaches that may be used to include joint instruction of separate valuers, joint appointment of valuers and expert valuer conferencing.*

CHAPTER 1 – INTRODUCTION

1.1 During public consultation for the Inspector-General of Taxation's (IGT) 2012-13 work program, a range of taxpayers, tax practitioners and their representative bodies raised concerns about the increasing role of valuations in tax law and the potential for increased uncertainty, disputation and costs. The IGT commenced this review in response to these concerns.¹

1.2 The IGT received a number of submissions and also met with taxpayers, tax practitioners and their representative bodies as well as valuers and members of the judiciary to gain a better understanding of the issues and identify areas requiring improvements.

1.3 A range of concerns were raised which may be grouped as follows:

- inherent difficulties associated with valuations such as:
 - lack of uniform requirements for performing valuations;
 - subjective nature of valuations and use of ranges; and
 - potentially prohibitive costs for obtaining professional valuations.
- the importance placed on valuations in tax legislation such as:
 - the increasing reliance on market value in a wide range of provisions in tax laws and the compliance costs it imposes on taxpayers and Australian Taxation Office (ATO) alike; and
 - minor changes in valuation amounts having a disproportionate effect on taxation outcomes where certain thresholds are exceeded.
- the ATO's administration of valuation requirements and risk management such as:
 - the need for greater use of administrative safe harbours;
 - the compliance costs arising from the ATO's approach to assessing valuations;
 - lack of discussion between the ATO and taxpayers on valuation issues before tax returns are lodged;
 - lack of guidance on the application of penalties with respect to positions based on valuations;
 - the valuation capability of the ATO and its officers including the instruction of valuers;

¹ The review was commenced pursuant to section 8(1) of the *Inspector-General of Taxation Act 2003*. The terms of reference for this review issued on 19 November 2013, which are reproduced in Appendix 1.

- taxpayer difficulties in accessing the ATO valuer's instructions;
 - the effect of the taxpayer's burden of proof and use of valuation ranges; and
 - the underutilisation of the private rulings process.
- the need for more efficient and effective processes to resolve valuation disputes.

1.4 The above concerns are discussed in the following chapters of the report.

1.5 Chapter 2 addresses concerns regarding the nature of valuations generally whilst Chapter 3 considers those specifically relating to tax laws. Concerns relating to ATO's compliance approaches and dispute resolution are examined in Chapters 4 and 5 respectively.

1.6 The IGT established a working group of key stakeholders to assist in exploring the issues raised and developing recommendations for improvements. These key stakeholders were Susan Cantamessa (Chartered Accountants Australia and New Zealand), Michael Clough (King & Wood Mallesons), Lance Cunningham (BDO Australia), Simon Dalgarno (Leadenhall Corporate Advisory), David Fox (Corporate Tax Association), Frank Hinoporos (Hall & Wilcox), Wayne Lonergan (Lonergan Edwards & Associates), Paul McNab (PwC), Peter Poulos (Maddocks), Tony Slater QC and senior ATO officials.

1.7 The IGT greatly appreciates the generosity of the members of this working group for freely giving their time and expertise. Their involvement has significantly enhanced the outcomes of this review. It should be noted, however, that the views expressed in this report are not necessarily those of individual members of the working group.

1.8 The IGT also worked progressively with ATO senior management to identify the areas for improvement and to distil specific recommendations.

1.9 In accordance with section 25 of the *Inspector-General of Taxation Act 2003* (IGT Act), the Commissioner of Taxation (Commissioner) was provided with an opportunity to make submissions on any implied or actual criticisms contained in this report. The Commissioner's response is included in full at Appendix 5. The Commissioner's response to each IGT recommendation is extracted and reproduced directly thereunder as they appear in the report. This report is produced pursuant to section 10 of the IGT Act.

CHAPTER 2 – GENERAL VALUATION ISSUES

2.1 This chapter explains some key valuation concepts and describes stakeholder concerns which may arise more generally and not just in a tax context.

STAKEHOLDER CONCERNS

2.2 Stakeholders concerns which are not limited to taxation include:

- lack of regulation and standard setting in the valuation profession;
- valuations being opinions and the use of ranges; and
- significant costs and the uncertainty of the benefits of valuations.

BACKGROUND

What is valuation?

2.3 Valuation is generally ‘the process of establishing the value of an asset or liability’ or ‘the amount representing an opinion or estimate of value’.² Valuation may involve valuing tangible (such as plant, equipment, antiques, collectables, inventory and property) or intangible assets (such as shares, goodwill, businesses, rights, intellectual property and financial instruments).

2.4 The Accounting Professionals and Ethical Standards Boards (APESB) in Australia defines valuation as:

the act or process of determining an estimate of value of a business, business ownership interest, security or intangible asset by applying Valuation Approaches, Valuation Methods and Valuation Procedures. A Valuation does not involve the verification of information in respect of the business, business ownership interest, security or intangible asset being valued.³

How valuation is performed

2.5 Broadly, valuation is performed by a person, the valuer, who estimates the most likely value of an asset or liability at a particular point in time. The valuer arrives at this estimate by selecting the most appropriate methodology to apply to a certain set of inputs.

2.6 These inputs usually include the facts and assumptions related to the asset or liability being valued. The inputs are provided by the client in their engagement

² International Valuation Standards Council (IVSC), *Glossary*, <<http://ivsc.org>>.

³ Accounting Professionals and Ethical Standards Boards (APESB), APES 225 Valuation services (May 2012) <www.apesb.org.au>.

instructions to the valuer together with a description of the asset or liability being valued and the particular point in time with reference to which the asset should be valued. The valuer may, depending upon the circumstances, also make enquires to test the inputs provided.

2.7 The valuer's opinion typically includes a range of values within a certain level of confidence and/or an estimated value (point estimate), depending on the circumstances. This opinion is generally communicated to the client in a report that includes the basis and reasons for it.

2.8 The output of the valuation process, therefore, is sensitive to the inputs provided in the client's instructions and the methodologies chosen by the valuer.

2.9 As valuations are opinions and involve professional judgement they may be independently assessed by a valuation review or critique. Such review or critique may be defined as an 'act or process of considering and reporting on a valuation undertaken by another party, which may or may not require the reviewer to provide their own valuation opinion.'⁴

2.10 The International Valuation Standards Council (IVSC) describes the valuation review as being an integral part of professional practice in order to ensure the 'accuracy, quality and appropriateness' of valuation reports.⁵ A valuation review may test the strength of a valuation by focusing upon:

- the apparent adequacy and relevance of the data used and enquiries made;
- the appropriateness of the methods and techniques employed;
- whether the analysis, opinions, and conclusions are appropriate and reasonable; and
- whether the overall product presented meets or exceeds Generally Accepted Valuation Principles (GAVP).⁶

Valuations of market value

2.11 As stated earlier, valuers may be engaged to express an opinion on the market value of an asset at a particular point in time.

2.12 In most cases, the term 'market value' in Australia takes on its generally accepted meaning developed from judicial authority, such as the test provided in *Spencer's case*⁷ which established the concept as being the price that a willing but not anxious purchaser would pay to a willing but not anxious seller. More specifically, market value is the value struck in the following conditions:

⁴ Above n 2.

⁵ IVSC, International Valuation Guidance Note 11, *Reviewing Valuations* (2007).

⁶ Ibid.

⁷ *Spencer v Commonwealth* (1907) 5 CLR 418.

- between a willing but not anxious vendor and purchaser;
- in a hypothetical market;
- the parties are fully informed of the advantages and disadvantages associated with the asset being valued; and
- both parties are aware of current market conditions.

2.13 The above definition may be adjusted for specific markets. For example, the IVSC definition adopted by real property valuers is:

The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.⁸

2.14 Furthermore, market valuations are to take into account the 'highest and best use' of an asset which the IVSC defines as 'the use of an asset that maximises its potential and that is physically possible, legally permissible and financially feasible.'⁹

VALUER AND VALUATION REGULATION AND STANDARD SETTING

2.15 Stakeholders have raised concerns that, unlike the legal or medical profession, there is generally no system of regulation or licencing that covers all valuers. As a result, there is a level of uncertainty for clients as to whether they have engaged an appropriate valuer.

2.16 A more specific concern was raised in relation to the relatively limited pool of professional valuation expertise in certain markets within Australia. This limitation gives rise to difficulties including conflict of interests for taxpayers and the ATO.

2.17 There are limited circumstances in which legislative restrictions or requirements are placed on people who may perform valuations. For example, several Australian States regulate land valuers through legislation directly. Qualification and registration is mandatory with the relevant State government departments in these cases. These valuers may also be deregistered by the same department if registration requirements are not maintained.

2.18 Certain states also require valuers, who undertake valuations on behalf of the government, to comply with the valuation and property standards promulgated by the Australian Property Institute (API) which is a professional valuer association.

2.19 There are also certain circumstances in which government bodies mandate a specific process for a valuer appointment. For example, in relation to retail shop leases, the New South Wales Civil and Administrative Tribunal may only appoint a specialist retail valuer from a list of valuers nominated by the Presidents of the API (NSW) and

⁸ IVSC, *IVS Framework* (2011) para [29].

⁹ IVSC, 'Highest and Best Use' <http://www.ivsc.org/glossary#letter_h>.

the Real Estate Institute (NSW) where called upon to determine the market rent of a lease.¹⁰

2.20 Generally, valuers may belong to professional bodies and associations. These associations usually have purpose statements such as:

- increasing or maintaining professional standards of its members; and
- providing continuing professional education to its members.

2.21 Some of these professional associations may be subject to Professional Standards Schemes. In this respect, the Professional Standards Councils in each state are responsible for approving applications from 'occupational associations' to be covered by the scheme.

Professional Standards Schemes are a statutory innovation. They require occupational associations to improve their professional standards and protect consumers by implementing robust risk management strategies and adhering to professional indemnity insurance standards. It rewards such practices by limiting the occupational liability of members of occupational associations.¹¹

2.22 These associations must implement risk management procedures in relation to:

- membership entry requirements;
- continuing occupational education;
- codes of ethics and practice;
- complaints and discipline of association members;
- standards for Professional Indemnity Insurance for all its members; and
- risk management which track the above and any claims against members.

2.23 Whilst Professional Standards Schemes do exist, they are restricted to a limited number of professional bodies involved in undertaking valuations in a particular context.¹²

2.24 However, some self-regulation does exist. For example, with respect to mineral and petroleum asset valuation, members of professional bodies such as The Australasian Institute of Mining and Metallurgy (AusIMM) and the Australian Institute of Geoscientists are bound by an industry code known as the *Code for the*

¹⁰ *Retail Leases Act 1994* (NSW) s 72AB(2).

¹¹ Professional Standards Councils, General information about Professional Standards Schemes, <www.psc.gov.au> accessed 1 January 2014.

¹² These organisations are the Association of Taxation and Management Accountants, the Australian Property Institute, the Australian Valuers Institute, CPA Australia, the Institute of Chartered Accountants Australia and the Institute of Public Accountants.

Technical Assessment and Valuation of Mineral and Petroleum Assets and Securities for Independent Expert Reports or ‘the VALMIN code’.¹³

2.25 There are generally no regulatory restrictions on who can perform valuations of businesses.¹⁴ However, people performing such valuations are generally expected to ‘have significant experience in areas such as financial markets, investment banking, corporate finance, corporate management, and academic qualifications in areas such as accounting, finance or economics.’¹⁵

2.26 Certain business valuers are members of CPA Australia, Chartered Accountants Australia and New Zealand (CAANZ) and the Institute of Public Accountants (IPA) and are therefore bound by various professional and ethical standards as set out by the APESB.

2.27 The APESB has issued the Accounting Professional and Ethical Standard (APES) 225 *Valuation Services* as well as Guidance Note (GN) 20 *Scope and Extent of Work for Valuation Services* to assist accountants in applying the standard.¹⁶ Additionally, CAANZ administers a ‘Business Valuation Specialist’ designation for those members who meet certain requirements.¹⁷

VALUATION AS OPINIONS AND USE OF RANGES

2.28 Notwithstanding professional qualifications and accreditation, valuation is said to be both an art and a science. As noted by the IVSC, ‘value is not a fact but an opinion...’¹⁸ Despite the need to rely on objective data there is a necessary degree of subjectivity and professional judgement.

2.29 Due to this reliance on professional judgement, the outcome of valuations may be imprecise, which the valuer may express through a range of values with varying levels of confidence. Furthermore, valuers may have differing opinions as between themselves based on their professional judgment although neither may be incorrect. Where valuations are used to calculate an obligation to pay a specific amount, the subjective nature of valuations and any ranges provided result in a number of challenges. Depending on the circumstances, a client may require a valuation to produce a range of values or a specific value i.e. a point estimate. For example, expert valuation reports assessing the reasonableness of a corporate takeover offer may produce a range of reasonable values. In contrast, the tax legislation requires taxpayers to use specific Australian dollar values for the purposes of correctly assessing and reporting their tax liabilities.

2.30 Providing a specific dollar value for a valuation without qualification in a range of circumstances may be problematic as the value is typically subject to at least

¹³ The VALMIN Committee, *Code for the Technical Assessment and Valuation of Mineral and Petroleum Assets and Securities for Independent Expert Reports* (2005 ed) <<http://www.valmin.org>>.

¹⁴ See for example *Soia v Bennett* [No 5] [2012] WASC 289 at 367.

¹⁵ ATO, *Market valuation for tax purposes* (23 June 2014) <www.ato.gov.au>.

¹⁶ Above n 3.

¹⁷ Chartered Accountants Australia and New Zealand, ‘Business Valuation’ (undated) <<http://www.charteredaccountants.com.au/Industry-Topics/Business-valuations.aspx>>.

¹⁸ Above n 8, para [8].

some uncertainty. Therefore, a valuation report typically explains the factors causing uncertainty and their effect on the possible values. Notwithstanding any difficulties with providing a specific value, the usefulness of the report may be undermined where a valuer provides too broad a range of possible values.¹⁹

2.31 For a given data set, a valuer may be able to produce a range of values at a given level of confidence. If their data is limited, the valuer may be required to produce a very wide range for a given level of confidence. If a client requires a narrower range, for example, to make the report more useful to them, the valuer may either:

- attempt to gather more data, so that the range of values is narrower whilst maintaining the same confidence level, potentially increasing the cost of the valuation; or
- given the same amount of data, provide a narrower range, but with a reduced level of confidence.

2.32 A range of values in a valuation report may be presented by a normal distribution of probabilities. For certain purposes, a client may select the 'mid-point', or mean, as the most appropriate point estimate. For example, the Australian Securities and Investments Commission considers an average of values within the range provides a 'fair and reasonable' price in a takeover context for the purpose of the *Corporations Act 2001*.²⁰

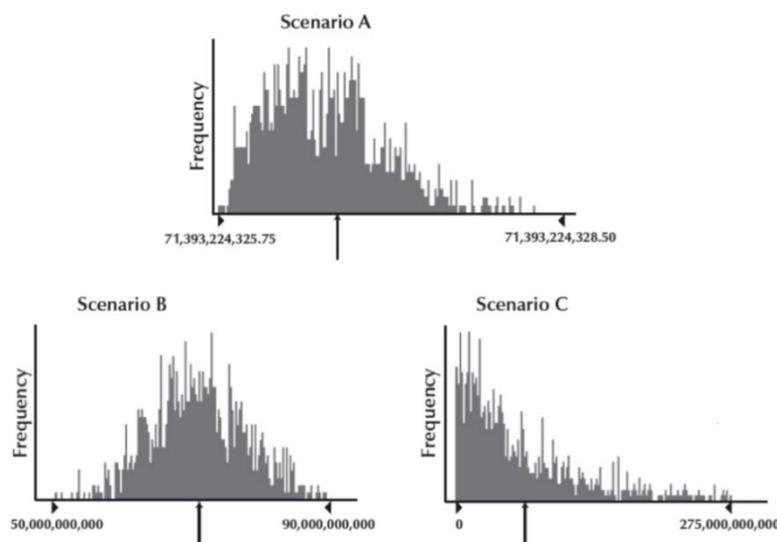
2.33 However, a range does not necessarily indicate that all values within that range are as likely as each other. To illustrate this point, the following diagram highlights three scenarios in which simply reporting a mean value obscures the distribution of probabilities. In Scenario A, the variability is narrow and immaterial. In Scenario B, the variability is wide but normally distributed. Scenario C shows a heavily skewed distribution 'with the most likely outcome being significantly lower ... than the mean outcome.'²¹

¹⁹ Australian Securities and Investments Commission (ASIC), *Regulatory Guide RG 111 Content of expert reports* (October 2007) paras RG [111.62] and [111.63].

²⁰ ASIC, *Regulatory Guide RG 163* (December 2000) which refers to *Re Btr Plc and Btr Nylex Limited v Westinghouse Brake and Signal Company (Australia) Limited; Ian Edric Prowse; Hawker De Havilland Limited and Australian Securities Commission* [1992] FCA 55 (21 February 1992) paras [51] and [53].

²¹ Ian Harris, Professor Michael Mainelli and Jan-Peter Onstwedder, 'Confidence Accounting: A proposal (Association of Chartered Certified Accountants, the Chartered Institute for Securities & Investment and Long Finance, 5 July 2012) p 7.

Figure 1: Three different distributions of possible values all showing a mean of 71,393,224,327



Source: Confidence Accounting: a proposal, ACCA, the Chartered Institute for Securities and Investment, Long Finance 5 July 2012.

2.34 In this respect, the IVSC has recommended ranges should not be used to communicate valuation uncertainty as users of valuations often require a specific value and a range would not be acceptable. Furthermore, users may incorrectly assume that ‘an equal probability attaches to any outcome within the range’ or ‘there is no possibility of a valuation falling outside of the indicated range.’²²

2.35 The IVSC has also highlighted that a lack of data not only results in more uncertainty with a valuation but also causes difficulties in quantifying that uncertainty.²³ The IVSC, therefore, advocates that any material valuation uncertainty should always be disclosed with a qualitative description and any quantitative explanations provided only where appropriate.²⁴

SIGNIFICANT COSTS AND UNCERTAIN BENEFITS OF VALUATIONS

2.36 Stakeholders raised concerns that the need to rely on professional valuers to undertake valuations increases the costs of complying with regulations or legal requirements. In addition, due to differences in various regulations or statutory regimes, the same assets or liabilities may need to be valued more than once, further increasing compliance costs.

2.37 Some stakeholders have indicated that depending on circumstances there may be no benefits in engaging a professional valuer or the benefits may be marginal particularly where an administrator or regulator may subsequently seek to challenge

²² IVSC, *Technical Information Paper 4 – Valuation Uncertainty* (January 2014) para [42].

²³ *Ibid* paras [39] and [40].

²⁴ *Ibid* para [37].

that valuation. Parties may seek to avoid the cost of a professional valuation in such cases by undertaking a private or director valuation.²⁵

2.38 The inputs and methodologies used in valuations may be different depending on the purpose of the valuation and the requirements of the relevant laws. For example, financial statements prepared according to accounting standards may require assets to be valued using certain approaches. A common approach is to use 'fair value'.²⁶

2.39 Assets may also need to be valued for insurance purposes. For example, a valuation may need to estimate the cost of replacing and rebuilding a house to determine the amount of insurance coverage and related premiums. A common approach is to use 'reinstatement cost'.²⁷

2.40 In certain proposed corporate takeovers, the *Corporations Act 2001* may require an independent expert's report to form an opinion as to whether the takeover offer is 'fair and reasonable'. Such an opinion would need to consider the value of the interests in the target company.²⁸

2.41 Each of the above types of valuations may require the use of a different 'standard of value' i.e. fair value, reinstatement cost and fair and reasonable. A valuation for one purpose, therefore, may not necessarily be useful or acceptable for another purpose.

2.42 Furthermore, laws imposing valuation do not necessarily lend themselves to a common or unified valuation approach, even if one standard of value is commonly used. This difference in approach arises from the difference in statutory schemes. For example, the Full Federal Court recently cited with approval the following comments made by the New South Wales Court of Appeal in *Leichhardt Municipal Council v Roads and Traffic Authority of New South Wales*:

Matters of valuation turn in large measure on the precise statutory scheme. These schemes differ from one area of discourse to another. It is always important to commence with the precise words of the statute. There appears to be a tendency to take a judgment about one statutory regime and classify its conclusion as a "valuation principle" which is applied to any process of valuation, no matter how different the statutory regime may be.

The need to determine the value of assets arises in many different legal contexts. It is the context which determines the relevant principles of valuation to be applied. An assumption that there is in existence some abstract body of "valuation principles" applicable in all contexts, irrespective of the statutory scheme or contractual provision, is liable to lead to error. Judgments in one context may prove instructive by way of an analogy when dealing with

²⁵ A director valuation is performed by the director of a company for the purposes of applying the accounting standards in its financial statements.

²⁶ Australian Accounting Standards Board (Cth), *AASB Standard AASB 13 Fair Value Measurement* (2013).

²⁷ Australian Property Institute, *Guidance Note 13 Valuations for insurance purposes* (undated) <<http://www.api.org.au>> para [2.9].

²⁸ Above n 19, para [RG 111.11].

another context. Nevertheless, statutory differences must be borne in mind. The ultimate task must always come back to the application of the principles in the particular context...²⁹

IGT OBSERVATIONS

2.43 The IGT acknowledges that the above stakeholder concerns raised in relation to valuations have much broader relevance and are well beyond taxation specific matters.

2.44 There seems to be a lack of standardisation, as far as valuations are concerned, across the various regulatory regimes and commercial landscape. Where standardisation has occurred, it is limited to a particular field or regulation. However, there may be good reasons for differences in valuation methods or approaches for a given market or purpose.

2.45 It is beyond the scope of this IGT review to make specific recommendation for changes to a broad range of regulations and standardisation of valuations and valuers across different fields or industries. However, where valuations are required for regulatory or compliance purposes, the regulator should be mindful of the costs associated with valuations and should seek to minimise such compliance costs. For example, the regulator may consider leveraging off comparable valuations obtained for other purposes.

2.46 The remainder of the report makes observations and recommendations with respect to valuations as it relates to tax administration, including aspects of the tax laws. Improvements in the administration of tax-related valuations may prove to be useful in generating a broader debate on the valuation costs imposed by the various regulatory regimes and commerce.

²⁹ *Leichhardt Municipal Council v Roads and Traffic Authority of New South Wales* [2006] NSWCA 353 at [35] and [36]; *Commissioner of Taxation v Resource Capital Fund III LP* [2014] FCAFC 37 at [47].

CHAPTER 3 – VALUATIONS REQUIREMENTS IN TAX LAWS

3.1 In addition to the complexities associated with valuations generally, particular challenges arise when valuations are required by the tax system. There are at least 206 different tax provisions that may require a taxpayer to determine an unrealised value of an asset or liability, or an alternative value to a realised asset or liability. These provisions are not all uniform and mandate different valuation approaches. A table of these provisions is contained in Appendices 2 and 3.³⁰

SUMMARY OF STAKEHOLDER CONCERNS

3.2 The tax-specific concerns that stakeholders have raised relate to practical difficulties and the compliance costs that valuation impose. These include:

- the requirement to allocate value to assets in a commercially unrealistic manner and the inability to rely on valuations already obtained for other purposes such as those required by accounting standards;
- the lack of safe harbours to minimise the need to undertake valuations;
- valuation requirements for small business taxpayers, particularly those for accessing the small business capital gains tax (CGT) concessions; and
- provisions that created 'all or nothing' outcomes for taxpayers or the ATO, with a small valuation difference causing a large, disproportionate change in tax liability.

USE OF EXISTING VALUATIONS

Stakeholder concerns

3.3 Stakeholders have contended that the notion of market value is used in a plethora of provisions in tax legislation like a 'cure-all' when it may be impractical or even frustrated due to a lack of market prism. The increasing use of market value, as a means of determining a taxpayer's liability, has also necessitated more valuations and added to the compliance burden.

3.4 Stakeholders have also argued that legislative mechanisms, which rely on pre-existing business or accounting concepts, should be available as an alternative to valuations where they achieve significantly the same outcomes. For example, stakeholders have cited reinstatement value (often used to value assets for insurance purposes) and unimproved land value as potential substitutes for market value in certain circumstances. It should be noted that these substitutes are relatively

³⁰ These provisions were identified by ATO officers during preliminary research for a research project to identify sources of valuation risk. This project was discontinued at the commencement of the IGT review.

uncomplicated concepts compared to market value which is required by many tax provisions.

3.5 Stakeholders have also raised concerns with laws that require the taxpayer to identify and allocate value to assets which were commercially unrealistic or inconsistent with how businesses treated those assets. For example, stakeholders highlighted the case of *Resource Capital Fund III LP v Commissioner of Taxation* (RCF case)³¹ where the Taxable Australian Real Property (TARP) provisions require the taxpayer to value mining rights and mining information separately. In practice, such assets would be sold as a bundle for the reason that the mining rights would be far less valuable without the mining information.

3.6 Furthermore, many tax provisions were said to require valuers to determine separate future cash flows derived from each asset, whereas such cash flows are not allocated separately to these assets in commercial practice. For example, valuers may be required to allocate a portion of the value to intellectual property attaching to a physical asset, such as copyright to an electricity distribution network, even though a sale agreement may make no such allocation as the physical assets would not be fit for purpose without that intellectual property.³²

3.7 Stakeholders have also raised concerns regarding the considerable cost created by tax laws which effectively require taxpayers to obtain valuations. The costs of such valuations are regressive and small businesses generally consider these costs prohibitive where their transactions are low in value. As a consequence, taxpayers may forego access to certain regimes such as the consolidation regime or incorrectly claim a concession to which they are not entitled such as the small business CGT concessions.

3.8 The requirement to obtain a valuation for tax purposes may arise as a result of legislative requirement to do so or as a means for a taxpayer to reduce their risk. For example, some tax provisions, such as those relating to consolidation, make reference to 'market value' as part of a calculation, such as applying the allocable cost amount to reset cost base assets.³³ The level of risk and complexity of determining market values for a joining entity's³⁴ assets may effectively require the taxpayer to obtain a professional valuation, although the legislation itself may not mandate it as such.

3.9 Other tax provisions, such as thin capitalisation, explicitly require the taxpayer value their assets, liabilities and equity capital. In doing so, taxpayers are required to comply with the accounting standards.³⁵ This is also an example of a valuation provision in the tax law where the standard of value is not 'market value' but 'fair value' as required by the accounting standards.

³¹ [2013] FCA 363.

³² See also, *SPI PowerNet Pty Ltd v Commissioner of Taxation* [2014] FCA 261.

³³ *Income Tax Assessment Act 1997* s 705-35(1)(c).

³⁴ A joining entity is an entity that is joining a consolidated group.

³⁵ *Income Tax Assessment Act 1997* s 820-680(1).

3.10 The key tax law provisions that were raised with the IGT in this review which require taxpayers to obtain valuations include³⁶:

- Thin capitalisation – requires taxpayers to value assets, liabilities and equity capital according to accounting standards.³⁷
- Self-managed superannuation funds – trustees must annually prepare financial accounts using the market value of assets³⁸ and the market value ratio of in-house assets to other assets cannot exceed 5 per cent.³⁹
- Consolidation – market value is used as the basis for applying the allocable cost amount to reset cost base assets⁴⁰ and determining available fractions for transferred losses.⁴¹
- Philanthropy – taxpayers seeking deductions for particular kinds of gifts of property must have the valuation determined by the Commissioner.⁴²
- Cultural gifts – taxpayers seeking deductions for donations of cultural gifts to certain institutions must obtain valuations from two approved valuers.⁴³
- Goods and Services Tax (GST) margin scheme – taxpayers are required to use ‘approved valuations’ when applying the margin scheme. The Commissioner can determine the requirements of approved valuations.⁴⁴
- CGT assets:
 - Generally, the cost base⁴⁵ or capital proceeds⁴⁶ of a CGT asset may be substituted by the market value of the asset at the relevant time if the parties were not dealing with each other at arm’s length.
 - TARP – foreign residents may be subject to CGT based on whether they satisfy the principal asset test. The test requires a calculation of the market values of the TARP and non-TARP assets of a test entity.⁴⁷
 - Small business concessions – taxpayers seeking these concessions may access them through four alternative tests, one of them being the Maximum Net Asset

³⁶ These are reproduced in Appendices 2 and 3.

³⁷ *Income Tax Assessment Act 1997* Division 820.

³⁸ *Superannuation Industry Supervision Regulations* r 8.02B.

³⁹ *Superannuation Industry (Supervision) Act 1993* s 82.

⁴⁰ *Income Tax Assessment Act 1997* s 705-35(1)(c).

⁴¹ *Income Tax Assessment Act 1997* s 707-320.

⁴² *Income Tax Assessment Act 1997* s 30-212; Regulation 30-212.02 then requires taxpayers to make applications for valuations directly to the Commissioner (previously the General Manager of the Australian Valuation Office).

⁴³ *Income Tax Assessment Act 1997* s 30-200.

⁴⁴ *A New Tax System (Goods and Services Tax) Act 1999* s 75-35. *A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination MSV 2009/1* is an example of such a determination.

⁴⁵ *Income Tax Assessment Act 1997* s 112-20.

⁴⁶ *Income Tax Assessment Act 1997* s 116-30.

⁴⁷ *Income Tax Assessment Act 1997* s 855-30.

Value (MNAV) test. This requires the taxpayer to consider the market values of its CGT assets before subtracting various liabilities and provisions.⁴⁸

- Taxation of financial arrangements (TOFA) – certain taxpayers who prepare audited financial statements may elect to have their gains or losses measured using 'fair value' consistent with 'the accounting principles'.⁴⁹

Different standards of value

3.11 The tax laws predominantly rely on the concept of market value which is not defined in the legislation and may lead to inconsistent application.

3.12 Furthermore, a number of tax provisions rely on other standards of value. For example, use of accounting standards in the thin capitalisation and TOFA regimes has facilitated an express reliance on 'fair value' rather than market value as mentioned above.⁵⁰

3.13 In relation to the thin capitalisation regime, a choice was provided to allow taxpayers to use accounting standards as a way of reducing compliance costs:

The Review of Business Taxation considered it appropriate to have regard to accounting principles in the development of taxation legislation. The use of Australian accounting standards in determining the value of assets for the purpose of applying the ... debt test will reduce compliance costs for many taxpayers as the tax values of assets will be more closely aligned with accounting principles and practice. For some taxpayers who do not need to prepare financial reports in accordance with accounting standards there may be initial compliance costs in applying the accounting standards. However, the use of accounting standards will provide a reliable, consistent and transparent method to value assets. All of which will provide greater certainty to taxpayers in applying the new measures.⁵¹

3.14 The tax laws also use other value concepts such as adjustable value, termination value⁵², market selling value and replacement value.⁵³

3.15 Examples of previous stakeholder concern regarding the use of different standards of values in legislation were conveyed during the reforms to the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and associated regulations to mandate annual financial reporting by self-managed superannuation fund (SMSF) trustees. The proposed regulations called for assets to be regularly valued at their 'net market value'.⁵⁴ Concerns were raised with the use of a different standard of value to

⁴⁸ *Income Tax Assessment Act 1997* s 152-20.

⁴⁹ *Income Tax Assessment Act 1997* s 230-210.

⁵⁰ *Income Tax Assessment Act 1997* Division 230.

⁵¹ Explanatory Memorandum, House of Representatives, New Business Tax System (Thin Capitalisation) Bill 2001, para [11.19].

⁵² *Income Tax Assessment Act 1997* Division 40.

⁵³ *Income Tax Assessment Act 1997* Division 70.

⁵⁴ Exposure Draft, Superannuation Industry (Supervision) Amendment Regulation 2012 (No.) Clause 5.

that already existing in the SIS Act, being ‘market value’ defined in section 10 of that Act.

3.16 Stakeholders recommended that net market value should be replaced with the existing market value concept⁵⁵, or with fair value to aid comparability with Australian Prudential Regulation Authority (APRA) superannuation funds⁵⁶ which was one of the original policy intents.⁵⁷ It was noted that a different concept would create confusion⁵⁸ and increase valuation costs:⁵⁹

Inconsistencies with valuation requirements for other superannuation purposes and other legislation is also a likely consequence as is a likely increase in costs for SMSF trustees.⁶⁰

3.17 The Regulations eventually adopted the pre-existing market value concept in the SIS Act. It should also be noted that, although the SIS Act uses market value, it is defined within the SIS Act.⁶¹

ATO valuation costs

3.18 The ATO approved expenditure for at least \$6 million on 205 valuer engagements during the period 1 July 2011 to 31 December 2013.⁶² This amount does not include the ATO’s opportunity costs, for example, time staff spent in collecting valuation-related information and drafting instructions for valuers.

3.19 The ATO has sought to reduce its costs by creating a specialist internal Valuation Gatekeeper Unit (VGU), which vets the need for external valuations. The ATO’s Small Business and Individual Taxpayers (SBIT) business line also uses a customised risk tool which estimates the likelihood of taxpayers breaching the asset value threshold for the small business tax concessions, without the need to obtain external valuation advice.

⁵⁵ The Association of Superannuation Funds of Australia Limited, Submission to The Treasury, *Consideration of Insurance, Separation of Assets and Valuation of Assets at Net Market Value* (4 June 2012) para [1.3] and SMSF Professionals’ Association of Australia, Submission to The Treasury, *Consideration of Insurance, Separation of Assets and Valuation of Assets at Net Market Value* (1 June 2012) p 3.

⁵⁶ The Institute of Chartered Accountants in Australia, Submission to The Treasury, *Consideration of Insurance, Separation of Assets and Valuation of Assets at Net Market Value*, 1 June 2012, p 2; CPA Australia, Submission to The Treasury, *Consideration of Insurance, Separation of Assets and Valuation of Assets at Net Market Value*, 1 June 2012, p 1; and WHK, *Consideration of Insurance, Separation of Assets and Valuation of Assets at Net Market Value* (1 June 2012).

⁵⁷ Explanatory Memorandum to Exposure Draft, Superannuation Industry (Supervision) Amendment Regulation 2012 (No.).

⁵⁸ The Association of Superannuation Funds of Australia Limited, Submission to The Treasury, *Consideration of Insurance, Separation of Assets and Valuation of Assets at Net Market Value* (4 June 2012) para [1.3].

⁵⁹ CPA Australia, Submission to The Treasury, *Consideration of Insurance, Separation of Assets and Valuation of Assets at Net Market Value* (1 June 2012) p 2.

⁶⁰ The Institute of Chartered Accountants in Australia, Submission to The Treasury, *Consideration of Insurance, Separation of Assets and Valuation of Assets at Net Market Value* (1 June 2012) p 2.

⁶¹ ITAA 1997 Dictionary only modifies the ordinary meaning of market value to account for GST.

⁶² See Table 2 in chapter 4.

3.20 As explained in the next chapter, case statistics from the ATO has highlighted that CGT is an area of tax law that the ATO incurs the greatest costs in obtaining external valuation advice. Some of these CGT areas are described below.

Market value substitution

3.21 Paragraph 112-20(1)(c) of the *Income Tax Assessment Act 1997* (ITAA 1997) generally requires a taxpayer to substitute the first element of the cost base of a CGT asset with its market value if they have not dealt at arm's length with the entity from which they acquired the CGT asset. Similar provisions exist in relation to capital proceeds from various CGT events.⁶³

3.22 During 1 July 2011 to 31 December 2013, the ATO engaged valuers on 21 occasions (11% of total ATO compliance and litigation valuer engagements) at a cost of \$427,824 (7% of total ATO compliance and litigation valuer costs) regarding this area of tax law.

Small business CGT concessions

3.23 The small business CGT concessions are contained in Division 152 of the ITAA 1997. In order to access these concessions, the taxpayer must establish their eligibility by passing one of the following four tests:

- the 'small business entity' (SBE) test, whereby taxpayer must carry on a business with an aggregated turnover of less than \$2 million per annum⁶⁴;
- the taxpayer is partner in a partnership that is itself an SBE;
- the taxpayer is an affiliate of or connected with an SBE⁶⁵; or
- the MNAV test, whereby the net value of the CGT assets of the taxpayer and any connected or affiliated entities does not exceed \$6 million just before the CGT event.

3.24 As the MNAV test relies on the market values of assets 'just before' the CGT event, small changes to the market values of assets can affect a taxpayer's eligibility to the concessions. For example, ATO Interpretative Decision (ATOID) 2003/745 highlights that a \$6,000 increase in the value of the taxpayer's assets, due to movements in share prices during the day, pushed the taxpayer from under the threshold (passing the test) earlier in the day to over threshold (failing the test) just before the CGT event later in the same day.⁶⁶

⁶³ *Income Tax Assessment Act 1997* s 116-30.

⁶⁴ *Income Tax Assessment Act 1997* s 328-110; Note that If the taxpayer meets the definition, it is also eligible to access a range of other small business concessions, not just the capital gains tax concessions. These additional concessions are listed in section 328-10 of the ITAA 1997.

⁶⁵ *Income Tax Assessment Act 1997* ss 152-10(1)(c)(iii)-(iv).

⁶⁶ ATO, *CGT small business relief: maximum net asset value test - 'just before' the CGT event - immediately before*, ATO ID 2003/745 (22 August 2003).

3.25 During 1 July 2011 to 31 December 2013, the ATO engaged valuers on 16 occasions (8% of total ATO compliance and litigation valuer engagements) at a cost of \$298,730 (5% of total ATO compliance and litigation valuer costs) regarding this area of tax law.

3.26 The ATO does not collect data to determine the direct costs incurred by taxpayers in obtaining valuations for tax purposes. However, the Board of Taxation (Board) has reported that the average cost of a valuation for the purposes of claiming the small business CGT concession was \$536.⁶⁷ This very low cost may be explained, in part, by the Board's observation that in some cases, 'the complexity of eligibility tests [for the small business tax concessions] means that some [small] businesses do not even bother trying to determine eligibility and may miss out on benefits because of the high cost of compliance.'⁶⁸

3.27 During this review, stakeholders have asserted to the IGT that a small business was more likely to incur costs of around \$10,000 to \$20,000 for a full valuation for the purpose of the small business CGT concessions. Indeed, the costs may be substantially higher for more complex assets and transactions.

Taxable Australian Real Property (TARP)

3.28 Foreign residents are generally exempt from CGT unless their capital gain is in relation to a CGT asset which is taxable Australian property.⁶⁹ Where the taxpayer is disposing of their membership interest in another entity, it is necessary to determine if the 'entity's underlying value is principally derived from Australian real property.'⁷⁰ This is the principal asset test and requires a comparison of the market values of the entity's 'TARP assets' and 'non-TARP assets'.⁷¹ Where the sum of the market values of the entity's TARP assets exceed the sum of the market values of the entity's non-TARP assets, the test is met. If the principal asset test is met, the foreign resident, who would otherwise disregard their capital gain, must include that capital gain in their Australian assessable income.

3.29 During 1 July 2011 to 31 December 2013, the ATO engaged valuers on 9 occasions (5% of total ATO compliance and litigation valuer engagements) at a cost of \$1,563,365 (25% of total ATO compliance and litigation valuer costs) regarding this area of tax law. Recent litigation indicates that the quantum of tax in dispute can be significant in TARP cases.⁷²

3.30 The IGT notes that in the particular case of distinguishing between mining rights (TARP) and mining information (currently non-TARP), the 2013-14 Federal

⁶⁷ Board of Taxation, *A Post-implementation Review of the Quality and Effectiveness of the Small Business Capital Gains Tax Concessions in Division 152 of the Income Tax Assessment Act 1997, A Report to the Treasurer* (October 2005) para [17.13].

⁶⁸ Board of Taxation, *Scoping study of small business tax compliance costs, A report to the Treasurer* (December 2007) para [8.6].

⁶⁹ *Income Tax Assessment Act 1997* s 855-10.

⁷⁰ *Income Tax Assessment Act 1997* s 855-5.

⁷¹ *Income Tax Assessment Act 1997* s 855-30.

⁷² *Resource Capital Fund III LP v Commissioner of Taxation* [2013] FCA 363; *Commissioner of Taxation v Resource Capital Fund III LP* [2014] FCAFC 37.

Budget⁷³ contained measures aimed at treating mining information as a TARP asset rather than a non-TARP asset.

IGT observations

3.31 The increasing use of the concept of market value in tax legislation is significantly adding to the compliance and administrative burdens for both taxpayers and the ATO respectively. However, market value has the advantage of being a long-standing concept that has received general acceptance and significant experience has been gained with its application particularly amongst the tax profession. Over time, the ATO has also developed and published some guidance in this area, such as the *Market valuation for tax purposes*⁷⁴ publication.

3.32 Nevertheless, the IGT considers that, in appropriate cases, taxpayers and the ATO may be able to use other standards of value rather than market value without a significant impact on revenue and with the benefit of avoiding tax specific valuation costs. For example, 'fair value' valuation necessitated by the accounting standards may be an appropriate substitute for market valuation bearing in mind that some taxation regimes, such as thin capitalisation and TOFA, already allow the use of such accounting standards for valuation.

3.33 Substantial additional compliance costs may be imposed, however, where such accounting standards are required to be used by taxpayers who do not already apply those standards, such as individuals and small businesses. In such instances, values generated by other natural business systems, as a result of comparable reports⁷⁵ or in accordance with existing taxation obligations may provide a lower cost alternative to requiring the adoption of accounting standards or valuations for tax purposes. For example, the ATO and taxpayers may find a turnover-based standard less costly and easier to apply than one based on asset value.

3.34 The IGT is of the view that, when designing new tax laws which may rely on market valuations, the potential compliance and administrative costs of obtaining such valuations should be considered as part of the Regulation Impact Statement (RIS). Such consideration would determine whether the reliance on market value has the 'highest net benefit' compared to other approaches.⁷⁶

⁷³ Australian Government, *Budget Measures*, Budget Paper No.2, 2013-14, p 35.

⁷⁴ Above n 15.

⁷⁵ This was a specific policy objective of the SMSF valuation requirements. See Explanatory Memorandum to Exposure Draft, Superannuation Industry (Supervision) Amendment Regulation 2012 (No.). See also Recommendation 8.16 and Paragraph 9.1.2 of the *Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System* (Cooper Review), Final Report (30 June 2010).

⁷⁶ Australian Government, *The Australian Government Guide to Regulation* (March 2014) p 48.

SAFE HARBOURS

Stakeholder concerns

3.35 A safe harbour may be defined as:

An objective standard or measure, such as a range, percentage, or absolute amount, which can be relied on by a taxpayer as an alternative to a rule based on more subjective or judgmental factors or uncertain facts and circumstances. A safe harbour cannot normally be used to the disadvantage of a taxpayer. A common use of a safe harbour is in relation to thin capitalization where a minimum proportion of equity to debt may be used as an alternative to demonstrating what an independent party would have been prepared to lend.⁷⁷

3.36 Stakeholders have suggested that, where there are no suitable alternatives to the use of market value, proxies, shortcuts or safe harbours should be considered. They believe that the revenue foregone by using such safe harbours would be offset by the reduction in valuation costs for taxpayers and the ATO as well as the scope of risks that the ATO must manage.

3.37 As safe harbours may be less advantageous to some taxpayers, stakeholders have suggested that it should be provided as an alternative to current valuation requirements rather than a replacement for them.

3.38 Safe harbours may be provided either through legislation or by administrative means and may either provide an alternative or replace legislatively required methods or inputs for calculation. A safe harbour, which does not displace the taxpayer's option of undertaking a market valuation or similar approach, provides flexibility for taxpayers to choose whether additional compliance costs should be incurred.

3.39 An example of a legislative safe harbour is found in the taxation of employee share schemes. While this regime generally refers to 'market value' when determining the discount provided to employees, taxpayers are permitted to use a range of methods to determine the market value of unlisted rights without resort to a formal valuation.⁷⁸

3.40 An example of an administrative safe harbour is the schedule of values for goods taken from trading stock, published by the Commissioner as a Taxation Determination (TD) from time to time. Where a sole trader, such as a butcher or baker, takes trading stock away from the business for personal use, section 70-110 of the ITAA 1997 requires them to return the cost of that trading stock as assessable income. Law Administration Practice Statement (PS LA) 2004/3 (GA) states:

However, in recognition that it is difficult, in certain businesses or industries, to determine the value of an item taken from trading stock for private use, the

⁷⁷ International Bureau of Fiscal Documentation, IBFD Tax Research Platform, *Safe Harbour Definition*: <<http://online.ibfd.org>>.

⁷⁸ *Income Tax Assessment Act 1997* s 83A-315 refers taxpayers to the Regulations for determining the market value. *Income Tax Assessment Regulations 1997* Regulations 83A-315.01 to 83A-315.09 contain the relevant tables, percentages and instructions for determining some of these values.

Commissioner has issued rulings providing a schedule of values of goods taken from trading stock for private use that may be used by taxpayers as a guide.⁷⁹

3.41 The latest iteration of this schedule is found in TD 2014/2.⁸⁰ This determination indicates the Commissioner will accept the amounts in the schedule as estimates of the value of goods taken from trading stock for private use by taxpayers in listed industries. In the context of valuations, a safe harbour could be used as an alternative choice for taxpayers by allowing them to use a pre-determined range of figures, percentages or amounts instead of determining the rate of apportionment themselves. An example of such use is found in the fuel tax credit system where the Commissioner will accept a fuel tax credit claimant's application of pre-determined ATO percentages⁸¹ as a 'fair and reasonable basis', rather than the claimant determining the rate of apportionment themselves. This example did not require any legislative change as the alternative method, or shortcut, was allowable within the scope of the legislation.

3.42 Alternatively, a safe harbour may actually replace a default approach, such as the write-off provisions for low-cost depreciating assets. Where certain taxpayers acquire a depreciating asset below a certain threshold, they have no choice but to treat the decline in value of a depreciating asset as its cost in the year the asset is first held, regardless of the effective life of the asset pursuant to subsection 40-80(2) of the ITAA 1997. This was intended to be a compliance cost saving measure.⁸²

3.43 The default rules under the capital allowances regime normally require the taxpayer to spread the decline in value of the asset over the effective life of the asset.⁸³ Certain taxpayers may have been better off using the default rules, but such an advantage is denied to them by the compulsory application of the low-cost asset write-off provision.⁸⁴ In this case, there is a trade-off between compliance cost savings to taxpayers and potentially disadvantaging them by denying them the choice to use a default method which may be more costly or complex.

⁷⁹ ATO, *The valuation of goods taken from trading stock for private use by sole traders or partners in a partnership*, PS LA 2004/3 (GA) (18 June 2004) para [16].

⁸⁰ ATO, *Income tax: value of goods taken from stock for private use for the 2013-14 income year*, TD 2014/2 (19 March 2014).

⁸¹ ATO, *Fuel tax credits - Road user charge - apportioning taxable fuel used in a vehicle for powering the auxiliary equipment of the vehicle*, PS LA 2013/4 (GA) (19 December 2013).

⁸² Explanatory Memorandum, House of Representatives, New Business Tax System (Capital Allowances) Bill 2001, para 9.6.

⁸³ *Income Tax Assessment Act 1997*, ss 40-70, 40-72, 40-75.

⁸⁴ For example, under the low asset write-off provisions, a \$300 asset with a 50% taxable use percentage in Year 1 could only ever provide a \$150 deduction in total. If this depreciating asset had an effective life of 3 years, using the prime cost method, the taxpayer could benefited from greater deductions if their taxable use percentage was 100% in years 2 and 3. The total deductions available would then be \$250. Subsection 40-80(2) does not give taxpayers this option.

IGT observations

Safe harbours

3.44 The tax laws often seek an appropriate balance between policy design and minimisation of costs in achieving the underlying intended outcome. Safe harbours which are used as substitutes for calculations of market-based values may minimise costs, however, they need to fit within policy design.

3.45 For example, the Board found Small and Medium Enterprises (SMEs) are discouraged from entering the consolidation regime due to the upfront costs and complexity associated with forming a consolidated group of which valuations perform a key role.⁸⁵ The Board's research found a 'clear trend that the smaller the size of a wholly-owned group, the less the likelihood that the group has chosen to enter the consolidation regime'.⁸⁶ As a result, the Board proposed simplified formation rules for SMEs by allowing a proxy for market value.⁸⁷

3.46 The above simplified formation rules were intended to replace the general asset tax cost setting rules. Some small businesses may be disadvantaged by this approach as compared to applying the general rules albeit with additional cost and complexity.

3.47 The above example illustrates that despite the difficulties and trade-offs associated with implementing safe harbours, they remain an important legislative and administrative tool for policy makers to reduce red tape and contain compliance costs.

3.48 The IGT is therefore of the view that where the relevant RIS has found that the 'highest net benefit' involves taxpayers undertaking a valuation, consideration be given to providing safe harbour as an alternative to reduce compliance costs particularly for SMEs.

RECOMMENDATION 3.1

The IGT recommends that, in designing tax laws, the Government consider:

- (a) *requiring valuations only where the relevant regulation impact statement demonstrates that it would be of the 'highest net benefit'; and*
- (b) *where valuation is required, provide safe harbours or allow the use of existing valuations obtained for other purposes such as accounting standards or as part of natural business systems.*

ATO response

In relation to 3.1(a) – Matter for Government

In relation to 3.1(b) – Matter for Government

⁸⁵ Board of Taxation, *Post-implementation review into certain aspects of the consolidation regime, A report to the Assistant Treasurer* (June 2012) para [6.20].

⁸⁶ *Ibid* para [6.8].

⁸⁷ *Ibid* para [6.21].

3.49 The next chapter considers the use of administrative safe harbours where legislative ones are not appropriate or do not currently exist.

SMALL BUSINESS CGT CONCESSIONS

Stakeholder concerns

3.50 Stakeholders gave strong support to safe harbours for smaller taxpayers or transactions presenting lower or common risks. The MNAV test in the small business CGT concessions was identified as a primary candidate. Stakeholders also noted that the current \$2 million SBE turnover threshold has not been updated since its introduction in 2007. The SBE test is a turnover-based rather than asset-based test which is an alternative means to access the small business CGT concessions. In addition, The Tax Institute's 2012 proposal to increase this turnover threshold to \$5 million also received strong support.⁸⁸ Stakeholders noted that complying with a turnover-based test was less complex than an asset-based test such as the MNAV test.

3.51 The ATO has advised that there were 27,841 and 23,984 small business CGT concession claimants in the 2009–10 and 2010–11 financial years respectively. Due to ATO data limitations, however, the ATO cannot determine what proportion of these claimants used the MNAV test to access the concession. A taxpayer, however, would be unlikely to use the MNAV test if it already satisfied an alternative SBE-based test.

3.52 In considering an eligibility threshold for small businesses to access the simplified consolidation entry rules, the Board considered a combined turnover and asset based threshold⁸⁹ and determined that a threshold based solely on turnover would be most appropriate:

6.25 The Board therefore recommends that the simplified formation rules should be made available to small to medium sized corporate groups with aggregated turnover of less than \$50 million in the prior income year ...

6.26 The definition of aggregated turnover should be consistent with that under the small business entity concessions, which includes the turnover of connected and affiliate entities. Although some submissions suggested that the test should apply to the turnover of the wholly-owned corporate group, the Board considered that this could be vulnerable to manipulation and that the aggregated turnover test would provide a degree of integrity for these simplified formation rules. The Board also considers that the aggregated turnover test under the small business entity concessions should already be familiar and understood by small to medium size businesses.

6.27 The Board agreed with comments raised by stakeholders that an asset threshold test would require independent valuations or the preparation of

⁸⁸ Australian Financial Review, *Small businesses set to get bigger* (16 March 2014) <www.afr.com>.

⁸⁹ The Board of Taxation, *Post-implementation review into certain aspects of the consolidation regime, Position Paper* (October 2010) para [5.36].

audited financial accounts, and would thus impose a significant compliance burden on small businesses. It therefore considers that an asset threshold test should not be incorporated into the eligibility criteria for the simplified formation rules unless, on further examination by the Government, this would allow very large businesses to obtain unintended benefits from these simplified rules.⁹⁰

3.53 The ATO has also advised that its SBIT business line uses a customised spreadsheet to risk assess the likelihood that a taxpayer fails the MNAV test. Although currently not a safe harbour used by taxpayers, this internal tool assists ATO officers to make decisions about whether to further test a taxpayer's valuation without the need to call upon the input of an expert valuer.

IGT observations

3.54 A method to reduce the overall valuation-related compliance costs, without removing taxpayer choice, is to reduce the number of taxpayers who need to obtain valuations. In relation to the small business CGT concessions, ultimately, there are three main options:

- option 1 – repeal the MNAV test and raise the SBE turnover threshold;
- option 2 – retain the MNAV test and raise the SBE turnover threshold; or
- option 3 – introduce a specific higher turnover-based threshold.

3.55 Current ATO data limitations prevent accurate quantification of the potential taxpayers and revenue affected by each option. However, in relation to option 1, the repeal of the MNAV test would increase economic simplicity as no valuations would need to be obtained or tested, thereby reducing the costs for the ATO, taxpayers and their advisors. Legal simplicity would also increase as the provision itself would cease to exist and the reliance on the SBE test is relatively straightforward. However, those taxpayers with very large turnovers and a maximum net asset value below the current threshold would be disadvantaged.

3.56 Where certain small business taxpayers have very high turnovers due to a unique feature of their particular industry, the law could specifically carve out those industry-related sales amounts from the turnover calculation as the SBE test currently does for retail fuel sales.⁹¹ It should be noted, however, that there may be a cost to the government in that more taxpayers may be able to access other tax concessions which rely on the SBE test.⁹²

3.57 In relation to option 2, increasing the SBE turnover threshold and retaining the MNAV test would increase economic simplicity for those taxpayers that would no longer need to incur costs to obtain valuations. However, it would not increase legal

⁹⁰ Above n 85, paras [6.25] - [6.27].

⁹¹ *Income Tax Assessment Act 1997* s 328-120(3).

⁹² These concessions are listed in section 328-10 of the *Income Tax Assessment Act 1997*.

simplicity as the MNAV test would continue to exist along with its reliance on valuations for those affected taxpayers.

3.58 Furthermore, tax advisor costs in maintaining knowledge of this area may remain relatively fixed as they may be required to provide advice with respect to the MNAV test. The ATO's costs may be reduced to some degree if compliance verification is limited to a smaller risk population. However, some fixed costs will remain, such as maintaining staff knowledge and support.

3.59 Unless the turnover threshold is indexed to a particular cost or growth factor, the economic simplicity of this measure would decline over time as more businesses, being still relatively 'small', would begin exceeding the turnover threshold and would thus need to turn to valuations to access the small business CGT concessions.

3.60 Whilst option 3 increases the legal complexity by introducing yet another option, it does provide economic simplicity in that the valuation costs would be reduced as few taxpayers would have to rely on the MNAV test. To minimise the impact on government revenue, those relying on this option could be prevented from accessing other small business concessions.

3.61 The IGT is of the view that reducing small business' reliance on valuations to access the small business CGT concessions is an important issue and that further consultation with the relevant stakeholders on the above three options would be worthwhile before any legislative change is recommended. In the meantime, the ATO may be able to provide some administrative assistance in this area which is explored in Chapter 4.

RECOMMENDATION 3.2

The IGT recommends that the Government consider consulting with small businesses and their representatives with a view to reducing the reliance on valuations to access the small business CGT concessions.

ATO response

Matter for Government

CONCESSION VALUE THRESHOLDS' IMPLICATIONS AND BEHAVIOURS

Stakeholder concerns

3.62 Stakeholders raised concerns that certain tax concessions or exemptions rely upon specific thresholds. These thresholds usually result in a taxpayer being subject or not subject to tax or being entitled to a certain concession. Stakeholders raised the small business CGT concessions' MNAV test and the TARP provisions applying to foreign resident capital gains as typical examples of provisions that depend upon valuation for effect.

3.63 As a result, a small change in a valuation may result in a taxpayer losing their entitlement to a concession, resulting in a large additional tax liability. Stakeholders were of the view that this 'all or nothing' relationship between the valuation and the tax outcome incentivised both the taxpayer and the ATO to devote significant resources to support their preferred valuation.

3.64 The concept of market value is generally used by the tax laws in two different ways, giving rise to two different revenue risks, namely:

- a value used as an amount to which the rate of tax is applied (directly or indirectly) to calculate a taxpayer's liability, giving rise to a 'proportional revenue risk'; and
- a value used to determine whether a taxpayer is liable to a tax or may access a concession, giving rise to a 'threshold revenue risk'.

Proportional compliance risk

3.65 A different opinion regarding the values to be applied in a market value substitution for the cost base of a CGT asset will have a corresponding or, 'proportional', effect on the tax payable. In these circumstances, the lower the market value, the lower the cost base and hence the larger the potential capital gain. In this case, any differences in the market value, say as a result of differences of opinion between valuers, has a direct and proportional impact on tax outcomes. This valuation risk may be described as a 'proportional compliance risk'.

Threshold compliance risk

3.66 The MNAV test explained earlier is an example of where a valuation risk can be described as a 'threshold compliance risk', where a relatively small change in market value can result a large and disproportionate change to the taxpayer's tax liability. In this test case, the threshold is an absolute amount, currently \$6 million.

3.67 An example best illustrates this threshold compliance risk effect. Assume that a taxpayer would have been otherwise eligible for the 15-year exemption (one of the four CGT concessions) and the capital gain from the disposal of the CGT asset was \$1 million. If the relevant conditions had been met, the taxpayer would be entitled to disregard the entire capital gain, resulting in no CGT. If, however, the market values of the taxpayer's assets were revised or challenged by the ATO so that it was \$5000 higher, the taxpayer would fail the MNAV test and not be eligible for the concession. The \$1 million gain would likely be subject to the normal rules, with a 50% discount applied and the resulting net capital gain of \$500,000 levied at the taxpayer's marginal tax rate. Assuming the highest marginal tax rate of 45% and 1.5% Medicare levy, the taxpayer may be facing an additional tax liability of \$232,500. In this example, a \$5000 change in a valuation results in a \$232,500 additional tax liability. The example is also illustrated in the table below.

Table 1: Example of a binary outcome for a threshold revenue risk

	Scenario 1	Scenario 2
Taxpayer's sum of relevant amounts of the purposes of the MNAV test.	\$5,996,000	\$6,001,000
Difference between relevant amounts	\$5,000	
Taxpayer's capital gain	\$1,000,000	\$1,000,000
MNAV test status	Pass	Fail
Taxpayer's assessable capital gain	\$0	\$232,500
Difference between assessable capital gain	\$232,500	

Source: IGT

3.68 The Board received submissions that the MNAV test's fixed threshold encouraged 'distortions to ensure that [the threshold] is not exceeded' or 'costly/artificial manoeuvring to ensure taxpayers fall within the concession.'⁹³

3.69 The ATO also recognises this 'all or nothing' effect on taxpayer behaviour. Of the SBIT small business CGT concessions compliance cases in 2010-11 and 2011-12 resulting in an amended assessment, objections were lodged in 71% and 100% of these cases respectively.⁹⁴ The ATO has observed:

... the significant dollars involved with any amended assessment (average case \$2.3m), would warrant the taxpayer incurring additional legal costs to progress the case to objections and appeals. This is particularly so where there are market valuation issues surrounding the determination of the maximum net asset value test.⁹⁵

IGT observations

3.70 The advantage for taxpayers to access a tax concession creates very strong incentives to incur significant valuation costs and to be over-zealous in defending the resulting favourable valuation.

3.71 Conversely, the ATO may be incentivised or be perceived to be incentivised to pursue marginal differences in valuation outcomes to deny a specific concession.

3.72 Importantly, where taxpayer and ATO valuations provide values within either side of a statutory threshold, the above advantages may result in both parties adopting uncompromising positions resulting in prolonged disputes and significant costs for both parties.

3.73 The use of market values as thresholds to tax liabilities or concessions may have a disproportionate effect on taxpayers and the ATO's risk-based decision making. In these cases, the IGT believes that such behavioural effects can be minimised by 'shading out' or tapering concessions whereby any difference between taxpayer and

⁹³ Taxation Institute of Australia, Submission to The Board of Taxation Post-implementation review of the small business capital gains tax concessions (1 March 2005) <<http://www.taxboard.gov.au>>.

⁹⁴ ATO, 'Intel on CGT Small Business Concession Cases' (Internal ATO document, 11 October 2012) p 10.

⁹⁵ Ibid p 11.

ATO valuations has more proportional impact. The IGT is of the view that such tapering may be considered as part of the preparation of the RIS.

3.74 It should be noted that in considering such tapering, the behavioural effects at the margins between shading out thresholds should be taken into account. In this respect, consultation with affected stakeholders, including the ATO, would ensure policy analysis takes into account potentially unintended consequences.⁹⁶

RECOMMENDATION 3.3

The IGT recommends that, where eligibility criteria for tax concessions or benefits require valuation, the Government should consider the use of tapering to avoid disproportionate outcomes that may arise due to minor differences in valuations.

ATO response

Matter for Government

⁹⁶ Above n 76 p 40.

CHAPTER 4 – ATO’S ADMINISTRATION OF VALUATION MATTERS AND MANAGEMENT OF ASSOCIATED RISK

SUMMARY OF STAKEHOLDER CONCERNS

4.1 Stakeholder concerns with the ATO’s administration of valuation matters and associated risk management, include:

- the lack of administrative safe harbours;
- the ATO’s assessment of valuation risk;
- the ATO’s reluctance to review taxpayers instructions to valuers before taxpayers’ returns are lodged;
- the lack of guidance with respect to penalties;
- the valuation capability of the ATO;
- difficulties for taxpayers in accessing the ATO’s instructions to its valuers;
- the taxpayer’s burden of proof and valuation ranges; and
- the underutilisation of the Market Valuation Private Rulings (MVPR) process.

BACKGROUND

ATO management of valuation risk

4.2 Part of the ATO’s risk management framework is to address risks of non-compliance with various tax obligations.⁹⁷ Where the tax provision effectively requires the taxpayer to obtain a valuation, the reliability of the valuation may present a risk factor which increases the likelihood and consequence of the taxpayer not reporting tax liabilities accurately.

4.3 For example, the ATO has specifically identified non-compliance with the small business CGT concessions as a risk on which it is focussing.⁹⁸ As set out in the previous chapter, this risk includes accurately valuing assets to verify eligibility for the concession. The ATO has advised that it has no specific enterprise-wide framework for managing these valuation risks as they are dealt with as part of the risks associated with the relevant provisions.

⁹⁷ For more detail about these obligations and how the ATO addresses them, see Chapter 2 of the IGT’s *Review into aspects of the ATO’s use of compliance risk assessment tools* (February 2014).

⁹⁸ ATO, ‘Compliance In Focus 2013-14’, <www.ato.gov.au>.

4.4 The ATO had, however, initiated a research project prior to the start of this IGT review to better understand the risks posed by valuations at a more strategic level, rather than on a provision by provision basis. The ATO supplied some documentation relating to this research project, parts of which are reproduced in Appendices 2 and 3 of this report. The ATO decided to discontinue this project as it considered that the IGT review would cover these issues.

4.5 In examining whether a particular valuation may be unreasonable, the ATO generally considers the integrity of the valuation process, objectivity and support for the inputs used, as well as the skills, experience and professional qualities of the valuer. As the tax laws do not, generally, impose limitations on who is permitted to perform a valuation⁹⁹ and given the lack of uniform professional standards, the ATO examines the professional qualities of valuers on a case-by-case basis. The ATO considers that valuations will be more reliable where they are undertaken by those who have:

- specific knowledge, experience and judgement in their field, which may be evidenced by their formal qualifications, licences and membership of appropriate industry and professional bodies;
- independence from the interests of the taxpayer;
- personal integrity which may be indicated by any applicable external regulation requirements; and
- competence which may be indicated by the process and market value definition used, the reasons why a particular methodology was chosen and the assumptions and information relied upon.¹⁰⁰

4.6 The ATO has advised that the total numbers of taxpayer valuations that have been reviewed and not challenged is not easily extracted from their systems and is not separately reported. However, a limited subset of this population may be gleaned from the cases where the ATO sought external valuation expertise. Approximately one-third of taxpayer valuations were not challenged after the ATO sought external valuer advice.

4.7 The areas in which the ATO seeks valuation input can be used as a proxy for identifying areas of tax law that the ATO currently considers pose the greatest valuation risk. Table 2 below shows these areas in terms of valuation engagements, their cost and relative proportions.

⁹⁹ The exceptions to this general rule are that only 'professional valuers' may provide market valuations for certain GST purposes and only 'approved valuers' may provide valuations under the Cultural Gift Program.

¹⁰⁰ Above n 15; See also ATO, *Valuation guidelines for self-managed super funds* (2014) <www.ato.gov.au>.

Table 2: Tax law areas in which the ATO engaged external valuation input

Tax area	Engagements	% of engagements	Approved Expenditure	% of expenditure
Capital gains tax	93	47%	\$ 3,027,733	51%
<i>CGT other</i>	38	19%	\$ 802,337	13%
<i>Market value substitution</i>	21	11%	\$ 427,824	7%
<i>Small business concessions</i>	16	8%	\$ 298,730	5%
<i>Taxable Australian Real Property</i>	9	5%	\$ 1,563,365	25%
<i>Off-market share buy-back</i>	9	5%	\$ 125,041	2%
Other	35	18%	\$ 978,466	15%
GST	17	9%	\$ 180,811	3%
Capital allowances	16	8%	\$ 930,814	15%
Debt recovery	11	6%	\$ 89,307	1%
Transfer pricing	10	5%	\$ 443,014	7%
Consolidation	9	5%	\$ 360,023	6%
Anti avoidance	6	3%	\$ 145,029	2%
TOTAL	197	100%	\$ 6,344,761	100%

Source: ATO Valuation Gatekeeper Unit (VGU) and RDR engagements from 1 July 2011 to 31 December 2013. Percentages rounded to the nearest one per cent and may not add up to 100 per cent.

4.8 From the above table, it is clear that the main area in which the ATO has engaged external valuation advice is CGT. This area has been further broken down into different sub-categories.

ATO compliance processes

4.9 The ATO's compliance activities usually involve gathering information from taxpayers or third parties to ascertain the correctness of statements made in income tax returns, activity statements and other returns or schedules lodged with the ATO. Where a tax provision is reliant on concepts of 'market value', the ATO may seek and test evidence of the market value and any relevant valuations undertaken.

4.10 The testing of valuation evidence may be undertaken internally by ATO officers, or by external valuers engaged by the ATO. These external valuers may have been Australian Valuation Office (AVO) staff (which was a business unit within the ATO but has since closed from 1 July 2014 – see paragraph 4.63 below) or valuers from the private sector. Each ATO business line has specific procedures for testing a taxpayer's valuation. The means by which the ATO obtains valuation advice is discussed in further detail below.

Different types of valuation services received by the ATO

4.11 According to the *APES 225 Valuation Services*, the services provided by valuers are a valuation engagement, a limited scope valuation engagement and a calculation engagement.

4.12 Valuations engagements are an assignment where the valuer is 'free to employ the Valuation Approaches, Valuation Methods, and Valuation Procedures that a reasonable and informed third party would perform taking into consideration all the specific facts and circumstances of the Engagement or Assignment available to the Member at that time.'¹⁰¹

4.13 Limited scope valuation engagements are assignments where, because of an imposed limitation, the valuer is potentially restricted from employing approaches 'that a reasonable and informed third party would perform taking into consideration all the specific facts and circumstances' available to the valuer at that time, 'and it is reasonable to expect that the effect of the limitation or restriction on the estimate of value is material.'¹⁰²

4.14 Calculation engagements require the valuer and the client to agree on the valuation approaches and methods the valuer will employ.¹⁰³

4.15 In addition to these three valuation products, the ATO had developed additional valuation products with the AVO. These were reflected in a Memorandum of Understanding (MOU) between the AVO and ATO. These additional products are the preliminary risk assessment (PRA), the valuation critique and technical advice.

4.16 PRAs are a 'high-level assessment of a valuation report that identifies areas of weakness' which include consideration of the appropriateness of the methodology, the information relied upon and the assumptions employed.¹⁰⁴

4.17 The ATO has advised that the valuation critique is defined according to IVSC guidance material which is outlined in Chapter 2 of this report. There is no ATO staff instruction prohibiting officers from amending taxpayers' assessments on the basis of a critique. However, senior ATO management¹⁰⁵ expect any ATO adjustment of a taxpayer's assessment, which relies on the valuation obtained by a taxpayer, to be based upon a full alternative ATO valuation. The reason is that, whilst an ATO valuer's critique of the taxpayer's valuation would identify weaknesses in the taxpayer's valuation, of itself, the critique is insufficient for making an adjustment.

4.18 Technical advice provides written reports on various technical valuation related matters that do not include PRA, valuation critique or calculation of a value. The MOU describes this service as answering:

¹⁰¹ Above n 3, p 5.

¹⁰² Above n 3, p 4.

¹⁰³ Above n 3, p 3.

¹⁰⁴ Australian Valuation Office, *Memorandum of Understanding between the Australian Valuation Office and the Australian Taxation Office* (7 June 2012) Schedule 1, p 4.

¹⁰⁵ ATO/IGT meeting, 24 February 2014.

particular valuation related queries raised by the ATO case teams in regards to their audit or review at early stages, before determining the next course of action or forming the ATO’s position in regards to the particular compliance issue.¹⁰⁶

4.19 ATO data indicates that other valuation services have also been obtained from the AVO or external valuers that do not correspond to the above descriptions. Furthermore, some engagements have descriptions which are a combination of the above valuation products. These have been included in a separate row in the table below.

Table 3: Types of valuation products obtained by the ATO between 1 July 2011 and 31 December 2013

Products	Number	Approved expenditure	Average approved expenditure
Technical advice only	32	\$ 445,231	\$ 13,913
Preliminary risk assessment only	1	\$ 9,240	\$ 9,240
Critique only	30	\$ 667,734	\$ 22,257
Limited scope valuation only	11	\$ 353,007	\$ 32,091
Full valuation	63	\$ 1,165,143	\$ 18,494
Combinations of the above or other items	36	\$ 901,420	\$ 25,039
Total	173	\$ 3,541,775	\$20,473

Source: ATO. Figures only include VGU compliance related engagements and not dispute related engagements.

ATO Public Groups and International

4.20 The ATO’s Public Groups and International (PG&I) business line manages compliance for ‘all listed entities, all foreign owned entities and the ATO’s international strategy.’¹⁰⁷ The ATO’s *Large business active compliance manual – income tax*¹⁰⁸ (Large Business Compliance Manual) publication sets out the ATO’s expectations for compliance officers in the PG&I business line when undertaking risk reviews, audits and pre-lodgment compliance reviews (PCRs). When planning for risk reviews, officers are to consider the engagement of valuers:

Matters involving valuation-related tax risks should have the expertise of a valuer to assist in risk assessment, adjustments and early dispute resolution.

Having a risk that has a valuation component does not automatically mean that a market valuer needs to be engaged. It does, however, mean the use of a valuer needs to be considered.¹⁰⁹

4.21 After information has been gathered and analysed, the compliance officer may conduct an internal workshop to develop an understanding of the business, identify relevant risks, further develop risk hypotheses and determine any further information or evidence required. The workshop participants may include the relevant

¹⁰⁶ Above n 104.

¹⁰⁷ ATO, *Large Business Bulletin* (December 2013) p 8.

¹⁰⁸ ATO, *Large business active compliance manual – income tax* (14 March 2014) <www.ato.gov.au>.

¹⁰⁹ Ibid para [2.5.1].

risk manager and internal technical leaders. Specialists or experts who may attend such workshops include 'Business Valuation Unit' staff.¹¹⁰ Business Valuation Unit staff were officers within the AVO who specialised in business and corporate valuations. The Business Valuation Unit was also known as the Corporate Valuation Unit.

4.22 When initiating and planning an audit (most audits are the result of a previous risk review confirming a risk), compliance officers are to consider, amongst other things, valuation related risks.¹¹¹

If the case involves valuation-related tax risks, the case officer should seek the expertise of a valuer to assist in risk assessment, adjustments and early dispute resolution...

If a significant tax risk has been identified involving a market value or valuation, it is best practice to:

- obtain the relevant documentation supporting the market value relied on
- seek the early engagement of a suitable valuer through our Valuation Gatekeeper and/or an economist
- have due regard to the advice of the valuer in relation to the possible range of market values or the valuation process.¹¹²

4.23 From 1 July 2011 to 31 December 2013, the PG&I business line accounted for 35 (20%) of the compliance related engagements of external valuers by the VGU and for \$1,141,763 (32%) of associated approved expenditure.¹¹³

ATO Private Groups and High Wealth Individuals

4.24 The ATO's Private Groups and High Wealth Individuals (PGH) business line manages compliance for taxpayers that are largely represented by SMEs, wealthy Australians and high wealth individuals.¹¹⁴ Large business taxpayers that are privately held are also managed by this business line.

4.25 The PGH business line's general approach to compliance is outlined in the publication *Tax compliance for small-to-medium enterprises and wealthy individuals* (Tax Compliance for SMEs).¹¹⁵ The publication includes 'distortions and inconsistencies in market valuations and apportionments' amongst a list of matters that attract the attention of the ATO.¹¹⁶

¹¹⁰ Ibid para [6.5.1].

¹¹¹ Ibid para [10.5].

¹¹² Ibid para [10.5.4].

¹¹³ See Table 6.

¹¹⁴ Wealthy Australians control net wealth over \$5 million. High wealth individuals control net wealth over \$30 million.

¹¹⁵ ATO, *Tax compliance for small-to-medium enterprises and wealthy individuals* (26 October 2012) <www.ato.gov.au>.

¹¹⁶ Ibid.

4.26 The guide does not outline how valuation expertise may be called upon to assist the ATO to determine valuation risks during compliance activities. It does, however, refer to valuation issues in the section regarding dispute resolution:

In relation to valuation matters, both parties may agree on the appointment of a third party expert to either critique or conduct a valuation, and commit to accept the outcome of that process.¹¹⁷

4.27 From 1 July 2011 to 31 December 2013, the PGH business line accounted for 90 (52%) of compliance related engagements of external valuers by the VGU and for \$1,778,444 (50%) of associated approved expenditure.¹¹⁸

Small Business and Individual Taxpayers

4.28 The SBIT business line is responsible for managing compliance for businesses with turnovers below \$2 million as well as individual taxpayers who are not covered by the PGH business line. Small businesses with turnovers above \$2 million are managed by the PGH business line.

4.29 Among the compliance risks managed by the SBIT business line is CGT. Non-compliance with the small business CGT concessions is one component of that CGT risk. The ATO has identified 'incorrect valuation advice' as one of the sources behind non-compliance with the small business CGT concessions regime.¹¹⁹

4.30 The number of taxpayers that claimed at least one of the small business CGT concessions during the 2009-10 and 2010-11 income years was 27,841 and 23,984 respectively. Taxpayers indicate their choice to apply the small business CGT concessions through the CGT schedule, which is usually lodged with the taxpayer's income tax return. The schedule, however, does not indicate which of the four tests (the three SBE tests or MNAV test) the taxpayer has applied to access these concessions. During the review, the ATO advised the IGT that, due to data limitations, it could not determine which SBE tests or MNAV test the claimants were using.

4.31 From 1 July 2011 to 31 December 2013, the SBIT business line accounted for 10 (6%) of compliance related engagements of external valuers by the VGU and for \$188,860 (5%) of associated approved expenditure.¹²⁰

4.32 Between 1 July 2011 and 31 December 2013 the ATO conducted or were still conducting 40 compliance cases in which the taxpayer applied the MNAV test. Of these cases, 11 were risk reviews and the remainder were audits. The outcomes of these reviews and audits are listed in the tables below.

¹¹⁷ Ibid.

¹¹⁸ See Table 6.

¹¹⁹ ATO, 'Risk Treatment Plan Capital Gains Tax in the Micro Market 2012-13' (Internal ATO Document, 4 March 2013).

¹²⁰ See Table 6.

Table 4: Outcomes of SBIT reviews of taxpayer claims of small business CGT concessions using the MNAV test, 1 July 2011 – 31 December 2013

Outcome	Number
No further action	3
Escalated to audit, but not on the valuation issue	1
In progress	1
Amended assessment due to voluntary disclosure	1
Escalated to audit including the valuation issue	5
Total reviews	11

Source: ATO

Table 5: Outcomes of SBIT audits of taxpayer claims of small business CGT concessions using the MNAV test, 1 July 2011 – 31 December 2013

Outcome	Number
No further action	18
In progress	7
Amended assessment	4
Total audits	29

Source: ATO

4.33 The ATO has advised that procedures for testing the taxpayer's valuation is not finalised but have provided the IGT with the latest draft procedure.¹²¹ This draft procedure specifies that during risk reviews of small business CGT concession cases, compliance officers must first ascertain whether the taxpayer is applying the SBE test or the MNAV test. If taxpayers are applying the MNAV test, taxpayers are to provide evidence for how they have met the MNAV test and related financial details. This evidence may include supplying a valuation report from a valuer and the accompanying instructions. Where the taxpayer has undertaken their own valuation, taxpayers would need to show how they calculated the relevant values.

4.34 The compliance officer then assesses the quality of the information provided against the risk factors outlined in the ATO publication *Market valuation for tax purposes*.¹²² This risk matrix is reproduced in Appendix 4. Discrepancies with the risk matrix are communicated to the taxpayer who then has an opportunity to revise their valuation and submit a new valuation.

4.35 Taxpayers may provide revised valuations to the ATO which are then considered by the case officer. Case officers use a customised spreadsheet to assist in determining whether the taxpayer's valuation is acceptable. The spreadsheet requires the case officer to input the taxpayer's financial details and applies pre-set formulas and ratios to give an ATO estimation of the taxpayer's net asset values.

4.36 The ATO includes a 'safety margin' in the spreadsheet, so that the ATO estimate must be a certain margin higher above the taxpayer's valuation before the ATO will consider formally challenging the taxpayer's valuation. As the ATO generally does not use external valuers for this process, such a challenge would only

¹²¹ ATO, 'SBIT Valuation Sequence Draft 3' (Internal ATO Document), provided to the IGT on 8 May 2014.

¹²² Above n 15 Table F1.

occur if the ATO was confident that its valuation was ‘well above’ the MNAV threshold of \$6 million. A case officer is required to consider putting the case to a panel of senior officers to assist with deciding the progress of the case. Furthermore, SBIT officers have also previously sought the assistance of an AVO officer.

4.37 Where the ATO’s valuation is higher than the safety margin above the MNAV threshold, the ATO has advised that it would amend those assessments without resorting to any further valuation input from external valuers.¹²³

4.38 The following table lists each compliance business line along with their approved external valuation engagements and their approved expenditure. These figures exclude valuations requested by the Review and Dispute Resolution (RDR) business line as those relate to disputes rather than compliance cases.

Table 6: ATO external valuation engagements by compliance business line, 1 July 2011 to 31 December 2013

BSL	Engagements	% of total engagements	Approved expenditure	% of total approved expenditure
ATP	5	3%	\$73,370	2%
CS&C	3	2%	\$85,750	2%
Debt	10	6%	\$88,707	3%
ITX	19	10%	\$183,561	5%
PG&I	35	20%	\$1,141,763	32%
PGH	90	52%	\$1,778,445	50%
SBIT	10	6%	\$188,860	5%
SPR	1	1%	\$1,320	0%
Total	173	100%	\$3,541,775	100%

Source: ATO information, VGU only data.

Note: Figures and percentages are rounded.

ATO staff guidance on using valuers

4.39 In addition to the ATO’s public guidance relating to valuations, such as the *Market valuation for tax purposes*, the *Large Business Compliance Manual* and the *Tax Compliance for SMEs* publications mentioned above, ATO officers can refer to a number of internal guides.

4.40 One ATO staff guide¹²⁴ indicates that ‘matters involving valuation-related tax risks should have the expertise of a valuer to assist in risk assessment, adjustments and early dispute resolution.’ However, there is limited guidance for ATO officers to assist them to understand when a valuation issue is likely to require such expertise.

4.41 ATO officers may engage valuation expertise from the private sector through a formal procurement process which is explained in greater detail below.

¹²³ ATO communication to the IGT, 7 and 9 May 2014.

¹²⁴ ATO, ‘Early dispute resolution attempts: valuation-related audit issues’ (Internal ATO Document, 22 September 2010).

4.42 An exception to the above requirement to obtain valuation expertise prior to adjusting a taxpayer's assessment is the SBIT business line's process for verifying compliance with the MNAV test of the small business CGT concession.

4.43 More specific guidance includes the ATO intranet page 'Using valuers in litigation' which highlights the role of valuers as expert witnesses in court.¹²⁵ Readers are directed to Federal Court Practice Note CM7 *Expert witnesses in proceedings in the Federal Court of Australia* for further information. The intranet page also provides some guidance about 'tolerances' and the extent to which divergences in opposing market values would attract judicial support. The page refers readers to Accounting Standard AASB 1031 as a reference point for determining materiality and how it could be translated into a permissible margin of error for valuation cases. The page nevertheless highlights that the ATO should consider the risk involved.

4.44 The ATO intranet page 'Expert witness' provides guidance to staff regarding the use of experts (not just valuers) during audits and litigation.¹²⁶ The page highlights some of the risks associated with using valuers in tax disputes, such as ensuring they are appropriately instructed as failure to do so may result in the court disregarding the expert's report.

4.45 The ATO publication *Our approach to information gathering*, outlines the general principles ATO officers apply when gathering information for risk assessment or verification purposes. The guide does not provide any specific guidance in relation to evidencing valuations. According to this guide, however, one of the general expectations that taxpayers can have of the ATO is that the ATO will 'engage technical experts and information-gathering specialists at the earliest opportunity when needed'.¹²⁷

When external valuers are to be engaged

4.46 When external valuers should be engaged to provide valuation assistance during a compliance case will depend on when the valuation issue emerges within the context of the specific tax risk being addressed.

4.47 For example, in Division 7A cases, the valuation of a distributable surplus may only occur after consideration of any deemed dividend.¹²⁸ Such a case may continue for a long period of time before the legal and factual issues are resolved. Once resolved, the valuation task may begin late in the case timeframe.

4.48 In contrast, the Commissioner's revaluation discretion in the thin capitalisation regime appears to require the input of an expert valuer as an inherent part of the legal and factual analysis. This discretion may only be exercised if the Commissioner considers the taxpayer has undervalued its liabilities or overvalued its assets.¹²⁹ In order for the Commissioner to consider that an undervaluation or

¹²⁵ ATO, 'Using valuers in litigation' (Internal ATO Document, 8 November 2013).

¹²⁶ ATO, 'Expert witness' (Internal ATO Document, 31 March 2010).

¹²⁷ ATO, 'Our approach to information gathering' (8 April 2014) <www.ato.gov.au>.

¹²⁸ *Income Tax Assessment Act 1936* ss 109C, 109Y.

¹²⁹ *Income Tax Assessment Act 1997* s 820-690.

overvaluation has occurred, significant valuation expertise must be brought to bear early on in the case.

4.49 The ATO has provided information about the cases in which it has sought valuation expertise. However, variations in the different types of cases and how valuation issues emerge prevent meaningful analysis of the timeliness of the ATO's engagements of valuation expertise.

ATO use of external valuers

4.50 The ATO's compliance personnel may obtain the services of external valuers to assist in risk identification, critiquing existing valuations or performing a full alternative valuation. The ATO's personnel requesting these services must obtain VGU consent in most instances.

VGU engagements

4.51 The VGU is responsible for all valuation engagements with the private sector with some exceptions. The VGU receives referrals from compliance teams to engage a valuer for a particular task. The VGU may provide advice to compliance teams such as whether a valuer is required or if the issue in dispute relates to an underlying legal issue rather than a valuation. Where the VGU decides that a valuer may be engaged, it obtains quotations for the proposed work.

4.52 The relevant compliance team requests approval for the expenditure from a delegate in the compliance area based on the chosen quotation. Once approved the VGU engages the valuer.

4.53 In addition to providing advice to compliance teams and facilitating the engagement, the VGU is responsible for ensuring that contracts with private sector valuers comply with government requirements.

4.54 The VGU may not consent to the engagement of a valuer for a variety of reasons, such as:

- the issue is not a valuation issue;
- potential valuation costs are disproportionate to the revenue at risk; and
- compliance teams may close a case beforehand.¹³⁰

4.55 The VGU received 331 referrals from compliance teams to obtain a valuation or valuation advice between 1 July 2011 and 31 December 2013. As set out in the Table 7 below, 173 of these referrals were approved with an aggregated maximum budget for expenditure of \$3,541,775. The actual amount expended was \$2,944,823.

¹³⁰ IGT communication with the ATO's VGU, 19 December 2013.

4.56 Where approval is given, the VGU will also provide advice on the most appropriate valuer for the circumstances. Valuers were sourced from the panel of valuers, non-panel valuers and AVO staff.

ATO panel of valuers

4.57 The ATO currently has a panel of private sector valuers under a Standing Offer arrangement which establishes a pre-agreed range of terms and conditions, including rates of remuneration. These valuers are also security cleared so they are able to deal with confidential taxpayer information without clearance being required on a per engagement basis which avoids some delay when engaging valuers.

4.58 Private sector valuation firms had tendered for a place on this panel. As a result of which there are currently 11 valuation firms on this panel. The current standing offer period is July 2012 to July 2015.

4.59 During 1 July 2011 to 31 December 2013, expenditure of \$2,517,684 was approved for panel valuers, with \$2,083,893 incurred in actual expenses covering 81 approved engagements (see Table 7 below).

Non-panel valuers

4.60 The ATO may not be able to engage a private sector valuer from the ATO panel for a number of reasons. For example, the valuation task may require a type or level of expertise that none of the panel valuers are willing or able to perform. Additionally, some panel valuers may have a conflict of interest, e.g. they may have already acted for, or are currently acting for the taxpayer which is in the relevant dispute with the ATO. In these circumstances, the ATO may engage non-panel valuers.

4.61 The VGU is also responsible for selecting the most appropriate non-panel valuer that represents value for money and has the right skills and capacity. These non-panel valuers must also undergo security clearances before being provided with taxpayer information.

4.62 During 1 July 2011 to 31 December 2013, expenditure of \$279,356 was approved for non-panel valuers, with \$177,413 incurred in actual expenses covering 14 approved engagements (see the Table 7 below).

The Australian Valuation Office

4.63 The AVO was a business unit within the ATO which serviced the ATO as well as several other government departments on a commercial fee-for-service basis. The AVO competed with private sector valuers to provide these services to the government sector. During 2012-13, the AVO mainly provided services to the Department of Human Services, which accounted for 93 per cent of its valuation output.¹³¹

¹³¹ Commissioner of Taxation, *Annual Report 2012-13* (2013) p 65.

4.64 The AVO was required to meet the Australian Government Competitive Neutrality Guidelines. In this respect, the AVO had been the subject of an investigation by the Australian Government Competitive Neutrality Complaints Office in 2004, which assessed the conduct and structure of the AVO against the guidelines.¹³²

4.65 The ATO and AVO have historically had an MOU to determine the type of valuation work the AVO would provide to the ATO and the circumstances in which that work would take place.

4.66 As noted above, the SBIT business line may have called on the services of AVO staff to assist with risk identification with valuation issues. As the AVO charged all clients on a commercial fee-for-service basis, the engagement of AVO staff for ATO valuation work was also required to go through the VGU.

4.67 The AVO was closed on 30 June 2014. Until 14 June 2014, certain legislation required that only the AVO could conduct certain valuation work. For example, taxpayers were required to lodge valuation applications to the General Manager of the AVO in relation to deductions for donations of certain property.¹³³ However, the relevant legislation has now been amended requiring applications to be lodged with the Commissioner. Since the closure of the AVO, the ATO now directly employs six former AVO valuers.

4.68 During 1 July 2011 to 31 December 2013 the VGU approved expenditure of \$741,984 for AVO valuers, with actual expenses at \$683,516 covering 77 approved engagements.

Table 7: VGU approved engagements 1 July 2011 to 31 December 2013

Source	Number of engagements	Approved expenditure	Actual expenditure
Panel	81	\$2,517,684	\$2,083,893
Non-panel	14	\$279,356	\$177,413
AVO	77	\$741,984	\$683,516
Unknown	1	\$2,750	unknown
Total	173	\$3,541,775	\$2,944,823

Source: ATO

Non-VGU valuation engagements

4.69 Some ATO business lines have previously made their own special arrangements to obtain valuation services without going through the VGU. For example, RDR business line has incurred valuations expenditure with respect to taxation disputes that are, or are likely to be, litigated. Between 1 July 2011 and 31 December 2013 the RDR business line had approved \$2,802,986 in valuer costs with respect to 24 tax dispute cases.¹³⁴

¹³² Australian Government, Productivity Commission, Australian Government Competitive Neutrality Complaints Office, *Australian Valuation Office AGCNCO Investigation Report 11* (21 May 2004).

¹³³ *Income Tax Assessment Regulations 1997*, Regulation 30-212.02.

¹³⁴ ATO communication to the IGT, 16 April 2014.

4.70 The RDR business line has also engaged valuers for the purpose of assisting the ATO during an independent review of a compliance case. This does not form part of the ATO's legal budget and is recorded separately in Table 8 below. This valuation service cost \$82,869.

4.71 It should be noted, however, that since 11 February 2014, the RDR business line has indicated that it will no longer be responsible for incurring expenses for non-legal expert witnesses or advisors, which includes valuers, during the pre-litigation stage of disputes. The RDR business line will continue to manage non-legal expert witness expenses for disputes that have reached litigation.¹³⁵

4.72 The PG&I business line has also engaged the services of an external valuer on an ad hoc basis which is facilitated by the VGU. The arrangement is in the form of an Official Order which allows PG&I officers to engage the private sector valuer for ad hoc advice at an agreed hourly rate, at a maximum of two days per month, up to a maximum value limit for the year.¹³⁶

4.73 The need for such an arrangement is described below:

From time to time LB&I and the Valuation Gatekeeper require valuation services which are best described as ad hoc in nature. The ad hoc description may include valuation services which can be classified as:

- minor general advice;
- low cost;
- preliminary discussions which do not necessarily lead to or result in another provider being engaged; or
- valuation service which do not justify, on a time and cost efficiency basis, a formal stand alone engagement ...

These categories of ad hoc work have been occurring with enough regularity to be viewed as a normal essential component of the ATO Valuation Gatekeeper operational requirements. They involve a level of technical knowledge greater than the general advice able to be provided by the ATO Valuation Gatekeeper.¹³⁷

4.74 The actual expenditure of this PG&I ad hoc work order totalled \$35,255 for the period 1 July 2012 to 31 December 2013.

¹³⁵ ATO, 'Office Minute: Clarification of arrangements for expenditure on legal services' (Internal ATO Document, 11 February 2014).

¹³⁶ ATO communication to the IGT, 16 April 2014.

¹³⁷ ATO, 'Office Minute to Assistant Deputy Commissioner LB&I regarding approval to vary an Official Order' (Internal ATO Document, 16 September 2012).

4.75 The table below shows the costs of all valuation engagement by source:

Table 8: ATO expenditure on valuers

Source	Engagements	Approved expenditure	Actual expenditure
VGU engagements from 1 July 2011 to 31 December 2013	173	\$3,541,775	\$2,944,823
RDR legal service engagements from 1 July 2011 to 31 December 2013	24	\$2,802,986	\$2,706,256
Independent Review engagements from 1 July 2011 to 31 December 2013	1	\$82,869	\$82,869
Ad hoc work order for PG&I from 1 July 2012 to 31 December 2013	7	\$38,620	\$35,255
Total	205	\$6,466,250	\$5,769,203

Source: IGT collation of ATO expenditure tables

Note: ATO officers are required to obtain approval before engaging valuers. The approval provides for a limit on the amount that can be paid to the valuer. Actual expenditure may be less due to the valuation engagement not taking as much time as initially planned.

Note: The current PG&I ad hoc work order commenced on 1 July 2012.

ATO instruction of valuers

4.76 Internal ATO guidance highlights the risks of incorrectly instructing or briefing experts, including valuers, in the course of audits or litigation:

Unfortunately, substantial resources and time can be spent on consulting with experts during the course of an audit only to find that, if the matter proceeds to litigation, either:

- (1) the question that was asked of the expert did not elicit an opinion that can be relied on in litigation- either because the opinion extends beyond the range of the expert's expertise or because the opinion does not articulate a matter that can form part of the Commissioner's case; or
- (2) the process of briefing the expert has weakened the independence and reliability of the report.

In these circumstances, it may be necessary to go back to the drawing board and either find a new expert (which is not always easy to do) or re-instruct the existing expert (which may not be possible if it is difficult to maintain the expert's independence).¹³⁸

4.77 This internal ATO guidance also refers to Australian Government Solicitor (AGS) guidance which advises that experts should only address particular questions of fact and not law.¹³⁹ Furthermore, the AGS guidance states that instructions to an expert should clearly state the assumptions the expert is to rely upon and that these assumptions should be limited to matters that are beyond dispute:

¹³⁸ Above n 126.

¹³⁹ Australian Government Solicitor, *A Guide to the Use of Experts in ATO Audits and Litigation* (undated).

...if the assumptions upon which an expert opinion is based are found to be incorrect, then at the very least the persuasiveness of the opinion will be undermined. At worst, the report may be found to be of no value at all.¹⁴⁰

4.78 Additionally, the AGS guidance emphasises the importance of providing the expert with primary or source documents to ensure the opinion is based on objectively ascertained facts. Secondary documents, such as ATO audit reports, should not be provided as it may adversely affect the independence and objectivity of the expert's opinion.

4.79 The AGS guidance also provides information about engaging 'consultants' in contrast to 'experts'. The main difference being that a consultant is engaged to assist ATO officers to understand technical concepts, and is not required to develop a formal opinion about a question of fact. Furthermore, consultants are not intended to be expert witnesses who will provide evidence during litigation. As a result, the ATO consider that there is considerable flexibility in the way the ATO can engage consultants, such as explaining commercial drivers behind transactions, providing 'guidance on documents to be obtained by the ATO' or 'suggest lines of enquiry that could be pursued'. The guidance further states that in litigation, consultants can assist by advising on:

- the strengths and weaknesses of evidence within their field of expertise
- documents to be sought under discovery
- questions for cross examination; and
- instructions to be given to an expert witness.¹⁴¹

4.80 This AGS guidance is no longer available to ATO officers as it was only available as an attachment to an ATO training package which was discontinued.

4.81 The ATO has advised that there is no other additional guidance provided to officers in this respect.¹⁴² However, some ATO officers have valuation experience, whilst other officers, having been former employees of the AVO, are qualified valuers with professional accreditation from various valuation professional bodies. Amongst these ATO officers are six former AVO valuers which the ATO has retained following the closure of the AVO.

Taxpayer access to ATO instructions to valuers

4.82 The ATO does not have a specific policy or process with respect to taxpayer access to ATO instructions to valuers. Valuers, like other experts, may be briefed by the ATO's internal legal area, within the RDR business line. Alternatively, the ATO may seek the assistance of counsel to not only advise on litigation such as prospects of success and undertaking advocacy work but also to ensure instructions to experts are relevant to the legal questions being addressed by counsel.

¹⁴⁰ Ibid p 7.

¹⁴¹ Ibid p 9.

¹⁴² ATO communication to the IGT, 24 April 2014.

4.83 The AGS guidance mentioned above notes that, in certain circumstances, legal professional privilege may be claimed over drafts or documents produced by experts 'for the assistance of Counsel, AGS and the Commissioner.'¹⁴³ In contrast, the guidance mentions that communications with consultants engaged directly by the Commissioner in the course of an audit will not be protected by legal professional privilege.¹⁴⁴

4.84 Although the ATO does not provide guidance on its use of confidential taxpayer information as a valuation input, it has publicly stated its position with respect to the use of confidential taxpayer data in determining the arm's length price in the context transfer pricing.¹⁴⁵ In Taxation Ruling TR 98/11, the ATO acknowledged taxpayer difficulties arising from their inability to obtain confidential information when the ATO used it as comparable data. However, the ATO considered the statutory objective did not limit its use of such information:

The statutory objective, consistent with the incorporation of the arm's length principle into our law, is to achieve the closest practicable degree of comparability with independent dealings. This outcome cannot be achieved where the ATO voluntarily restricts itself to particular sources of data. The public policy intention of ensuring that Australia receives its fair share of tax must also be considered...

In view of the above considerations, the ATO rejects the suggestion that it should be limited to publicly available third party data.¹⁴⁶

Market valuation private rulings

4.85 MVPRs are a specific type of private ruling covered by section 359-40 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953). Upon the request of a taxpayer, this section allows the Commissioner to refer a full valuation, or a valuation review, to a valuer and charge taxpayers for those engagements. Regulation 61 of the *Taxation Administration Regulations 1976* requires the Commissioner to charge the taxpayer the amount that the Commissioner was required to pay the valuer for that engagement.

4.86 Information provided by the ATO indicate that, during the period 1 July 2011 to 31 December 2013, the ATO sought valuation advice in relation to 17 private rulings, of which nine were specifically identified as MVPRs.¹⁴⁷ These nine rulings resulted in \$94,634 in approved ATO expenditure, of which two involved a valuation. The remaining seven valuation engagements involved a critique, methodology analysis, or technical advice.

4.87 As part of the MVPR process for obtaining ATO valuations, the ATO requires the taxpayers to supply the ATO sufficient information for a valuer to identify the asset

¹⁴³ Above n 139, p 8.

¹⁴⁴ Above n 139, p 9.

¹⁴⁵ ATO, *Income tax: documentation and practical issues associated with setting and reviewing transfer pricing in international dealings*, TR 98/11 (24 June 1998).

¹⁴⁶ *Ibid* para [9.21].

¹⁴⁷ ATO communication to the IGT, 10 April 2014.

to be valued and location details if required.¹⁴⁸ Where taxpayers request ATO confirmation of an existing valuation, the taxpayer is required to send as part of their ruling application 'a copy of [their] valuation report...[which] should contain sufficient information for a valuer to replicate the valuation process.'¹⁴⁹

International approaches

United States

4.88 In the United States, the Internal Revenue Service (IRS) has an internal team of specialist staff (known as 'engineers') whose role is to supply technical expertise to the IRS during audits (known as 'examinations'). This expertise includes the valuation of businesses, intangible property, real property and personal property.¹⁵⁰ Valuation experts, known as 'valuators', are tasked with resolving issues as early as possible and minimise the need for litigation. They are to do so by working with the IRS requesting area and the taxpayer.¹⁵¹

4.89 The IRS also recognises that valuers must exercise professional judgement in coming to their conclusions and they may have to do so with incomplete information. Valuers are expected to 'decide when they have substantially enough information to make a proper determination.'¹⁵² IRS valuers must 'employ independent and objective judgment in reaching conclusions and will decide all matters on their merits, free from bias, advocacy, and conflicts of interest.'¹⁵³

4.90 The IRS Office of Appeals is an independent organisation within the IRS tasked with resolving disputes between the IRS and taxpayers which may have arisen as a result of compliance activity.¹⁵⁴ Appeals officers may be expected to resolve simpler valuation issues but are also expected to appropriately engage valuation expertise for more complex matters. These valuation experts may be drawn from within the IRS itself, such as from the 'engineers' described above. There are occasions, however, where appeals officer may use the services of an external valuator or appraiser:

In some cases you and your manager may want to have an appraisal from an independent, non-IRS appraiser. This is often the case when the taxpayer has hired an independent appraiser who is highly qualified and whose court testimony could not be easily rebutted by a valuation prepared by an IRS appraiser, who might be viewed as biased by the court. Outside appraisers are

¹⁴⁸ ATO, *Supporting document requirements for private rulings – determining or confirming the value of a thing*, <www.ato.gov.au>.

¹⁴⁹ Ibid.

¹⁵⁰ Internal Revenue Service, *Internal Revenue Manual*, para [4.48.1.2].

¹⁵¹ Ibid para [4.48.4.3.1].

¹⁵² Ibid para [4.48.4.3.2].

¹⁵³ Ibid para [4.48.4.3.2].

¹⁵⁴ Internal Revenue Service, *Appeals – About the Office of Appeals* (16 June 2014) <www.irs.gov>.

also used in specialty areas in which the IRS does not have the required expertise.¹⁵⁵

United Kingdom

4.91 In the United Kingdom, Her Majesty's Revenue and Customs (HMRC) have access to two main sources of valuation expertise. The first is the Valuation Office Agency (VOA) which is a separate agency within HMRC that provides property valuation services and advice to the UK public sector generally. The second source is the Shares and Assets Valuation (SAV) team which is a business area within HMRC dealing with the valuation of a wide range of intangible and other assets for the purposes of the taxes that HMRC administers.

4.92 The VOA deals with the valuation of real property and tangible assets and also administers valuations for the business rates and council tax regimes. In Australia, the equivalent of these valuation regimes is administered by states' Valuers-General.

4.93 HMRC administers a number of taxes requiring valuations such as Inheritance Tax, Capital Gains Tax and the Annual Tax on Enveloped Dwellings (ATED). ATED is a type of property tax on corporate owners of residential property. The tax is a flat chargeable amount which is dependent on the four value bands into which a property may fall. Taxpayers with dwellings that have a value falling close to the threshold of the value bands have an incentive to undervalue their property in order to pay a lower ATED charge.

4.94 After assessing the possible tax at risk, HMRC may refer a taxpayer's valuation to the VOA to be checked for acceptability. The VOA officer may directly discuss the value of the property with the taxpayer and decide whether the taxpayer's valuation is acceptable or needs to be challenged with an alternative VOA valuation. As the VOA is the custodian of property survey data for the business rates and council tax regimes, it is able to quickly confirm the taxpayer's valuations or make alternative valuations.

4.95 The SAV team mainly deals with intangibles such as goodwill and intellectual property, as well as unquoted shares and other specialised assets, such as works of art. When HMRC officers check tax returns containing a valuation issue not related to real property, the valuation issue is referred to the SAV team for an initial risk assessment. Upon risk assessment, the SAV officer will advise the HMRC officer whether the valuation is acceptable and, if not, will provide an alternative estimate of value. Where the valuation is acceptable, the valuation issue is closed but the HMRC officer may continue to review any non-valuation related aspects of the tax return.

4.96 Where the taxpayer's valuation is unacceptable and the SAV officer has provided an alternative estimated value, the HMRC officer then considers the amount of tax at risk and determines whether to open a formal enquiry into the valuation issue.

¹⁵⁵ Business Valuation Resources, *Valuation Training for Appeals Officers Course Book* (January 1997) p 17 <www.bvresources.com>.

4.97 Where such an enquiry is opened, the SAV officer takes over the valuation issue and deals directly with the taxpayer and their advisors in relation to information gathering and negotiation of an agreed value. The SAV officer periodically keeps the HMRC officer informed about the progress of the valuation issue.

GREATER USE OF ADMINISTRATIVE SAFE HARBOURS BY THE ATO

Stakeholder concerns

4.98 Stakeholders were of the view that there was additional scope to reduce the need for taxpayers to rely on valuations through the use of ATO administrative safe harbours.

4.99 Stakeholders were of the view that administrative safe harbours were particularly useful for lower risk and lower value transactions, especially for smaller taxpayers that would normally find the cost of a valuation regressive or prohibitive. They also highlighted that, in the absence of safe harbours, some taxpayers may use other shortcuts with far less accurate results posing a higher risk to the government revenue.

4.100 Although technically not a safe harbour, stakeholders pointed to the ATO's small business benchmarks as a positive development that assisted small businesses to understand the likelihood of an ATO audit with respect to the correct reporting of income and associated record keeping.

4.101 As stated in Chapter 3, examples of areas where the ATO already provides administrative safe harbours are trading stock and fuel tax credits.¹⁵⁶

IGT observations

4.102 The IGT is of the view that the ATO should consider developing additional administrative safe harbours for tax provisions in order to reduce the compliance burden for taxpayers. This may involve consultation with stakeholders to determine which areas of tax law best lend themselves to such an approach.

4.103 In this respect, it is encouraging to note that the ATO has already begun exploring how safe harbours could be further used to 'decrease compliance costs in low-risk areas'.¹⁵⁷

4.104 In relation to small businesses, the IGT has earlier in this report¹⁵⁸, recommended legislative changes to reduce taxpayers' reliance on valuations to access the small business CGT concessions. In the meantime, however, the ATO could provide assistance with respect to this concession in the same manner it currently does with the small business benchmarks. The ATO website has a 'CGT small business concessions tool' to assist taxpayers to assess their eligibility for these concessions. The

¹⁵⁶ Chapter 3 paras [3.40] and [3.41].

¹⁵⁷ ATO, *National Tax Liaison Group March 2014 minutes* (19 May 2014) item 2.2 <www.ato.gov.au>.

¹⁵⁸ Recommendation 3.2 of this report.

tool requires market values of business assets to be entered. However, taxpayers may not have these readily available and would have to obtain them at significant costs.

4.105 The IGT is of the view that the ATO could incorporate aspects of the SBIT business line's risk assessment tool, which estimates the likelihood of taxpayers breaching the \$6 million MNAV threshold, into the existing website tool. Taxpayers using this improved tool could input the required financial information (which the ATO currently requests when conducting a review of a claim) and be provided with an indication of the likelihood of exceeding the threshold. Such indication may save some taxpayers the need to conduct costly market valuations for all their assets, for example, where they may be clearly eligible or ineligible.

4.106 The above would operate in a manner similar to the small business benchmarks in that both are not technically safe harbours, but rather they operate to assist taxpayers to understand the risk of ATO compliance activities and to take action accordingly.

RECOMMENDATION 4.1

The IGT recommends that the ATO:

- (a) *continue consultation with stakeholders to develop and implement, where possible, administrative safe harbours that may reduce compliance costs associated with valuation; and*
- (b) *develop and make publicly available a tool that provides an indication as to the eligibility of a taxpayer for the small business CGT concessions through the maximum net asset value test.*

ATO Response

In relation to 4.1(a) – Agree

In relation to 4.1(b) – Agree

In relation to 4.1(b) – We agree the tool would be useful and will consider against other competing priorities.

VALUATION RISK ASSESSMENT

Stakeholder concerns

4.107 Stakeholders were of the view that, in a self-assessment system, the ATO should accept taxpayers' reliance on valuations for simpler transactions involving smaller amounts as the costs involved in testing the inputs and process of such valuations is disproportionate to the amounts at issue. A few stakeholders suggested that the ATO might use alternative and less costly indicators for assurance, such as the qualifications of the taxpayers' valuers.

4.108 For transactions that are of higher risk, stakeholders suggested that the ATO's current use of critiques to test taxpayers' valuations were unnecessarily formal and time consuming. Their observations included that a great deal of effort and expense may go into producing a voluminous critique which only seeks to find weaknesses in

the taxpayer's valuation. It may not propose an alternative value which means it cannot and should not be relied upon to amend a taxpayer's assessment.

4.109 Stakeholders also contended that much of the valuation work commissioned or undertaken by the ATO (including critiques), during compliance activities, have been found to be irrelevant or simply inadmissible in a number of cases that have progressed through to litigation.

4.110 Stakeholders were of the view that the ATO could use a higher-level risk assessment 'product' that was less formal, less expensive and quicker to develop than a critique. Stakeholders proposed that external valuers would be suitable for this role rather than ATO officers.

IGT observations

4.111 As noted earlier, the ATO's risk management approach currently does not seek to identify valuation as a specific risk flag or indicator.

4.112 ATO compliance action may involve obtaining considerable amounts of information to test inputs and processes associated with taxpayers' valuations. For high risk valuations or those involving large sums, such testing would appear appropriate. However, where lower risk transactions are concerned, the compliance costs involved may have a regressive effect as discussed in Chapter 3. The risk to government revenue may also be disproportionate to the cost for both the taxpayer and the ATO.

4.113 In relation to critiques, as noted in Table 3 above, the ATO can incur considerable expenses. The average approved expenditure of \$22,257 to an extent masks the variability of the cost. When broken down by asset type, the average approved expenditure of critiques for valuation of real property and intangibles were \$3,700¹⁵⁹ and \$14,786¹⁶⁰ respectively, whilst a single critique of a valuation of a mining tenement had approved expenditure of \$181,839.

4.114 In relation to the costs of critiques, as noted earlier, stakeholders felt a high level, less formal and cheaper alternative may actually be more effective. The IGT notes that the preliminary risk assessment product that appeared in the MOU between the AVO and ATO seems to be such an alternative. The ATO's data, however, indicates that this service was requested only once.

4.115 The IGT working group also considered critiques and suggested an alternative which seemed quite similar to the preliminary risk assessment engagement mentioned above. Although it was acknowledged that valuation matters can be quite complex and require significant resources, appropriately qualified and experienced valuers can often expeditiously identify the key issues or points of principle that need to be addressed. It was also suggested that such a process could have a tight engagement process to ensure it was cost effective. In addition, the external valuer would be appointed on a non-ongoing basis to ensure a balanced approach that

¹⁵⁹ Six real property critiques totalling \$22,000.

¹⁶⁰ Eight critiques of businesses, shares, goodwill and intellectual property totalling \$118,290.

guarded against an elongated process or inadvertent engagement creep. All parties would need to ensure the engagement mandate was clear that a preliminary risk assessment was the intended outcome and not a detailed critique or valuation.

4.116 Accordingly, the IGT is of the view that the ATO should make greater use of products such as preliminary risk assessment to quickly identify the risk associated with a taxpayer's valuation. Such a product should be developed in consultation with stakeholders to, for example, minimise the amount of information that they may have to provide for this purpose.

4.117 The ATO also needs to consider how to engage valuers for purposes of risk assessment. Their current engagement processes with respect to critiques or valuation may be too formal. As mentioned earlier, the PG&I business line currently has special arrangements with a private sector valuer for the purpose of providing informal ad hoc advice. The IGT believes that the ATO should consider this arrangement for adoption across the ATO for risk assessment purposes.

4.118 The IGT is also of the view that, where the ATO seeks to use in-house valuers for preliminary risk assessments, such as the six former AVO valuers mentioned earlier, the method of engagement and communication protocols should be the same as those for engaging private sector valuers. This is to ensure that these in-house valuers are providing advice on the basis of their professional and independent judgement in accordance with their applicable professional standards and not just as ATO employees.

4.119 To avoid unnecessary costs, before engaging valuers even for preliminary risk assessment, the ATO officers should ensure that the relevant factual and legal issues have been identified and settled as far as practicable. This may involve obtaining legal advice. For example, in the RCF case¹⁶¹, the valuation outcome was highly dependent on how the relevant provisions were to be interpreted. As noted earlier, the VGU currently provides guidance on these issues to ATO officers requesting valuation services.

4.120 The IGT is of the view that, depending on the finding of the preliminary risk assessment, the ATO should then consider any further action that should be taken such as commissioning a critique or full valuation or whether any identified factual and legal issues need to be resolved first.

4.121 A full valuation may not always be necessary before challenging a taxpayer's assessment. The use of critiques may be appropriate, for example, where the cost of a full valuation would be disproportionate to the risk being addressed. For cases involving substantial amounts of disputed revenue, the ATO should only amend assessments on the basis of a full alternative valuation.

4.122 If a taxpayer's assessment is to be amended, as a matter of due process, the ATO should give full reasons why the ATO rejects the taxpayer's valuation, such as by

¹⁶¹ *Resource Capital Fund III LP v Commissioner of Taxation* [2013] FCA 363 at [98]-[108].

providing the calculations used in its preliminary risk assessment, critique and/or valuation.

4.123 In the event that the ATO adopts the above structured approach, it should provide guidance to its staff and taxpayer on its valuation products and how it uses them to mitigate risk and verify taxpayer compliance with the law.

RECOMMENDATION 4.2

The IGT recommends that the ATO:

- (a) *continue to develop a strategy to identify the various valuation risks and the compliance action for mitigating those risks;*
- (b) *where ATO compliance officers identify valuation risks:*
 - i) *as a first step, use valuers to undertake a 'preliminary risk assessment' to assess such risk;*
 - ii) *agree or agree to disagree on relevant legal or factual issues; and*
 - iii) *consider whether further action, such as commissioning a critique or a full valuation, is required, taking into account factors such as the cost associated with each option as compared to the disputed amount; and*
- (c) *where a taxpayer's assessment is to be amended as a result of a critique or full valuation, provide the relevant details contained in the preliminary risk assessment, critique and/or full valuation to that taxpayer.*

ATO response

In relation to 4.2(a) – Agree

In relation to 4.2(b) – Agree

In relation to 4.2(c) – Agree

4.2(b) We agree with the steps outlined noting the detail and focus on each step will vary dependant on the complexity of the valuation issue and timely interaction and co-operation of the taxpayer.

4.2(c) In rare circumstances the Commissioner may not be able to provide details to the taxpayer, for example, where the release of the material could cause harm.

4.124 In the absence of a national accreditation scheme for all valuers¹⁶², stakeholders have also indicated that the professional qualities of the valuer could be used by the ATO in lower risk situations to quickly exclude valuations undertaken by certain valuers from scrutiny.

4.125 The IGT acknowledges the concerns of other stakeholders that the above approach risks becoming an 'ATO accreditation' regime which would not be an appropriate role for the ATO. The ATO could publish a list of those valuers that the ATO regularly uses without making any explicit endorsement.¹⁶³ Such a list, however,

¹⁶² See Chapter 2 paras [2.15] to [2.25].

¹⁶³ See para [4.57] for background information on the ATO's panel of valuers.

would still resemble a de facto accreditation scheme which may inappropriately influence taxpayers' choice without sufficient regard paid to their relevant area of expertise.

4.126 Whilst there are tax-related standards for valuers with respect to the Cultural Gift Program and the GST margin scheme, the IGT believes that the costs involved in implementing similar standards across the valuation profession for all tax-related valuations would outweigh the benefits. This is because the professional qualities of a valuer are only one of several criteria the ATO uses to test the reasonableness of a valuation.

4.127 Notwithstanding the benefits of increased consumer confidence in choosing valuers, valuations are required for a multitude of non-tax related purposes. The IGT is, therefore, of the view that it would not be appropriate for the ATO to take on an actual or de facto regulatory role for valuers.

TAXPAYERS' INSTRUCTIONS TO VALUERS

Stakeholder concerns

4.128 Stakeholders have acknowledged that the reasonableness of a valuation depends on the way in which a valuer is instructed and the quality of inputs provided. However, they expressed concern that the ATO was not availing itself of the following opportunities to review taxpayers' instructions to valuers and thereby minimise the risk of disputes and costs:

- the ATO does not encourage the use of a standard form for instructing valuers which may clearly sets out the facts, assumptions and basis for methodologies; and
- the ATO does not take advantage of the opportunities to provide certainty to taxpayers before returns are lodged by, for example, reviewing taxpayer instructions to valuers during pre-lodgement processes such as Annual Compliance Arrangements (ACA) or PCRs.

4.129 Stakeholders have also highlighted that gaining certainty before lodgement of tax returns is likely to avoid disputes and potential interest and penalties.

4.130 Relevantly, the ATO has specifically identified taxpayer valuer instructions as part of what it regards as 'valuation process risk'.¹⁶⁴ In this respect, the ATO holds certain expectations of those who instruct valuers:

We expect that a person commissioning a valuation for tax purposes will be able to demonstrate that they provided the valuer with instructions that clearly:

- set out the scope and purpose of the valuation
- ensured the valuer's independence in writing the report and in drawing conclusions
- recognised the valuer's right to refuse to provide an opinion or report if not provided with the information and explanations they needed
- granted the valuer access to the taxpayer's premises and the necessary records
- ensured the valuer would be provided with all necessary help needed to complete the report, and
- established that any fee, where levied, did not depend on the outcome of the report.

Instructions to valuers will usually be in the form of a written request or could be documented in the engagement letter.¹⁶⁵

4.131 However, with the exception of MVPRs, the ATO does not have formal processes to review taxpayers' instructions to their valuers before tax returns are lodged.

4.132 'Potential inconsistencies in market valuations'¹⁶⁶ are one of the types of risks that the ATO expects taxpayers to disclose during an ACA process but it does not provide taxpayers with any specific description of how valuation risks are expected to be managed. Furthermore, the ATO's public guide, Large Business Compliance Manual, refers to the management of valuation risks in the context of risk reviews and audits, but does not describe any PCR-specific process with respect to valuations.

4.133 In relation to templates for instructing valuers, the ATO itself uses a standard template for requesting valuation services through the ATO VGU¹⁶⁷, however, it is not shared with the taxpayer.

IGT observations

4.134 Valuations are very much dependent on how valuers are instructed and the quality of inputs provided to them. Accordingly, it would be helpful if taxpayers and

¹⁶⁴ Above n 15, Table F1.

¹⁶⁵ Above n 15.

¹⁶⁶ ATO, *Annual compliance arrangements* (7 June 2013) <www.ato.gov.au>.

¹⁶⁷ ATO, 'Request for valuation services' (Internal ATO Document).

the ATO could agree on valuer instructions and inputs before significant costs are incurred in obtaining divergent valuations and before relevant the tax return is lodged.

4.135 In this respect, the IGT is of the view that it would be helpful if both the taxpayer and the ATO used a standard form for instructing their valuers. Such a form could clearly outline the facts, assumptions and methodology and the reasons for using that methodology. Such forms could then be exchanged between the ATO and taxpayer so that apparent differences could be easily detected and addressed.

4.136 For example, if these forms show material agreement on the facts, assumptions and methodologies, any resulting differences between the valuation of the ATO and the taxpayer are more likely to be attributable to acceptable differences in professional judgement as opposed to fundamental errors of fact. Where there are key differences in assumptions, both parties could explore the matter further to determine whether there is a legal issue at play, for example, the definition of a particular asset. If a legal issue is at play which is critical to the reliability of any facts, assumptions or methodologies, then the legal issue could be clarified, agreed, settled or litigated early¹⁶⁸ before further costs are incurred on commencing the valuation process.

4.137 The IGT considers that, for large business taxpayers designated as 'higher consequence', the ACA and PCR processes provide a suitable platform for taxpayers to disclose valuer instructions to the ATO and initiate ATO consideration of those instructions. Such processes are intended to surface potential tax risks, including potential valuation discrepancies. Providing early ATO certainty on aspects of the taxpayer's instructions would provide opportunity for the ATO and taxpayer to address those risks at the time the valuation is being sought.

4.138 Such certainty could be provided by the ATO risk assessing the valuation instructions, discussing the assessment with the taxpayer to reach agreement on the instructions and/or to jointly instruct an independent valuer.

RECOMMENDATION 4.3

The IGT recommends that the ATO:

- (a) *in consultation with stakeholders, develop a standard template for instructing valuers; and*
- (b) *where a material valuation risk is identified during pre-lodgement processes, conduct a risk assessment of the taxpayer's valuation instructions with a view to reaching agreement on the instructions and/or to jointly instructing an independent valuer.*

ATO response

In relation to 4.3(a) – Agree

In relation to 4.3(b) – Agree

¹⁶⁸ By way of declaratory proceedings: see IGT, *Review into the Australian Taxation Office's Use of Early and Alternative Dispute Resolution* (July 2012) para [4.63].

PENALTIES

Stakeholder concerns

4.139 Stakeholders were uncertain about how the ATO took into account the taxpayer's instruction process when considering possible misstatement penalties. Stakeholders noted that there is no ATO guidance on the application of penalties for taxpayers who obtain a valuation from a relevant expert. Stakeholders were of the view that the process of undertaking valuation is a relevant factor when considering whether reasonable care was taken, whilst the actual valuation outcome itself may be a relevant factor when considering whether the taxpayer had a reasonably arguable position.

4.140 It was observed that whilst protections from penalties exist for taxpayers who appropriately engaged the services of a registered tax practitioner, no such protection exists for situations where a taxpayer relied on the services of a professional valuer. In the absence of ATO guidance, stakeholders believed that ATO officers may incorrectly consider that a lack of reasonable care penalty should apply even if the valuer was properly instructed.

4.141 The application of penalties for not having a 'reasonably arguable position' in relation to a valuation was considered in the recent Federal Court case of *SPI PowerNet v FCT*.¹⁶⁹ The Court observed that one needs to identify 'what was argued for' before one can determine whether it was 'about as likely to be correct as incorrect, or is more likely to be correct than incorrect'.¹⁷⁰ The Court held in this case that the taxpayer's position was reasonably arguable as it 'was based upon sound valuation principles and depended upon an arguable construction of the operation of s 124R(5)'.¹⁷¹

IGT observations

4.142 The IGT notes that the ATO has not published guidance about the application of false and misleading statement penalties in circumstances involving valuation discrepancies.¹⁷²

4.143 In this respect, the case of *SPI PowerNet* shows that it is important for a taxpayer's valuation to be based on sound valuation principles and the relevant statutory provision. The IGT is of the view that taxpayers who attempt to undertake their own valuations without adequate knowledge of valuation principles, or whose methodology or valuation hypothesis is based on an unsettled interpretation of a tax law provision, expose themselves to significant risk of not having a reasonably arguable position.

4.144 Conversely, where a taxpayer appropriately instructs a professional valuer, the assumptions or valuation hypothesis is based on a reasonable arguable

¹⁶⁹ *SPI PowerNet Pty Ltd v Commissioner of Taxation* [2014] FCA 261, para [53].

¹⁷⁰ *Ibid*, para [55].

¹⁷¹ *Ibid*.

¹⁷² In his previous *Review of the ATO's administration of penalties*, the IGT foreshadowed that this current review would consider valuation-related penalty issues.

construction of the relevant legislative provision and the valuation itself is conducted according to sound valuation principles, the taxpayer would likely be considered to have a reasonably arguable position regardless of the valuation outcome.

4.145 The IGT also considers that the ATO could provide greater guidance regarding the application of penalties to valuation discrepancies. Such guidance may also assist taxpayers to decide on the trade-off between the cost of the valuation and the likelihood of ATO challenge, amendment and penalties. Where taxpayers have followed such guidance when instructing a valuer, they should be regarded as more likely to have taken reasonable care.

RECOMMENDATION 4.4

The IGT recommends that the ATO publish more detailed guidance on the application of penalties to valuation discrepancies.

ATO Response

Agree

We will address this action by application of Recommendation 5.3 of the Inspector General's Review of Penalties by providing explicit examples relating to valuations in our guidance products.

VALUATION CAPABILITY WITHIN THE ATO

Stakeholder concerns

4.146 Stakeholders were of the view that, although it was appropriate that ATO officers need not necessarily be professional valuers to conduct compliance activities, those officers needed some level of valuation skill to recognise valuation issues, gather the relevant information and instruct appropriate valuers.

4.147 Stakeholders were of the view that ATO officers currently lack the capability to quickly detect when a valuation issue is likely to arise during a compliance case. As a result, stakeholders observed that valuation expertise were often brought late in the compliance process with compliance officers providing unreasonable deadlines for the valuation to be completed and thereby compromise the quality of the resulting valuation.

4.148 It was also observed that the information required to support a valuation is different to that used to support other propositions of fact or law. Stakeholders were of the view that ATO officers needed a better understanding of the evidence required to reject or accept a taxpayer's valuation in order to ensure that information requests were appropriately targeted.

4.149 Stakeholders also raised concerns that some ATO officers inadequately or narrowly instruct valuers leading to a valuation outcome that was likely to result in a dispute. This was attributed to ATO officers' inability to provide valuers with correct facts and assumptions.

IGT observations

ATO officer recognition of valuation issues

4.150 The ATO no longer has a significant body of in-house valuation expertise, unlike the USA's IRS and the UK's HMRC. The AVO, which no longer exists as mentioned earlier, had operated in a similar fashion to the UK's VOA in that it dealt mainly with tangible assets and real property. However, it did not administer valuations for council rates as the VAO does. As such, the AVO had no control over the type and quality of data that would be needed to quickly make valuations of real property.

4.151 If the ATO were to re-establish an in-house valuation function, the ATO would likely need to hire significant numbers of valuers to cover the range of assets subject to tax-related valuations. Maintaining the currency of those valuers' expertise and developing their capability in new and emerging areas may make it impractical and costly for the ATO to manage the function efficiently and effectively.

4.152 The ATO's current use of private sector valuers gives the ATO access to a wide pool of expertise that can be engaged in a flexible manner. As long as conflicts of interest and issues of independence are appropriately managed, these arrangements allow the ATO to draw on the expertise as and when required. The VGU's management of formal valuation engagements should assist the ATO in filtering unnecessary engagement requests and selecting the best available valuers for the needed circumstances.

4.153 Notwithstanding the access to private sector experts, concerns remain with aspects of ATO compliance officer capability in dealing with valuation issues. ATO compliance officers are not expected to be valuation experts. However, in light of the increasing use of valuation concepts in tax legislation and the closure of the AVO, the IGT is of the view that the ATO should, over the long term, seek to increase the overall valuation capability of those officers that may deal with valuation matters.

4.154 The IGT considers that the ATO could make greater use of private sector valuers, as well as its own valuers, to assist in improving its valuation capability in the short term. In addition to the preliminary risk assessment role that valuers could perform for the ATO as described earlier in this chapter, these valuers could also assist with the design and delivery of learning and development products to improve ATO officer capability in recognising valuation risks.

4.155 The ability of the ATO to engage valuation expertise early in compliance cases is dependent upon not only the capability of ATO officers to detect valuation risks but also whether the factual and legal issues have been reasonably settled.

4.156 As noted earlier, the example of Division 7A shows that a case may continue for a long time before the legal and factual issues are resolved. Once resolved, the valuation task may begin late in the case timeframe and prolong the case. The ATO could seek to reduce timeframes by undertaking valuations in parallel with the legal and factual analysis. However, this approach risks unnecessary valuation expenses where the parties' views of the facts and application of the law change.

ATO information gathering

4.157 The IGT is of the view that understanding the evidentiary requirements for accepting or rejecting a taxpayer's valuation may be a complex task as it may require some legal knowledge regarding evidence as well as specific valuation knowledge. ATO compliance officers should consider obtaining legal and valuation advice as to the evidence required to verify the valuation.

4.158 Despite the difficulties in developing this capability, it is an important step in ensuring that the ATO's valuers are promptly provided with all the factual material needed to test the valuation whilst ensuring that taxpayers are not subject to excessive information requests.

ATO officer instruction of valuers

4.159 During the review, the IGT was made aware of a significant case which turned on how ATO officers had instructed its valuers. The ATO has advised that the key learning from this case was to ensure valuers were correctly instructed and that instructions take into account the precise requirements of the valuation task, in light of the specific statutory scheme to which the valuation related. During the review, valuers had confirmed that the standard of ATO officer instructions varied in consistency and was of a lesser quality than those from the AGS.

4.160 In this respect, the AGS guidance described earlier provides valuable instruction on the risks of incorrectly instructing valuers and how those risks should be addressed. As the ATO has not replicated this guidance elsewhere, the IGT considers that the ATO should update its policies and procedures dealing with valuations to provide this AGS guidance. Recommendation 4.3 above for a standard template for valuer instructions will also assist ATO officers to improve their instructions to valuers.

4.161 As noted earlier, the PG&I business line contracts private sector valuers on an ad hoc basis. The IGT is of the view that the ATO could make greater use of these types of ad hoc or consulting arrangements to improve ATO officer capability in instructing valuers.

RECOMMENDATION 4.5

The IGT recommends that the ATO use legal and valuation expertise, including external expertise, to:

- (a) assist in areas such as identifying issues, gathering information and instructing valuers; and*
- (b) provide training to staff to build capability for the long term.*

ATO response

In relation to 4.5(a) – Agree

In relation to 4.5(b) – Agree

ATO SHARING VALUER INSTRUCTIONS WITH TAXPAYERS

Stakeholder concerns

4.162 Stakeholders raised concerns that the ATO was reluctant to grant taxpayers access to its instructions although on occasions it has been for valid reasons such as:

- use of confidential information as valuation inputs which had been obtained from other taxpayers; and
- claims of legal professional privilege as counsel had been engaged to instruct the valuer.

4.163 Stakeholders have also contended that the only way that they can get access to the ATO's valuation instruction is through Freedom of Information (FOI) requests.

4.164 Stakeholders were of the view, that despite any internal ATO measures to ensure valuers were correctly instructed, sharing instructions with the taxpayer would be a useful step to ensure that any errors or omissions were corrected before the ATO's valuers undertook their task.

IGT observations

4.165 Notwithstanding internal ATO quality assurance measures noted earlier, shortcomings in instructions to valuers may be identified by allowing taxpayer to have access to the ATO's instructions. Providing such taxpayer access would also assist in reducing unnecessary costs and disputation as fundamental differences of opinions in relation to the facts, assumptions or related legal issues would be identified, addressed and/or resolved before additional valuations are undertaken.

4.166 Furthermore, the IGT is of the view that taxpayers should be fully aware of the case against them and be given an opportunity to test the facts and assumptions used by the ATO's valuer. Taxpayers should not have to resort to making FOI requests in order to obtain the ATO's instructions to its valuers. Notwithstanding any legal professional privilege that may apply when valuers are instructed by ATO legal officers or counsel, the ATO should voluntarily provide this information to taxpayers on an informal basis.

4.167 Another barrier to sharing ATO's instructions to valuers with relevant taxpayers is that the ATO cannot disclose confidential information which is used as an input for valuation instructions. This ATO view is expressed in a public ruling relating to arm's length prices in the transfer pricing provisions and in a recent IGT report.¹⁷³

4.168 The IGT is of the view that the valuation requirements in tax provisions other than transfer pricing should be treated differently as the policy intent differs for transfer pricing where the main aim is to ensure 'Australia receives its fair share of

¹⁷³ See IGT, *Review into the ATO's Management of Transfer Pricing Matters* (June 2014) para [3.13]. The ATO would not publish the comparable data it uses for transfer pricing matters due to confidentiality issues.

tax'.¹⁷⁴ The concept of market value in other tax context seems to suggest that the ATO should limit its use of information to that which is available to the market or taxpayers who are expected to act 'knowledgeably, prudently and without compulsion'.¹⁷⁵

4.169 The IGT considers that it is fundamental to the efficient resolution of valuation disputes that the parties rely on information that is available to both of them. The IGT is, therefore, of the view that the ATO should only use information that would be available to a knowledgeable and prudent taxpayer.

4.170 It should also be noted even if the ATO were to continue using confidential information, such information may have to be disclosed if the matter proceeds to litigation.

RECOMMENDATION 4.6

The IGT recommends that the ATO:

- (a) *allow taxpayer access to its instructions to valuers; and*
- (b) *only use publically available information or information that can be disclosed to the taxpayer in arriving at its market valuation.*

ATO response

In relation to 4.6(a) – Agree

In relation to 4.6(b) – Agree

In rare circumstances, the Commissioner may be obliged to take into account information that cannot be disclosed in order to meet his legal obligations to correctly assess.

TAXPAYERS' BURDEN OF PROOF AND VALUATION RANGES

Stakeholder concerns

4.171 As a valuation is effectively an opinion, a valuation may yield a specific value (also known as a 'point estimate') or a reasonable range of values. Stakeholders were concerned that the taxpayer's burden of proof (of proving in tax litigation that the ATO assessment is excessive¹⁷⁶) operates to unfairly favour the ATO where the only differences between taxpayer and ATO valuations were attributable to acceptable differences of professional judgement. In these circumstances, taxpayers who have obtained an independent valuation that is reasonable cannot be certain that the ATO will accept their valuation in whole or part.

¹⁷⁴ Above, n 145, para [9.22].

¹⁷⁵ Above, n 8.

¹⁷⁶ *Income Tax Assessment Act 1936* ss 14ZZK-14ZZO.

4.172 Certain stakeholders were also of the view that where the ATO's and taxpayer's valuation ranges overlap, the ATO should accept any taxpayer proposed value within that overlapping area. Other stakeholders cautioned against a blanket approach to overlapping ranges, citing complexities associated with defining a 'range' and the possibility of encouraging behaviours that seek wider ranges as a means of manipulating this approach.

4.173 In respect of the tax laws, specific values are required to be reported for certain tax purposes. The valuer, however, may provide a range of possible values.¹⁷⁷ Although the ATO recognises that valuation involves a subjective assessment¹⁷⁸, the ATO expects that such a range will be 'reasonable' regardless of the valuer or the method adopted¹⁷⁹ and that taxpayers will be able to justify the specific value chosen within that range.

4.174 The ATO has advised that it 'does not have any particular policy in obtaining a specific value from a valuer and does not have any guidance or a standard approach with respect to selecting a specific value.'¹⁸⁰ However, the ATO intranet page 'Using valuers in litigation' provides some guidance to ATO officers about 'tolerances' for divergent valuations. It suggests a 10 per cent materiality threshold consistent with AASB 1031:

A divergence in market value of less than 10% is unlikely to attract judicial support on review and may not justify the resources necessary to secure adjustment. On the other hand, it is expected that gross misvaluations or misallocations would be pursued through to litigation if necessary, depending on the risk involved. Other substantial misvaluations may nevertheless be subject to risk assessment and challenge, as determined under ATO risk management procedures.¹⁸¹

IGT observations

4.175 Taxpayers have the burden of proof in relation to valuation matters. As noted earlier, valuations are opinions which are typically expressed as ranges, not absolute amounts. They include a point estimate which is the most likely value out of many possible values within the range.

4.176 Even where taxpayers and the ATO agree on the facts and legal issues as well as instructions given to the valuer, point estimates of both parties may differ. However, the IGT is of the view that, in these circumstances, the ATO should have a basis on which to accept a taxpayer's valuation. This would be consistent with principles of a self assessment system.

¹⁷⁷ Above n 15.

¹⁷⁸ Above n 125.

¹⁷⁹ ATO, 'Valuations Issues Paper' (12 January 2012) <www.ato.gov.au>.

¹⁸⁰ ATO communication to the IGT, 16 April 2014.

¹⁸¹ Above n 125.

Applying a 10 per cent tolerance to point estimates

4.177 Drawing on the ATO guidance materials and AASB position outlined above, one option to address the above differences in point estimates is for the ATO to accept the taxpayer's point estimate if it falls within 10 per cent of its own. This 10 per cent tolerance on either side of the ATO's point estimate would be a helpful starting point but may be expanded upon and used in a pragmatic manner that reduces disputation and provides greater certainty for taxpayers.

4.178 Where the taxpayer's point estimate diverges from the ATO's point estimate by more than 10 per cent, it may be useful for both parties to consider whether the taxpayer's range overlaps with the ATO's range. Where there is some overlap, this may be a useful starting point for further discussions between valuers on the reasons for the divergence. Recommendation 4.6 above, which facilitates taxpayer access to the ATO's instructions, would also assist in this regard.

Figure 2: Overlapping valuation ranges

Scenario 1: The taxpayer's point estimate (blue arrow) for capital proceeds from a CGT event is within 10 per cent of the ATO's point estimate (pink arrow) and should be accepted by the ATO.



Scenario 2: The taxpayer's point estimate (blue arrow) does not fall within 10 per cent of the ATO's point estimate (pink arrow). The ATO should conduct negotiations/discussions in light of the overlap of ranges.



Source: IGT

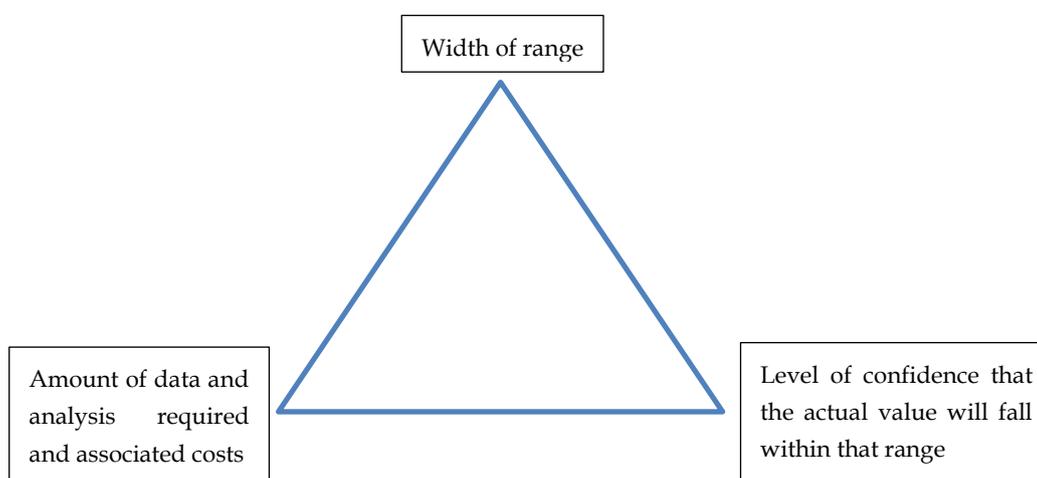
4.179 There may be certain circumstances where the 10 per cent range may not be completely appropriate. The circumstances where that would arise may be rare or manifestly obvious from the particular market in which the valuation is being considered and may justify a narrower valuation range. Conversely, where valuation ranges are wide due to a greater degree of uncertainty attaching to the given market, then a broader dialogue may be required to ascertain the appropriateness of the taxpayer's adopted valuation amount.

Determining the appropriate width of ranges

4.180 One way of ensuring that a proposed valuation range is of appropriate 'width' is by recognising the role of confidence levels and the costs of valuation in determining the range.

4.181 There is a trade-off in the relationship between the level of confidence in a given range, the width of the range as well as the information, research and cost associated with the valuation as explained in Chapter 2. This relationship is shown diagrammatically below:

Figure 3: Valuation trade-off between confidence, range and cost



Source: IGT

4.182 It is impractical, if not impossible, for the ATO or another administrator to expect taxpayers to obtain a valuation where the valuer was 100 per cent confident that one specific value was the only reasonable value. Even if it were possible to achieve such a level of certainty, the costs would be prohibitive. In recognising practicalities and the need to manage compliance costs, it is important that the ATO acknowledge commercially realistic valuations are likely to involve a combination of a range of values and a confidence level that is less than 100 per cent.

4.183 The IGT is of the view that another option to improve the framework and provide greater certainty is for a standard level of qualitative and quantitative confidence to be accepted for particular valuations for tax purposes. The objective of the standard level of confidence is to provide guidance to taxpayers, the ATO and valuers about the rigour expected of a valuation whilst ensuring valuation costs do not unnecessarily escalate.

4.184 Acting as a minimum, the standard confidence level mitigates the risk of the ATO having unreasonable expectations about the narrowness of a valuation range, as a very narrow range either requires a reduction in the confidence level or increases costs as a result of additional data and analysis required.

4.185 Conversely, as a ceiling, the standard confidence level may reduce the risk of an ATO challenge of the taxpayer's valuation and increase certainty of the intended outcome for tax purposes by accommodating a range that the ATO may otherwise reject as too wide were it not for the standard confidence level.

4.186 Depending upon the level of confidence for a valuation range, taxpayers may have stronger grounds to choose the mid-point of that range as their point estimate for tax purposes.

4.187 In the event of an ATO challenge to a taxpayer valuation, the ATO valuation should apply the same standard level of confidence to produce a given range and a consequent mid-point for the ATO's point estimate.

4.188 Whilst it is likely that the point estimates of the ATO and the taxpayer will differ, the ranges may assist both parties in exploring a compromise as both parties have a common understanding as to the rigour of those ranges. The IGT is of the view that, similar to the Scenario 1 in Figure 2 above, where a taxpayer's original self-assessed point estimate is within the ATO's valuation range, the ATO should accept the taxpayer's valuation. The advantage of this approach, however, is that neither the taxpayer nor the ATO are constrained by an arbitrary 10 per cent range when determining whether to accept the taxpayer's point estimate.

4.189 There are, however, a number of limitations with the above approach. First, the approach proceeds on the assumption that values are normally distributed and, hence, it is not suitable where non-normally distributed values are at play.

4.190 Secondly, valuers would need to measure the confidence level of their valuations to show that it met this proposed standard confidence level. For valuations where there is a lack of input data, or such inputs are heavily reliant on professional judgement, it may be impractical to calculate a quantitative level of confidence.

4.191 For valuations which are more reliant on plentiful quantitative data, it may be more feasible to establish a quantitative level of confidence. However, where there is uncertainty attaching to several inputs, determining the confidence level for a range may be a complex process, potentially increasing costs for both the taxpayer and the ATO. As noted in Chapter 2, the IVSC recognises the difficulties associated with quantifying uncertainty and advocates the use of qualitative descriptions instead.

ATO valuer opinion of taxpayer point estimate

4.192 The IGT is of the view that ATO valuations should not only serve to produce an alternative point estimate, but they should also seek to provide a mechanism to allow ATO officers to be pragmatic and accept the taxpayer's point estimate where appropriate.

4.193 An ATO preliminary risk assessment or critique may provide a prima facie basis to accept or challenge the taxpayer's valuation. Where the matter has been escalated to a full valuation, the ATO valuer undertaking the full valuation task is also in a good position to consider the reasonableness of the taxpayer's point estimate. Such a valuer has not only considered the taxpayer's inputs and methodology, but has also had to assemble their own inputs and apply their own methodology. This allows the valuer to compare the respective approaches and give an opinion on whether the taxpayer's point estimate was reasonable, or whether there were aspects of the taxpayer's valuation (such as particular inputs or methodology) that were unreasonable.

4.194 In addition, where the valuer engaged by the ATO is of the opinion that the taxpayer's point estimate is reasonable, this should be a basis on which to accept the taxpayer's point estimate, notwithstanding that it is different to the ATO's point

estimate. Such an approach is expected to ameliorate disputes and provide accommodation around the costs associated with the taxpayer's burden of proof. Where the ATO does not accept the taxpayer's valuation, notwithstanding that it was regarded as reasonable by the ATO valuer, the ATO should clearly communicate to the taxpayer the reasons for rejecting it.

4.195 Where the valuer engaged by the ATO was of the opinion that the taxpayer's point estimate was unreasonable, the ATO should also communicate that outcome and reasons for it to the taxpayer.

RECOMMENDATION 4.7

Where a valuation dispute is primarily due to the professional judgement of valuers engaged by each party, the IGT recommends that the ATO provide guidance to its staff on when they should accept the taxpayer's point estimate. Such guidance may provide a number of methods and when each may be appropriately used. Examples of these methods may include applying a 10 per cent tolerance to point estimates or obtaining an opinion from the ATO's valuer as to the reasonableness of the taxpayer's point estimate.

ATO response

Agree

MARKET VALUATION PRIVATE RULINGS

Stakeholder concerns

4.196 As noted earlier, taxpayers may seek ATO binding advice on valuations through the MVPR process which allows taxpayers to obtain, at the taxpayer's expense, an ATO valuation or ATO confirmation of a taxpayer valuation. However, as shown by ATO statistics and submissions to this review, the MVPR process is rarely used and one professional body noted that the limited feedback from its members indicated a positive experience for larger businesses, but not SME taxpayers.

IGT observations

4.197 The IGT is of the view that the underutilisation of the MVPR system may be due to several factors.

4.198 First, the Commissioner is required to pass on the costs of a valuation to the taxpayer. For a taxpayer seeking a valuation, these costs may be comparable to the costs they would bear if they had obtained a valuation without ATO involvement. As the ATO appoints the valuer and controls the instruction process, the certainty gained from a private ruling on a valuation matter may not outweigh the relinquishing of control over the appointment and instruction process whilst bearing the costs. Although a small sample size, it is perhaps telling that only two out of the nine

identified MVPRs involved an actual valuation, with the remainder in the nature of a confirmation of the taxpayer's original valuation.¹⁸²

4.199 The IGT is of the view that the ATO may be able to address some of the above factors by jointly appointing the valuer and allow the taxpayer greater access to the valuer so that the taxpayer has a greater degree of confidence with the instruction process.

4.200 The ATO could also consider bearing some of the cost of the MVPR valuation as it would relieve the ATO from having to obtain its own critique or valuation. However, this may require changes to the relevant regulations.

4.201 Secondly, the ATO has publically stated that it 'generally will not rule on the market value for a future event'.¹⁸³ This narrows the scope of MVPRs and their usefulness for taxpayers wishing to plan future transactions.

4.202 Thirdly, there may be a lack of awareness of the availability of MVPRs. Notwithstanding its brief description in ATO publications, there may be opportunity for the ATO to further promote this service to raise awareness of its availability.

4.203 The IGT is of the view that in certain circumstances taxpayers should be able to obtain an advanced ATO view on the acceptability of valuation instructions prior to obtaining a valuation. This could be done by way of either sharing the taxpayer's instructions with the ATO before or at the same time as instructing the valuer or inviting the ATO to jointly instruct the taxpayer's valuer.

RECOMMENDATION 4.8

The IGT recommends that the ATO:

- (a) *promote the availability of Market Valuation Private Rulings (MVPR);*
- (b) *jointly appoint valuers with taxpayers for MVPR purposes and allow the taxpayer greater access to the valuer; and*
- (c) *consider bearing some of the valuation costs of MVPRs to reflect potential ATO savings.*

ATO response

In relation to 4.8(a) – Agree

In relation to 4.8(b) – Agree

In relation to 4.8(c) – Disagree

In relation to 4.8(c) – While we agree with the objective of the recommendation to promote the use of Market Valuation Private Rulings, we are unable to agree to bear the cost. We are not in a position to reliably forecast costs nor savings that may arise from an unknown increase in applications.

¹⁸² See para [4.86] above.

¹⁸³ Above n 15.

CHAPTER 5 – DISPUTE RESOLUTION APPROACHES IN VALUATION MATTERS

STAKEHOLDER CONCERNS

5.1 Stakeholders raised concerns with the time and cost involved in resolving valuation disputes under the current objection and litigation processes. They were of the view that valuation disputes arose when the ATO and taxpayer were each relying on a different set of facts, assumptions, methodologies or understanding of the applicable law. Stakeholders suggested that these differences could be resolved more effectively by adopting approaches that either:

- assisted parties to obtain a common understanding of the other's positions and the reasons for those positions at the early stages of any compliance activity; or
- where competing views persisted, provide a non-binding opinion or a binding determination from a third party.

BACKGROUND

5.2 Chapters 3 and 4 of this report have recommended changes to ensure that the above causes for valuation disputes are minimised by a number of means including:

- reducing the need for valuations by use of safe harbours and valuations obtained for other purposes;
- minimising the difference between the ATO's and taxpayers' instructions through, for example, risk assessment of taxpayers' valuer instructions during pre-lodgement processes, adopting a standard instruction template and greater use of an improved MVPR system;
- providing greater taxpayer access to the ATO's instructions to its valuers; and
- accommodating a level of difference between valuations which are primarily attributable to the professional judgement of different valuers.

5.3 The IGT has also already considered dispute resolution and use of ADR in a number reviews, particularly in the IGT's *ADR Review* where there are particular recommendations aimed at valuation disputes.¹⁸⁴ Accordingly, this chapter looks at any remaining improvements that may be made in the valuation context.

¹⁸⁴ IGT, *Review into the Australian Taxation Office's Use of Early and Alternative Dispute Resolution* (July 2012) Recommendations 4.4 and 4.5. See also IGT, *Review into Aspects of the Tax Office's Settlement of Active Compliance Activities* (December 2009), where the ATO agreed to Action Item 24 to review settled valuation cases to identify and test early dispute resolution opportunities for valuation cases.

5.4 The following section describes a range of dispute resolution approaches before making specific comments on their suitability to resolve valuation-related tax disputes.

Expert valuer conferencing

5.5 Expert valuer conferencing is a process used by the Federal Court to bring the valuers of the opposing parties together outside of the formal court hearing. The conference is designed to seek areas of agreement and articulate the areas of and reasons for any remaining disagreement. The valuers are often requested to reflect these in a written report called the 'expert report'. These conferences may be mediated by a professional mediator.

5.6 The RCF case¹⁸⁵ is an example of where an expert valuer conference was ordered by the judge.

5.7 Expert valuer conferencing may also be used by the ATO and taxpayers before litigation. For example, there are a range of dispute resolution mechanisms allowing the taxpayer and ATO officers to meet directly to discuss the facts and issues at hand. These mechanisms include case conferencing and in-house facilitation. Case conferencing usually involves a taxpayer and their advisor meeting face-to-face with ATO compliance and specialist officers.

5.8 In-house facilitation, on the other hand, involves a trained ATO officer, independent of the compliance case, to act as a facilitator to guide a discussion between the ATO and the taxpayer. The IGT recommended such a process in his *ADR review* particularly for smaller less complex disputes. The ATO has advised that it has implemented this recommendation with some success and it is now employing it in broader contexts.¹⁸⁶

5.9 The ATO has a general policy of resolving disputes as early as possible¹⁸⁷ and provides specific internal guidance notes on resolving market value issues:

Where appropriate and feasible, all reasonable attempts to resolve issues surrounding market value are to be undertaken at the earliest possible time during an audit or review, before market valuation-related adjustments are made.¹⁸⁸

5.10 The ATO's practice statement on ADR contains staff guidance on expert valuer conferencing:

58. The purpose of a valuer conference should be for the experts to explain the information and assumptions used in the methodology and the methodology that both parties have adopted. Even if the valuer conference does not result in agreement between the parties, the ATO personnel should ensure that the

¹⁸⁵ Above n 161 at [82].

¹⁸⁶ ATO, 'Correct a mistake or dispute a decision - Facilitation Process' (27 March 2014) <www.ato.gov.au>.

¹⁸⁷ ATO, 'Dispute Management Plan 2013-14' (20 January 2014) <www.ato.gov.au>.

¹⁸⁸ Above n 124.

valuer conference results in establishing points of agreement and the areas that remain in dispute.¹⁸⁹

5.11 As noted earlier, the ATO does not provide specific guidance on granting taxpayer access to the ATO's valuers or conducting expert valuer conferencing during compliance activities.

Expert reports

5.12 In Federal Court proceedings, expert evidence, such as valuation opinions, are often first presented as written reports. The court may make orders limiting the expert's evidence-in-chief to the contents of the expert's written report.¹⁹⁰ As noted above, the Court may then order that the valuers of both parties take part in an expert conference. One of the main outcomes of such a conference, besides narrowing issues for dispute, is to facilitate the production of an expert report. As reflected in the RCF case¹⁹¹, the court may order that the expert report be completed jointly by the valuers of both parties.

Jointly instructing separate valuers

5.13 The joint instruction of separate valuers is an approach that allows each party to retain their own valuer but to agree on a common set of instructions for each of them. Such an approach was thought to reduce the scope for different valuation outcomes. Reasonable differences in the resulting valuation could then be attributable to professional judgement, whilst much larger differences could indicate differences in the valuer's approach or methodology which may need further reconciliation.

Jointly appointed valuers or third experts

5.14 During a valuation dispute, it is likely that both the taxpayer and the ATO have each already obtained valuations from their own separate valuers. Both parties may agree to jointly appoint another valuer as a 'third expert' to help break the deadlock.

5.15 Many commercial contracts also include dispute resolution clauses. Where the dispute is in respect of commercial property, the matter may be referred for determination by a valuer chosen by the President of a nominated valuation professional body or dispute resolution association.

5.16 The ATO's *Tax Compliance for SMEs* publication envisages a similar process:

In relation to valuation matters, both parties may agree on the appointment of a third party expert to either critique or conduct a valuation, and commit to accept the outcome of that process.¹⁹²

¹⁸⁹ ATO, *Alternative Dispute Resolution (ADR) in ATO disputes*, PS LA 2013/3 (1 August 2013) paras [57]-[61].

¹⁹⁰ *Federal Court Rules 2011* r 23.15(c).

¹⁹¹ Above n 161 at [82].

¹⁹² Above n 115.

Early Neutral Evaluation (ENE)

5.17 ENE is very similar to jointly appointing a valuer or a third expert as described above. The main difference is ENE usually involves the third party being from a legal background, such as a retired judge. Although any expert may perform the role of the evaluator, the ATO has advised that they have usually used a retired judge.

5.18 The ATO has also advised that ENE is preferred over mediation in high risk valuation disputes. The ATO observed that taxpayers were more comfortable with a process in which a respected independent third party expressed an expert opinion about the relative merits of each case.

Single experts

5.19 The 'single expert' is appointed by the court to provide expert evidence. One key feature is that neither litigant is generally permitted to present their own expert evidence without the permission of the court as there is a presumption in favour of a single expert witness.¹⁹³ Such a feature is used in the Family Court¹⁹⁴, the Queensland Supreme Court¹⁹⁵ and the New South Wales Land and Environment Court.¹⁹⁶

5.20 One of the main reasons for the single expert witness system is to avoid 'unnecessary costs arising from the appointment of more than one expert witness'.¹⁹⁷ Although unable to present their own expert evidence, litigants may cross-examine the single expert.¹⁹⁸ In preparing for such cross-examination, litigants may retain a 'shadow expert' to assist litigants with formulating questions for the single expert.

5.21 These shadow experts do not present opinion evidence to the court which means that they do not owe a duty to the court.¹⁹⁹

5.22 The Federal Court has the capacity to implement a single expert witness approach through the application of its 'Court expert' rules.²⁰⁰

5.23 Single experts are also used to settle matters relating to retail shop leases. State laws, such as those in New South Wales²⁰¹ and Queensland²⁰², require certain valuation tasks in relation to retail shop leases to be conducted by an independent 'specialist retail valuer'. Lessors and lessees reviewing leases on the basis of 'current market rent' are to agree between themselves the appointment of such a valuer to determine the current market rent. Those specialist retail valuers are to be drawn from

¹⁹³ New South Wales Law Reform Commission, *Expert Witnesses*, Report 109 (2005) para [4.36].

¹⁹⁴ *Family Law Rules 2004* r 15.49.

¹⁹⁵ *Uniform Civil Procedure Rules 1999* (Qld) r 429H.

¹⁹⁶ *Uniform Civil Procedure Rules 2005* (NSW) r 31.19-54; See also Justice Peter McClellan, 'Expert Witnesses – The Experience of the Land and Environment Court of New South Wales' (Paper presented at the XIX Biennial LAWASIA Conference, 20 March 2005) p 12.

¹⁹⁷ *Family Law Rules 2004* r 15.42, see also *Uniform Civil Procedure Rules 1999* (Qld) r 423(c).

¹⁹⁸ *Family Law Rules 2004* r 15.50; *Uniform Civil Procedure Rules 1999* (Qld) r 429H(7).

¹⁹⁹ See *Federal Court Practice Note CM 7 Expert witnesses in proceedings in the Federal Court of Australia*.

²⁰⁰ *Federal Court Rules 2011* r 23.01.

²⁰¹ *Retail Leases Act 1994* (NSW) s 31.

²⁰² *Retail Shop Leases Act 1994* (Qld) s 28.

a list of valuers prepared by professional bodies (in New South Wales) or the Valuers Registration Board (in Queensland).

Concurrent evidence or ‘hot tubbing’

5.24 The court practice of concurrent evidence, or colloquially known as ‘hot tubbing’, is a judicial innovation designed to address some practical difficulties of admitting expert evidence. Experts may give evidence one after another and be sworn in and cross examined and re-examined at the same time. This can be done by putting a question relevant to one subject or issue to each expert in turn until the cross examination or re-examination for that subject is completed.²⁰³ This can be contrasted with the usual approach to adducing evidence whereby an expert witness presents their evidence and the opposing party cross-examines them on all issues before the next expert witness takes the stand.

5.25 During hot tubbing, experts may be called upon to opine on each other’s evidence.²⁰⁴ Some of the observed benefits from this approach include:

It enables each expert to concentrate on the real issues between them. The judge or listener can hear all the experts discussing the same issue at the same time to explain his or her point in a discussion with a professional colleague. The technique reduces the chances of the experts, lawyers and judge, jury or tribunal misunderstanding what the experts are saying.²⁰⁵

5.26 The Federal Court, in its submission to the Australian Law Reform Commission, stated that:

It has been the judges’ experience that having both parties’ experts present their views at the same time is very valuable. In contrast to the conventional approach, where an interval of up to several weeks may separate the experts’ testimony, the panel approach enables the judge to compare and consider the competing opinions on a fair basis. In addition, the Court has found that experts themselves approve of the procedures and they welcome it as a better way of informing the Court. There is also symbolic and practical importance in removing the experts from their position in the camp of the party who called them.²⁰⁶

Multi-member tribunal or panel

5.27 As valuation disputes progress, parties may wish to seek a binding determination from a Tribunal or similar body comprised of members with expertise in valuations. Examples of current multi-member specialist tribunals include the three-

²⁰³ *Federal Court Rules 2011* r 23.15(f)-(g).

²⁰⁴ *Federal Court Rules 2011* r 23.15(h).

²⁰⁵ Steven Rares, ‘Using the “Hot Tub” – How Concurrent Expert Evidence Aids Understanding Issues’ (12 October 2013) para 4.

²⁰⁶ Australian Law Reform Commission, *Managing Justice: A Review of the Federal Civil Justice System*, Report No 89 (2000) para [6.117].

member Australian Competition Tribunal (formerly Trade Practices Tribunal).²⁰⁷ Such a Tribunal can be distinguished from other dispute resolution approaches by the following key features:

- headed by a judge or former judge as a legal expert;
- independent from the administrator/regulator such as the ATO;
- additional members may be subject matter experts such as valuers;
- the outcome is binding on the parties; and
- appeals may be made to the Federal Court only on matters of law.

5.28 The Administrative Review Council, in their report on the Administrative Review of Patent Decisions, noted considerable advantages in multi-member panel reviews:

There are considerable advantages in having review conducted by a multi-member panel which brings together expertise from a variety of disciplines. The Council believes that members with scientific or technical expertise would assist the Tribunal to appreciate the technical issues involved in a patent decision, while legally qualified members could assist in analysing and resolving any legal issues. It notes that there is a concern that the use of experts may result in cases being judged on the basis of the expert's personal views rather than on the merits of the case. However, the Council considers that it is unlikely that tribunals, particularly multi-member tribunals, would not assess cases on their merits.²⁰⁸

IGT OBSERVATIONS

Expert valuer conferencing

5.29 The IGT has previously made a recommendation in his *ADR review* that, if both parties agree, the ATO should:

... adopt expert valuer conferencing like those utilised by the Federal Court, to ensure that conflicting experts are afforded an opportunity to meet independently and discuss their different expert opinions with a view to resolving or narrowing these differences.²⁰⁹

²⁰⁷ The Copyright Tribunal of Australia is another similar specialist Tribunal which, like the Australian Competition Tribunal, is administered by the Federal Court of Australia.

²⁰⁸ Administrative Review Council, *Report to the Attorney-General Administrative Review of Patent Decisions*, Report No 43 (1998) para [2.41].

²⁰⁹ Above n 168, recommendation 4.5.

5.30 Although the ATO has updated its ADR practice statement to include expert valuer conferencing, the IGT notes that taxpayer valuers do not have access to the ATO's valuers until the formal dispute stage.²¹⁰

5.31 The IGT is of the view, therefore, that the ATO could make greater use of this approach in a less formal way during audit and objection stages of valuation disputes.

5.32 Difficulties in gaining access to the ATO's valuers may stem from the additional costs the ATO may incur in making its valuers available for meetings or conferences. The lack of an explicit ATO procedural framework for ATO officers to respond to requests for such access, especially in a compliance context, may add to these difficulties. The IGT also notes that, unlike the IRS's valuers and HMRC's VOA and SAV valuers, the ATO's valuers do not have the same level of autonomy or authority to directly negotiate a value with the taxpayer.

5.33 The IGT has observed in previous reviews²¹¹, that the most effective way to test the views of two experts with differing opinions is to provide those experts with an opportunity to discuss their competing views with each other and reach a common understanding of the strengths and weaknesses of each other's views. Such a process has been found, if not to resolve issues in dispute, to narrow those issues and provide each party with a greater appreciation of the litigation risks.

5.34 This issue arose more specifically in the IGT's *Review of the ATO's Management of Transfer Pricing Matters* where stakeholders raised concerns that they could not gain access to the ATO's transfer pricing specialists (either internal or external) with the risk that the ATO specialists had provided advice to ATO officers based on incorrect assumptions that the latter had provided. As a result, the ATO agreed to the IGT's recommendation that, with respect to transfer pricing compliance activities, the ATO ensure:

- specialist units engage with taxpayers and their advisers where requested and appropriate; and
- at the outset, taxpayers and their advisers are made aware that they are able to, and how they may request, access to the various specialist units.²¹²

5.35 Private sector valuers who were consulted during this IGT review also observed that, from their experience, ATO-taxpayer disputes may be resolved quicker or narrowed where expert conferencing approaches are used, particularly because taxpayers are likely to better appreciate the independence of the ATO valuers.

5.36 In the IGT's view, in addition to the implementation of existing IGT recommendation relating to expert valuer conferencing²¹³, the ATO could further promote their use by, for example, updating the current *Market valuation for tax purposes* publication to outline various dispute resolution mechanisms, including the

²¹⁰ Above n 189.

²¹¹ IGT, *Report into the Australian Taxation Office's large business risk review and audit policies, procedures and practices* (September 2011) para [9.45].

²¹² Above n 173, recommendation 3.3.

²¹³ Above n 168, recommendation 4.5.

availability of expert valuer conferencing. Internal staff guidance could also be updated to ensure that ATO officers managing the risk of valuation disputes are better prepared to offer and manage such an approach.

Expert reports

5.37 Whilst the IGT appreciates the usefulness of expert reports in assisting the judiciary to understand the areas of disagreement, they can be costly to produce and their use may not be justified where, for example, the ATO and the taxpayers are still attempting to resolve the dispute without the intervention of a third party.

5.38 The IGT is of the view that the use of an expert report may be justified in circumstances such as where direct expert conferencing has already taken place and areas of dispute remain. However, this must be balanced with the additional cost and time associated in preparing such a report.

Jointly instructing separate valuers

5.39 The IGT is of the view that where taxpayers and the ATO wish to retain their own valuer, jointly instructing these valuers reduces the risk of divergent valuations. The process of agreeing on the instructions beforehand in itself presents a valuable opportunity to identify differences which may need to be reconciled before the respective valuations are undertaken.

Jointly appointed valuers or third experts

5.40 In the *ADR review*, the IGT had recommended that the ATO adopt a more open process that seeks to accommodate joint appointment of valuers. In these circumstances, the parties were to agree on certain criteria. The ATO agreed with this recommendation and noted that, in their experience with valuation disputes, 'most taxpayers do not wish to share an expert and generally prefer to retain their own valuation expert.'²¹⁴ In such cases the ATO could consider jointly instructing separate valuers as mentioned above.

Early Neutral Evaluation (ENE)

5.41 The IGT has noted in his *ADR Review* that:

There is considerable merit in the use of ADR, and in particular early neutral evaluation, in the resolution of valuation disputes which are not resolved through direct discussions between the ATO and taxpayers. In such cases, the IGT considers that the matter should default to ADR prior to the finalisation of an audit, objection or the matter proceeding to litigation.²¹⁵

5.42 The IGT notes the benefits of the ENE process but the costs may be prohibitive for taxpayers with limited resources where the evaluator is drawn from a specialised or

²¹⁴ Above n 168, recommendation 4.4.

²¹⁵ Above n 168, para [4.87].

limited pool of experts. Although the ENE process may be the most effective and efficient means to resolve hotly-contested complex factual issues, the ATO could explore more cost effective ways to implement ENE for smaller taxpayers.

Single experts

5.43 The IGT is of the view that there may be appropriate circumstances in which a tax-related valuation matter may be determined by a single valuer. For example, the MVPR process allows a taxpayer to obtain an original valuation ‘through’ the ATO. In these circumstances, it may be possible that such a valuation is the only one undertaken for that issue. It is the taxpayer’s prerogative, however, to challenge that valuation if they see fit.

5.44 In terms of using valuers as single experts in the litigation context to save costs, the IGT is of the view that such savings may be limited as both parties are likely to incur cost of engaging shadow experts. Furthermore, these shadow experts are not bound by a duty to assist the Court and would not be subject to the same rigour and cross-examination as expert witnesses providing evidence in court.

5.45 The IGT also notes that, although the Federal Court has the discretion to appoint single expert witnesses, its Practice Note CM7 *Expert witnesses in proceedings in the Federal Court of Australia* focuses on situations where each litigant has retained their own expert witness.

Concurrent evidence

5.46 The IGT notes the benefits of hot tubbing in a litigation context. However, it may not have as much utility during compliance activities or the objection stage, whilst the ATO and taxpayer are seeking to resolve a dispute or potential dispute without engaging any further third parties.

Multi-member tribunal or panel

5.47 The IGT notes the benefits of establishing a multi-member tribunal or panel, however, new legislation would be needed to establish such a new tribunal and, in particular, give effect to the binding nature of its decisions.

5.48 The Administrative Appeals Tribunal (AAT) currently has the capacity to convene multi-member panels containing technical specialists and already operates panels with members that have expertise in the fields of ‘accountancy, aviation, engineering, law, medicine, pharmacology, military affairs, public administration and taxation.’²¹⁶ Therefore, the AAT could more readily convene a specialist panel some members of which may be valuers. The current AAT membership, however, has limited expertise in the field of valuations and there would be costs associated with expanding the current AAT membership to include valuation expertise.

²¹⁶ Administrative Appeals Tribunal, *Annual Report 2012-13* (2013) p 14.

RECOMMENDATION 5.1

The IGT recommends that the ATO:

- (a) ensure that it facilitates taxpayer requests for expert valuer conferencing on competing valuations to reach a common understanding of inputs and methodologies used by each valuer, the resulting valuation and the reasons for it;*
- (b) make taxpayers aware that they can request expert valuer conferencing as mentioned at (a) above; and*
- (c) in its guidance relating to valuations, update the range of dispute resolution approaches that may be used to include joint instruction of separate valuers, joint appointment of valuers and expert valuer conferencing.*

ATO response

In relation to 5.1(a) – Agree

In relation to 5.1(b) – Agree

In relation to 5.1(c) – Agree

The ATO agrees that more may need to be done to improve awareness and facilitate access. Taxpayers may already request expert valuer conferencing. Paragraphs 57-59 of Practice Statement PS LA 2013/3 Alternative Dispute Resolution (ADR) in ATO Disputes covers the process of expert valuer conferencing to discuss how their different valuations were obtained.

APPENDIX 1 – TERMS OF REFERENCE AND SUBMISSION GUIDELINES

BACKGROUND

Australia's tax system increasingly relies on concepts such as 'market value'. Whilst there may be sound economic reasons for using such concepts, their use has necessitated a growing need for taxpayers to undertake significant valuation work.

Valuations are required in numerous taxing regimes, including: income tax consolidation, capital allowances, trading stock, transfer pricing, taxation of financial arrangements, capital gains tax, fringe benefits tax, goods and services tax, self-managed superannuation funds (SMSF), minerals resource rent tax, general anti-avoidance rules and employee share schemes.

Market value is often undefined in these regimes, leaving the meaning to be determined by the courts. The Australian Taxation Office (ATO) has issued both general guidance regarding market valuations, as well as specific valuation advice for certain regimes, such as SMSF and MRRT.

Valuations may be required for a variety of assets, transactions, businesses and liabilities amongst others. Assets may be tangible, such as land and property, plant and equipment, or intangible, such as intellectual property and rights. Depending on the circumstances, taxpayers may perform their own valuation or engage the services of a professional valuer, particularly for complex or difficult valuations. Certain tax regimes specifically require the use of professional valuers for certain methods.¹

When verifying compliance with the tax laws, it may be necessary for the ATO to determine if a taxpayer's valuations are appropriate. In doing so, the ATO may engage professional valuers who may be from the private sector or the Australian Valuation Office (AVO). The AVO operates as a business line within the ATO which provides fee-based valuation services exclusively to the public sector.

Concerns have been raised with the Inspector-General of Taxation (IGT), by taxpayers, tax practitioners and their representative bodies, regarding the ATO's administration of valuation matters. In general, these concerns relate to:

- the uncertainty and cost associated with valuations;
- the ATO's management of the compliance risk associated with valuations;
- the independence, capability and the ATO's engagement of the AVO and private sector valuers; and
- interactions between the ATO, taxpayers and valuers and how disputes are resolved.

¹ For example, ATO, *A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination*, MSV 2009/1 (14 October 2009).

The IGT seeks to understand the underlying causes for the above concerns and their impacts as well as opportunities for improvement. The IGT has previously made recommendations relating to valuation disputes in his *Review into Aspects of the Tax Office's Settlement of Active Compliance Activities*² and more recently his *Review into the Australian Taxation Office's Use of Early and Alternative Dispute Resolution*.³ The IGT intends to build on the work of these previous reviews.

The IGT will conduct this review pursuant to subsection 8(1) of the *Inspector-General of Taxation Act 2003* (IGT Act) and welcomes your input. The following terms of reference and guidelines are provided to assist with the preparation of your submissions.

TERMS OF REFERENCE

The IGT review into the ATO's administration of valuation matters will focus on:

The valuation requirements in tax and superannuation laws

1. *The extent to which the tax and superannuation laws require valuations and the impact on various types of taxpayers; and*
2. *Alternatives or simplifications to valuation requirements with the aim of reducing uncertainty and compliance costs.*

The ATO's management of compliance risk associated with valuations

3. *The level and nature of ATO compliance and interpretative work which requires valuation input;*
4. *The ATO's strategy for managing valuation risks;*
5. *The ATO's internal and external advice and guidance in relation to valuations; and*
6. *The ATO's conduct of risk assessment and compliance activities pertaining to valuation matters.*

The independence, capability and the ATO's engagement of the AVO and private sector valuers

7. *The extent to which valuation input is provided by ATO officers, AVO officers and private sector valuers;*
8. *The ATO officer's use of the valuer's professional advice; and*
9. *The interaction between the ATO and AVO or private sector valuers including:
independence and the terms of engagement including conflicts of interest and remuneration;*

² IGT, *Review into Aspects of the Tax Office's Settlement of Active Compliance Activities*, December 2009.

³ Above n 168.

capability, timeliness and quality of the valuation service; and

nature of any informal communication between the ATO and the valuer.

Taxpayer, ATO and valuer interaction including dispute resolution

10. *The level of, and reasons for, valuation disputes;*

11. *The ATO's process for resolving valuation disputes; and*

12. *The interaction between the ATO, taxpayers and their respective valuers and the use of the latter's evidence from the commencement of compliance activities through to litigation.*

The IGT may also examine any other relevant concerns raised or potential improvements.

SUBMISSION GUIDELINES

The IGT envisages that your submission will be set out in two parts:

- your experiences and views on the use of valuations in tax and superannuation law and how the ATO administers valuation matters; and
- suggestions for improvement.

Your experiences and views on the use of valuations in tax and superannuation law and how the ATO administers valuation matters

It is important to provide a detailed account of specific valuation related provisions in the law or specific ATO valuation related practices which have had an impact on you. We are seeking examples of ATO practices that have contributed to positive outcomes as well as negative impacts.

The following questions are designed to assist you in your response.

The valuation requirements in tax and superannuation laws

1. *Have you been affected by tax law provisions which require a valuation? If so:*
 - a. *Which provisions were they?*
 - b. *Was the valuation done by an independent professional valuer or yourself? In the case of the former, what were the terms of engagement?*
 - c. *What valuation methods were used? Were alternative methods available and considered? Please provide reasoning.*
 - d. *How much did the valuation cost?*
 - e. *Was the valuation critical to your tax position? If so, what was the impact?*

2. *Would you have obtained the valuation in the ordinary course of your affairs if the law did not require it? How would you compare the valuation costs with the size of your business/income and/or the transaction in question?*

The ATO's management of compliance risk associated with valuations

3. *What was your first interaction with the ATO with respect to a valuation matter?*
4. *Did you seek any advice or guidance from the ATO regarding valuation issues before completing your tax return? If so, what type of advice or guidance did you seek? Please comment on your experience in this regard.*
5. *Were you involved in any ATO compliance activities in which valuations were raised as an issue? If so:*
 - a. *How did the ATO conduct the valuation aspect of the compliance activity?*
 - b. *Did the ATO compliance officer advise you that a valuer had been consulted before raising any valuation concerns with you? If so, what was the nature of that advice?*
 - c. *Were you or your valuer given an opportunity to engage with the ATO officer and/or valuer? Please comment on your experience.*
 - d. *Was any ATO advice applicable to your valuation matter? If so:*
 - i. *How did the ATO apply the advice?*
 - ii. *Were there any issues raised regarding the taxpayer's valuation being inconsistent with that ATO advice?*
6. *If you were involved in any ATO real-time compliance activity, such as a Pre-lodgement Compliance Review (PCR), were valuation issues raised? If so, please describe how this was done.*

The independence, capability and the ATO's engagement of the AVO and private sector valuers

7. *Were you involved in any ATO compliance activities in which the ATO engaged the AVO or private sector valuers? If so:*
 - a. *Are you aware of the terms of engagement between the ATO and the AVO or private sector valuers?*
 - b. *How do you view the valuation capability of the ATO officers, AVO officers or private sector valuers involved in the process?*
 - c. *What was your perception of the independence of the AVO or private sector valuer? Please provide reasons for your perceptions.*

Taxpayer, ATO and valuer interaction including dispute resolution

8. *If you were involved in a dispute regarding a valuation matter please provide a detailed account of your experience and ensure that the following questions are addressed:*

- a. *How and when did the dispute arise?*
- b. *If you had already carried out a valuation as part of self assessment, did the ATO accept your valuation? If not, why not?*
- c. *Did the ATO initially engage its valuers to critique your valuation or conduct a fresh valuation? Please comment on the impact of the selected approach on managing the dispute process.*
- d. *Did the ATO's valuer interact with you or your valuer? Please comment on any such interactions and their utility and effectiveness. What was the role of the ATO case officer during this interaction?*
- e. *Were attempts made early in the process to narrow the issues in dispute or resolve them? For example, were attempts made to agree on facts and matters of principle at the outset such as the most appropriate valuation method?*
- f. *Please comment on the financial impact of the manner in which the dispute was managed.*
- g. *Were you offered or made aware of any form of alternative dispute resolution (ADR) by the ATO?*

Your suggestions for improvement

The IGT is also seeking your views on potential improvements to the use of valuations in tax and superannuation laws and the ATO's administration of valuation matters.

The following questions are designed to assist you in your response.

The valuation requirements in tax and superannuation laws

1. *What alternatives to concepts such as market value could be used to reduce the need for valuations in tax matters?*
2. *Where alternatives are not easily identified, you may wish to comment on simplification or improvements such as defining market value and consistency with other regulatory requirements such as accounting or international valuation standards.*
3. *Should these alternatives or simplifications be enshrined in legislation or can they be addressed administratively by the ATO? Please explain your views.*

The ATO's management of compliance risk associated with valuations

4. *How could the ATO improve its public advice and guidance on valuation matters to increase certainty for taxpayers in relation to valuation matters?*
 - a. *Which areas warrant more advice or guidance?*
 - b. *What form should such advice or guidance take?*
 - c. *Could such advice or guidance suggest the most appropriate methodology in certain circumstances or provide rules of thumb?*

5. *What steps could the ATO and taxpayers take to address valuation issues earlier such as before a taxpayer self assesses? For example, with respect to large business taxpayers, should valuation matters be considered during PCRs? More generally what improvements could be made to the process of obtaining an advance ATO view on valuation matters?*
6. *How should the ATO approach different levels and types of valuation risks? What thresholds could the ATO use to make this differentiation effective?*

The independence, capability and the ATO's engagement of the AVO and private sector valuers

7. *When, and how, should the ATO's valuers be involved in ATO compliance activities?*
8. *How could the ATO improve the way in which it engages valuers?*
9. *What information about the ATO's engagement with its valuers should be public or accessible to the affected taxpayer?*
10. *How can the ATO improve the perceived or actual independence of the valuers it engages?*
11. *How can the ATO ensure that the valuers it engages have the appropriate capability?*
12. *What are your views on valuation critiques? What role should they play and how can the ATO improve the use of them?*

Taxpayer, ATO and valuer interaction including dispute resolution

13. *What aspects of the interaction between taxpayers, the ATO and their respective valuers could be improved?*
14. *At what point should each parties' valuers interact? What should be the role of the taxpayer and ATO during these interactions?*
15. *What could taxpayers, the ATO or their respective valuers do to help shorten the duration of a dispute and/or minimise unnecessary costs?*
16. *What are your thoughts on the use of valuer conferencing, jointly instructed valuers, jointly appointed valuers, expert valuer panels, single experts, or mediated approaches? How and when could they be used by the ATO and taxpayers to resolve disputes? What other approaches could be used?*
17. *Are there any aspects of the way in which valuation issues are resolved during litigation that you have found helpful? How could these be improved or employed earlier?*
18. *Are you aware of other approaches to managing evidence from expert witnesses? How could these be applied in resolving valuation disputes? For example, the Federal Court of Australia, Family Court of Australia, Administrative Appeals Tribunal and the NSW Land and Environment Court, amongst others, have special procedures available for the use of expert witnesses.*

Lodgement

The closing date for submissions is 20 December 2013. Submissions can be sent by:

Post to: Inspector-General of Taxation
 GPO Box 551
 SYDNEY NSW 2001

Email to: valuations@igt.gov.au

Confidentiality

Submissions provided to the IGT are maintained in strict confidence (unless you specify otherwise). This means that the identity of the taxpayer, the identity of the adviser and any information contained in such submissions will not be made available to any other person, including the ATO. Sections 23, 26 and 37 of the IGT Act safeguard the confidentiality and secrecy of such information provided to the IGT – for example, the IGT cannot disclose the information as a result of a Freedom of Information (FOI) request, or as a result of a court order generally. Furthermore, if such information is the subject of client legal privilege (also referred to as legal professional privilege), disclosing that information to the IGT will **not** result in a waiver of that privilege.

APPENDIX 2 – TABLE OF VALUATION-RELATED PROVISIONS IN THE *INCOME TAX ASSESSMENT ACT 1936*

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
Part III - Liability to Taxation			
Division 1 - General		21A Non-cash business benefits	The 'arm's length value' is used to account for non-cash business benefits.
Division 2 - Income	Subdivision A - Assessable income generally	26AJ Investment-related lottery winnings to be included in assessable income	The 'arm's length value' is used to account for property or services, reduced by the recipient's contribution (if any).
		26BB Assessability of gain on disposal or redemption of traditional securities	The 'arm's length consideration' is used to substitute for any gain assessable.
		26BC Securities lending arrangements	The 'market value' is used to account for eligible and borrowed securities.
	Subdivision D - Dividends	44 Dividends	The 'market value' is used to account for demerger dividends.
		45BA Effect of determinations under section 45B for demerger benefits	The 'market value consideration' is used to account for demerger benefits.
		45C Effect of determinations under sections 45A and 45B for capital benefits	The 'market value consideration' is used to account for capital benefits.
		47A Distribution benefits - CFCs	The 'arm's length value' is used to account for shares or units in relation to redemption or buy-back.
Division 3 - Deductions	Subdivision A - General	51AK Agreements for the provision of non-deductible non-cash business benefits	The 'arm's length value' is used to account for the benefit.
		63E Debt/equity swaps	The 'market value' is used to account for the equity value of shares or units.
		70B Deduction for loss on disposal or redemption of traditional securities	The 'arm's length consideration' is used work out the amount of any loss.
		73A Expenditure on scientific research	The 'market value' is used to account for the purchase of a building.
	Subdivision H - Period of deductibility of certain advance expenditure	82KZMGB CGT event in relation to interest in 82KZMG agreement	The 'market value' is used to account for interest.
Division 3A - Convertible notes		82L Interpretation	Defines the relevant valuation period, in relation to a share.
		82T Value of shares	Defines the value of a fully paid share as at the valuation date.
Division 6AAA - Special provisions relating to non-resident trust estates etc.	Subdivision A - Preliminary	102AAB Interpretation	The 'market value' is used to account for the net worth (assets of the trust estate, reduced by the liabilities) in relation to a trust estate.
		102AAK Deemed transfers of property or services to trust estate	The 'market value' is used to account for the part transferred by a particular partner.
	Subdivision D - Accruals system of taxation of certain non-resident trust estates	102AAZD Assessable income of attributable taxpayer to include attributable income of trust estate to which taxpayer has transferred property or services	The 'market value' is used to account for the transferred property or services.

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
Division 6A - Alienation of income		102B Certain income transferred for short periods to be included in assessable income of transferor	The 'arm's length consideration' is used to determine the application of subsection 102B(1) in respect of transfers.
Division 7 - Private Companies		103A Private companies	The 'market value' is used to account for the share capital of a company when exercising the Commissioners discretion.
Division 7A - Distributions to entities connected with a private company	Subdivision B - Private company payments, loans and debt forgiveness are treated as dividends	109CA Payment includes provision of asset	The 'arm's length consideration' is used to determine the amount of a use payment.
	Subdivision E - Payments and loans through interposed entities		The 'arm's length consideration' is used to ascertain the amount of the payment from the private company to the target entity.
Division 9AA - Demutualisation of insurance companies and affiliates	Subdivision C - Tax consequences of demutualisation	121AS CGT consequences of demutualisation	Company valuation amounts required.
Division 10E - PDFs (pooled development funds)	Subdivision A - Shares in PDFs	124ZR Effect of company ceasing to be a PDF	The 'market value' is used to account for CGT purposes.
Division 11A - Dividends, Interest and Royalties paid to Non-Residents and to Certain Other Persons		128AC - Deemed interest in respect of hire-purchase and certain other agreements	The 'market value' is used to account for the relevant agreement property (eligible value).
Division 11B - Equity investments in small-medium enterprises			The 'market value' is used to account for consideration on the disposal of shares.
Division 16E - Accruals assessability, etc., in respect of certain security payments		159GZ Stripped securities	The 'market value' is used to account for the underlying security.
Division 16J - Effect of cancellation of subsidiary's shares in holding company		159GZZZF Effect on subsidiary of share cancellations to which this division applies	The 'market value' and 'adjusted market value' are used to account for shares.
		159GZZZG Pre-cancellation disposals of eligible interests	The 'adjusted market value' is used to account for eligible interests.
Division 16K - Effect of buy-backs of shares	Subdivision A - Interpretation	159GZZZM Purchase price in respect of buy-back	The 'market value' is used to account for property other than money received in respect of a share buy-back.
	Subdivision C - Off-market purchases	159GZZZQ Consideration in respect of off-market purchase	The 'market value' is used to determine deemed consideration.
Division 16L - Tax-exempt infrastructure borrowings		159GZZZE Infrastructure borrowings to be non-assessable and non-deductible	The 'market value' is used to account for deemed re-acquisition after exemption period.

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
Part X - Attribution of Income in Respect of Controlled Foreign Companies			
Division 7 - Calculation of attributable income of CFC	Subdivision C - Modifications relating to Australian capital gains tax		The 'market value' is used to account for property included as part of payment.
Schedule 2D - Tax Exempt Entities that Become Taxable			
Division 57 - Tax exempt entities that become taxable	Subdivision 57-E - Assets and liabilities	57-25 Deemed disposal and re-acquisition of assets	The 'adjusted market value' is used to account for consideration. The 'adjusted market value' is used to account for cost base and reduced cost base. Other market value requirements.
		57-30 Deemed cessation and re-assumption of liabilities	The 'market value' is used to account for the corresponding right or other asset (adjusted market value).
Schedule 2H - Demutualisation of Mutual Entities other than Insurance Companies and Health Insurers			
Division 326 - Demutualisation	Subdivision 326-D - CGT consequences of disposal of demutualisation shares or an interest in such shares by a member of a mutual entity where the entity or a holding company of the entity becomes a listed public company		The 'adjusted market value' is used formulas.
	Subdivision 326-E - CGT consequences of disposal of demutualisation shares or interests in such shares by a member of a mutual entity where the entity or a holding company of the entity becomes a company that is not a listed public company		'Adjusted market value' requirements.

APPENDIX 3 – TABLE OF VALUATION-RELATED PROVISIONS IN THE *INCOME TAX ASSESSMENT ACT 1997*

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
Part 2-1 Assessable Income			
Division 20 - Amounts included to reverse the effect of past deductions	Subdivision 20-B - Disposal of a car for which lease payments have been deducted	20-135 No amount included if earlier disposal for market value	
Part 2-5 Rules about Deductibility of Particular Kinds of Amounts			
Division 25 - Some amounts you can deduct		25-110 Capital expenditure to terminate lease etc.	The 'market value' is used to account for expenditure.
Division 27 - Effect of input tax credits etc. on deductions	Subdivision 27-B - Effect of input tax credits etc. on capital allowances	27-80 Cost or opening adjustable value of depreciating assets reduced for input tax credits	The 'market value' is used to account for the cost of depreciating assets.
		27-95 Balancing adjustment events	The 'market value' is used to account for depreciating assets (termination value).
Division 28 - Car expenses	Subdivision 28-D - The "12% of original value" method	28-45 How to calculate your deduction	The 'market value' is used in the '12% of original value' method when a car is leased. The 'cost' is used in the '12% of original value' method when a car is acquired.
Division 30 - Gifts or contributions	Subdivision 30-A - Deductions for gifts or contributions		Various valuation requirements
	Subdivision 30-C - Rules applying to particular gifts of property		
	Subdivision 30-DA - Donations to political parties and independent candidates and members		
Division 31 - Conservation covenants		31-5 Deduction for entering into conservation covenant	The 'market value' is used to account for the difference between the market value of the land just before and after you enter into the covenant.
		31-15 Valuations by the Commissioner	You must seek a valuation of the change in the 'market value' of the land from the Commissioner.
Division 35 - Deferral of losses from non-commercial business activities		35-40 Real property test	The 'market value' may be used to account for real property or interest.
		35-50 Apportionment	Either the 'reduced cost base', 'market value' or 'other value' is used account for assets.
Part 2-10 - Capital Allowances: Rules About Deductibility of Capital Expenditure			
Division 40 - Capital allowances	Subdivision 40-C - Cost		The 'market value' is used to account for various cases.
	Subdivision 40-D - Balancing adjustments		
	Subdivision 40-F - Primary production depreciating assets		

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
	Subdivision 40-G - Capital expenditure of primary producers and other landholders		
	Subdivision 40-H - Capital expenditure that is immediately deductible		
	Subdivision 40-I - Capital expenditure that is deductible over time		
	Subdivision 40-J - Capital expenditure for the establishment of trees in carbon sink forests		
Division 45 - Disposal of leases and leased plant			The 'market value' is used to account for any other benefit you receive or are entitled to receive.
Part 2-15 - Non-Assessable Income			
Division 51 - Exempt amounts		51-5 Defence	The 'market value' is used to account for rations and quarters supplied to you without charge.
Division 59 - Particular amounts of non-assessable non-exempt income		59-40 Issue of rights	The 'market value' is used to account for rights issued.
Part 2-25 - Trading Stock			
Division 70 - Trading stock	Subdivision 70-B - Acquiring trading stock	70-20 Non-arm's length transactions	The 'market value' is used to account for the outgoing.
		70-30 Starting to hold as trading stock an item you already own	Various 'market value' requirements when determining an item's cost.
	Subdivision 70-D - Assessable income arising from disposals of trading stock and certain other assets		The 'market value' is used to account for items of trading stock.
	Subdivision 70-E - Miscellaneous	70-120 Deducting capital costs of acquiring trees	'Market value' and 'non-arm's length' rules.
Part 2-40 - Rules Affecting Employees and Other Taxpayers Receiving PAYG Withholding Payments			
Division 80 - General rules		80-15 Transfer of property	The 'market value' is used to account for property included as payment.
Division 83A - Employee share schemes	Subdivision 83A-B - Immediate inclusion of discount in assessable income	83A-30 Amount for which discounted ESS interest acquired	The 'market value' is used to account for ESS interests acquired after 30 June 2009.
	Subdivision 83A-C - Deferred inclusion of gain in assessable income		
	Subdivision 83A-E - Miscellaneous	83A-315 Market value of ESS interest	
Part 2-42 - Personal Services Income			
Division 86 - Alienation of personal services income	Subdivision 86-B - Entitlement to deductions	86-75 Superannuation	The 'market value' is used to account for the entity's principal work.
Division 87 - Personal services businesses	Subdivision 87-A - General	87-25 The employment test for a personal services business	The 'market value' is used to account for the individual's principal work.

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
Part 3-1 - Capital Gains and Losses: General Topics			
Division 103 - General rules		103-5 Giving property as part of a transaction	The 'market value' is used to account for property included as part of payment, cost or expenditure.
Division 104 - CGT events			Various CGT events may involve a CGT gain or loss which depends on the 'market value' of the CGT asset. Events: D4 E1; E2; E3; E5; E6; E7; E9 I1; I2 J1; J4 K1; K3; K4; K5; K6.
Division 110 - Cost base and reduced cost base	Subdivision 110-A - Cost base	110-25 General rules about cost base	The 'market value' is used to account for property you gave, in acquiring the asset.
Division 112 - Modifications to cost base and reduced cost base	Subdivision 112-A - General modifications	112-20 Market value substitution rule	The 'market value' is used to account for acquisitions either where you did not incur expenditure, some or all of the expenditure you incurred to cannot be valued or you did not deal at 'arm's length' with the other entity.
Division 115 - Discount capital gains and trusts' net capital gains	Subdivision 115-A - Discount capital gains	115-45 Capital gain from equity in an entity with newly acquired assets	
	Subdivision 115-B - Discount percentage	115-115 Foreign or temporary residents - percentage for individuals	The 'market value' may be used to account for periods starting earlier than 8 May 2012.
	Subdivision 115-D - Tax relief for shareholders in listed investment companies	115-290 Meaning of listed investment company	The 'market value' is used to account for the proportion CGT assets that are certain investments.
Division 116 - Capital proceeds		116-10 Modifications to general rules	The 'market value' may be used to modify the general rules (market value substitution rule).
		116-20 General rules about capital proceeds	The 'market value' is used to account for any other property received, or are entitled to receive, in respect of the event happening (capital proceeds).
		116-30 Market value substitution rule: modification 1	
		116-80 Special rule if CGT asset is shares or an interest in a trust	The 'market value' is used to account for shares, or the interest in trusts (capital proceeds).
Division 118 - Exemptions	Subdivision 118-A - General exemptions	118-10 Collectables and personal use assets	Various 'market value' requirements.
		118-20 Reducing capital gains if amount otherwise assessable	
		118-25 Trading stock	
		118-60 Certain gifts	

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
	Subdivision 118-B - Main residence	118-192 Special rule for first use to produce income 118-227 Amount of exemption available after the principal beneficiary's death - cost base and reduced cost base	
Division 122 - Roll-over for the disposal of assets to, or the creation of assets in, a wholly-owned company	Subdivision 122-A - Disposal or creation of assets by an individual or trustee to a wholly-owned company		Various 'market value' requirements.
	Subdivision 122-B - Disposal or creation of assets by partners to a wholly-owned company		The 'market value' is used to account for a partners interest.
Division 124 - Replacement-asset roll-overs	Subdivision 124-B - Asset compulsorily acquired, lost or destroyed		The 'market value' is used to account for the original and other asset.
	Subdivision 124-C - Statutory licences		The 'market value' is used to account for the original licence and new license.
	Subdivision 124-E - Exchange of shares or units		The 'market value' is used to account for the original and new shares.
	Subdivision 124-F - Exchange of rights or options		The 'market value' is used to account for the original and new rights.
	Subdivision 124-G - Exchange of shares in one company for shares in another company		The 'market value' is used to account for shares.
	Subdivision 124-H - Exchange of units in a unit trust for shares in a company		The 'market value' is used to account for shares and units.
	Subdivision 124-I - Change of incorporation		The 'market value' is used to account for shares etc.
	Subdivision 124-J - Crown leases		The 'market value' is used to account for assets.
	Subdivision 124-L - Prospecting and mining entitlements		The 'market value' is used to account for assets.
	Subdivision 124-M - Scrip for scrip roll-over		The 'market value' is used to account for interest/shares, equity and debt etc.
	Subdivision 124-N - Disposal of assets by a trust to a company		
	Subdivision 124-Q - Exchange of stapled ownership interests for ownership interests in a unit trust		The 'market value' is used to account for ownership interests; and stapled entity's assets.
Division 125 - Demerger relief	Subdivision 125-B - Consequences for owners of interests		The 'market value' is used to account for ownership interests.
	Subdivision 125-C - Consequences for members of demerger group		The 'market value' is used to account the asset because of the demerger.
Division 126 - Same-asset roll-overs	Subdivision 126-B - Companies in the same wholly-owned group	126-85 Effect of roll-over on certain liquidations	The 'market value' is used to account for of the CGT roll-over asset/s.
	Subdivision 126-G - Transfer of assets between certain trusts		The 'market value' is used to account for interests.

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
Division 128 - Effect of death			The 'market value' is used to account for modifications to the cost base and reduced cost base of the CGT asset in the hands of the legal personal representative or beneficiary.
Division 130 - Investments	Subdivision 130-A - Bonus shares and units		
	Subdivision 130-B - Rights		
Division 132 - Leases		132-15 Lessee of land acquires reversionary interest of lessor	The 'market value' is used to account for land.
Division 149 - When an asset stops being a pre-CGT asset	Subdivision 149-B - When asset of non-public entity stops being a pre-CGT asset	149-35 Cost base elements of asset that stops being a pre-CGT asset	The 'market value' is used to account for assets.
	Subdivision 149-C - When asset of public entity stops being a pre-CGT asset	149-75 Cost base elements of asset that stops being a pre-CGT asset	The 'market value' is used to account for assets.
Division 152 - Small business relief	Subdivision 152-A - Basic conditions for relief under this Division	152-40 Meaning of active asset	The 'market value' is part of requirements.
Part 3-5 - Corporate Taxpayers and Corporate Distributions			
Division 164 - Non-share capital accounts for companies		164-15 Credits to non-share capital account	The 'market value' is used to account for various interests.
		164-20 Debits to non-share capital account	The 'market value' is used to account for non-share equity interest in the company.
Division 165 - Income tax consequences of changing ownership or control of a company	Subdivision 165-CC - Change of ownership or control of company that has an unrealised net loss		The 'market value' either of each asset individually or together is used to calculate whether a company has an unrealised net loss.
	Subdivision 165-CD - Reductions after alterations in ownership or control of loss company		The 'market value' either of each asset individually or together is used to calculate whether a company has an unrealised net loss. Also requires the 'market values' of the equity or debt.
Division 170 - Treatment of certain company groups for income tax purposes	Subdivision 170-C - Provisions applying to both transfers of tax losses and transfers of net capital losses within wholly-owned groups of companies		The 'market value' is used to account for the adjustment to the cost base and reduced cost base of an equity or debt interest.
Division 197 - Tainted share capital accounts	Subdivision 197-A - What transfers into a company's share capital account does this Division apply to?	197-15 Exclusion for amounts transferred under debt/equity swaps	The 'market value' is used to account for the shares issued by the company.
		197-35 Exclusion for transfers made in connection with demutualisations of insurance etc. companies	Company valuation amount.
		197-40 Exclusion for post-demutualisation transfers relating to life insurance companies	

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
Part 3-6 - the Imputation System			
Division 202 - Franking a distribution	Subdivision 202-C - Which distributions can be franked?	202-45 Unfrankable distributions	The 'market value' is used to account for the excess purchase price of the share at the time of the buy-back.
Division 207 - Effect of receiving a franked distribution	Subdivision 207-E - Exceptions to the rules in Subdivision 207-D		Special rule about whether interests in unit trusts are defeasible.
Part 3-10 - Financial Transactions			
Division 230 - Taxation of financial arrangements	Subdivision 230-C – Fair value method		The 'fair value' is used to account for a gain or loss from a financial arrangement (tax-timing method).
	Subdivision 230-D - Foreign exchange retranslation method	230-290 Balancing adjustment if election ceases to apply	'Fair value' requirements.
	Subdivision 230-E - Hedging financial arrangements method		Some 'fair value' requirements in various sections.
	Subdivision 230-F - Reliance on financial reports	230-430 Balancing adjustment if election ceases to apply	
	Subdivision 230-I - Other provisions	230-505 Financial arrangement as consideration for provision or acquisition of a thing	'Market value' of the thing. 'Fair value' requirements in parts of the subdivision.
	Subdivision 230-J - Additional operation of Division	230-530 Additional operation of Division	'Fair value' requirements
Division 240 - Arrangements treated as a sale and loan		240-3 How the recharacterisation affects the notional seller	The 'cost', 'value' or 'arm's length value' is used to account for the consideration for the notional sale.
		240-7 How the recharacterisation affects the notional buyer	The 'cost', 'value' or 'arm's length value' is used to account for the acquisition.
	Subdivision 240-F - The end of the arrangement	240-90 What happens if the notional buyer ceases to have the right to use the property	The 'market value' is used to account for the property at the end of the arrangement.
Division 242 - Leases of luxury cars			The 'market value' is used to determine whether a luxury car exceeds the car limit set.
Division 245 - Forgiveness of commercial debts	Subdivision 245-C - Calculation of gross forgiven amount of a debt		The 'market value' is used to account for the value of the debt when it is forgiven. Various other 'market value' requirements throughout the division.
Division 247 - Capital protected borrowings		247-10 What capital protected borrowing and capital protection are	The 'market value' of a thing needs to be considered (the protected thing).
Division 250 - Assets put to tax preferred use	Subdivision 250-B - When this Division applies to you and an asset		The 'market value' is used to account for the asset and financial arrangement.
	Subdivision 250-C - Denial of, or reduction in, capital allowance deductions		
	Subdivision 250-D - Deemed loan treatment of financial benefits provided for tax preferred use		

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
	Subdivision 250-E - Taxation of deemed loan		
Part 3-30 - Superannuation			
Division 285 - General concepts relating to superannuation		285-5 Transfers of property	The 'market value' is used to account for the property.
Division 295 - Taxation of superannuation entities	Subdivision 295-B - Modifications of provisions of this Act		The 'market value' of superannuation interests is used in the definition of an Australian superannuation fund.
	Subdivision 295-D - Contributions excluded		The 'market value' of the transferor's investment is used limit the transfer.
Part 3-32 - Co-operatives and Mutual Entities			
Division 315 - Demutualisation of private health insurers	Subdivision 315-B - Cost base of certain shares and rights in private health insurers		The 'market value' is used to determine the cost base of shares and rights issued under the demutualisation.
	Subdivision 315-C - Lost policy holders trust		
	Subdivision 315-D - Special cost base rules for certain shares and rights in holding companies		
Division 316 - Demutualisation of friendly society health or life insurers	Subdivision 316-B - Capital gains and losses connected with the demutualisation	316-65 Valuation factor for sections 316-60, 316-105 and 316-165	The 'market value' is used to account for the friendly society's health insurance business.
	Subdivision 316-D - Lost policy holders trust		The 'market value' is used to account for property.
Part 3-35 - Insurance Business			
Division 320 - Life insurance companies	Subdivision 320-F - Complying superannuation/FHSA asset pool	320-200 Consequences of transfer of assets to or from complying superannuation/FHSA asset pool	
	Subdivision 320-H - Segregation of assets to discharge exempt life insurance policy liabilities	320-230 Valuations of segregated exempt assets and exempt life insurance policy liabilities for each valuation time	
		320-255 Consequences of transfer of assets to or from segregated exempt assets	
Part 3-45 - Rules for Particular Industries and Occupations			
Division 355 - Research and Development	Subdivision 355-F - Integrity Rules	355-400 Expenditure incurred while not at arm's length	The 'market value' is used to account for relevant R&D.
	Subdivision 355-H - Feedstock adjustments		The 'market value' is used to account for the marketable product.
Division 385 - Primary production	Subdivision 385-E - Primary producer can elect to spread or defer tax on profit from forced disposal or death of live stock		The 'market value' is used to account for livestock.
Division 394 - Forestry managed investment schemes			The 'market value' is used to account for the forestry interest.

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
Part 3-50 - Climate Change			
Division 420 - Registered emissions units			The 'market value' is used to account units and other requirements. Not detailed due to expected government changes.
Part 3-90 - Consolidated Groups			
Division 701 - Core rules		701-60 Tax cost setting amount	The 'market value' is used to account for the asset's tax cost setting amount in some cases.
		701-63 Right to future income and WIP amount asset	The 'market value' is used to account for the valuable right.
Division 705 - Tax cost setting amount for assets where entities become subsidiary members of consolidated groups	Subdivision 705-A - Basic case: a single entity joining an existing consolidated group		The 'market value' for membership interests, assets etc are required throughout subdivision (Allocable Cost Amount (ACA) and pre-CGT factor).
	Subdivision 705-B - Case of group formation		The 'market value' is used to account for membership interests in subject entity, first level entity's direct and indirect membership interests and first entity's membership interests in third entity held through second entity.
	Subdivision 705-D - Where multiple entities are linked by membership interests		The 'market value' is used to account for linked membership interests.
Division 707 - Losses for head companies when entities become members etc.	Subdivision 707-C - Amount of transferred losses that can be utilised		The 'market value' is used to account for available fraction. 'Market value' rules throughout the subdivision. There are modified 'market value' rules and rules to prevent inflation of modified market value.
Division 711 - Tax cost setting amount for membership interests where entities cease to be subsidiary members of consolidated groups			Various 'market value' requirements.
Division 713 - Rules for particular kinds of entities	Subdivision 713-A - Trusts		Working out a joined group's allocable cost amount for a joining trust.
	Subdivision 713-E - Partnerships		Special rules where partnership joins/leaves a consolidated group 'Market value' of partnership cost setting interest.
Division 715 - Interactions between this Part and other areas of the income tax law	Subdivision 715-A - Treatment of unrealised losses existing when ownership or control of a company changes before or during consolidation		The 'market value' is used to account for membership interests, assets etc.

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
Division 719 - MEC groups	Subdivision 719-F - Losses		The 'modified market value' is used to account for available fraction for bundle of losses.
	Subdivision 719-K - MEC group cost setting rules: pooling cases		The 'market value' is used to account for the setting the cost of all reset interests.
Part 3-95 - Value Shifting			
Division 723 - Direct value shifting by creating right over non-depreciating asset	Subdivision 723-A - Reduction in loss from realising non-depreciating asset		The 'market value' is used to account for the right and underlying asset.
Division 725 - Direct value shifting affecting interests in companies and trusts	Subdivision 725-A - Scope of the direct value shifting rules		The 'market value' is used to determine changes attributable to the value shift.
	Subdivision 725-B - What is a direct value shift?		
	Subdivision 725-C - Consequences of a direct value shift		'Market value' requirements throughout the division.
	Subdivision 725-D - Consequences for down interest or up interest as CGT asset		
	Subdivision 725-E - Consequences for down interest or up interest as trading stock or a revenue asset		
	Subdivision 725-F - Value adjustments and taxed gains		
Division 727 - Indirect value shifting affecting interests in companies and trusts, and arising from non-arm's length dealings	Subdivision 727-B - What is an indirect value shift		The 'market value' is used to determine the effects on the interests (both direct and indirect) in entities.
	Subdivision 727-C - Exclusions		
	Subdivision 727-D - Working out the market value of economic benefits		Rules of thumb are included to make it easier to determine the 'market value' of some kinds of economic benefits.
	Subdivision 727-G - The realisation time method		
	Subdivision 727-H - The adjustable value method		
	Subdivision 727-K - Reduction of loss on equity or loan interests realised before the IVS time		
	Subdivision 727-L - Indirect value shift resulting from a direct value shift		
Part 4-5 - General			
Division 768 - Exempt foreign income and gains	Subdivision 768-G - Reduction in capital gains and losses arising from CGT events in relation to certain voting interests in active foreign companies		The 'market value' is one method used to determine the active foreign business asset percentage.
	Subdivision 768-R - Temporary residents		The 'market value' is used to account for the cost base and reduced cost base of the asset (at the time you cease to be a temporary resident).
Division 775 - Foreign currency gains and losses	Subdivision 775-B - Realisation of forex gains or losses		The 'market value' is used to account for capital proceeds.

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
			The 'market value' is used to account for the benefit you receive by way of a non-cash benefit.
	Subdivision 775-F - Retranslation under foreign exchange retranslation election under Subdivision 230-D	775-315 Balancing adjustment when election ceases to apply to arrangement	'Fair value' requirements
Division 815 - Cross-border transfer pricing	Subdivision 815-A - Treaty-equivalent cross-border transfer pricing rules		The 'arm's length principle' is used to ensure that certain amounts are appropriately brought to tax in Australia.
	Subdivision 815-B - Arm's length principle for cross-border conditions between entities		The 'arm's length principle' is used to determine a tax advantage in Australia from cross-border conditions.
	Subdivision 815-C - Arm's length principle for permanent establishments		The use of 'arm's length principle' is extended to permanent establishments (PEs).
Division 820 – Thin Capitalisation rules	Subdivision 820-G - Calculating the average values		The 'average value' of assets, liabilities and equity etc is required. The Commissioner to substitute a more 'appropriate value' for an average value.
Division 855 - Capital gains and foreign residents	Subdivision 855-A - Disregarding a capital gain or loss by foreign residents	855-30 Principal asset test	The 'market value' is used to account for taxable Australian real property (TARP) and non-TARP assets.
	Subdivision 855-B - Becoming an Australian resident		The 'market value' is used to account for the cost base and reduced cost base of the asset at the time you become an Australian resident.
Part 6-1 - Concepts and Topics			
Division 960 - General	Subdivision 960-S – Market value	960-405 Effect of GST on market value of an asset	The 'market value' in this subdivision is reduced by the amount of GST credits that relate to a taxable supply and anything restricting or preventing the conversion of non-cash benefits is disregarded.
		960-410 Market value of non-cash benefits	
		960-415 Amounts that depend on market value	
Division 974 - Debt and equity interests	Subdivision 974-B - Debt interests	974-35 Valuation of financial benefits - general rules	
		974-40 Valuation of financial benefits - rights and options to terminate early	
		974-45 Valuation of financial benefits - convertible interests	
		974-50 Valuation of financial benefits - value in present value terms	

DIVISION	SUBDIVISION	SECTION	IGT COMMENTS
Part 6-5 - Dictionary Definitions			
Division 995 - Definitions		995-1 Definitions	<p>'Market value' has a meaning affected by subdivision 960-S.</p> <p>'Modified market value' of an entity has the meaning given by section 707-325.</p> <p>Various other definitions rely on 'market value'.</p> <p>Definition of 'fair value' election.</p> <p>'Arm's length consideration' has the meaning given by section 300-1 of the <i>Minerals Resource Rent Tax Act 2012</i>.</p>

APPENDIX 4 – ATO RISK FACTORS FOR VALUATIONS

4.1 The following table is reproduced from Table F1 in the ATO publication *Market valuation for tax purposes*, available on www.ato.gov.au.

Table 9: ATO risk matrix for quality of the valuation process and documentation

Risk →	High	Medium	Low
↓ Criteria	→		
Appropriateness of methodologies	Assuming continuation of existing use, the valuations do not sufficiently demonstrate that: <ul style="list-style-type: none"> - methods are consistent over similar asset types - methods are the most appropriate - appropriate data was used. 	Assuming continuation of existing use, the valuations demonstrate mostly that: <ul style="list-style-type: none"> - methods are consistent over similar asset types - methods are the most appropriate - appropriate data was used. 	Assuming continuation of existing use, the valuations demonstrate fully that: <ul style="list-style-type: none"> - methods are consistent over similar asset types - methods are the most appropriate - appropriate data was used.
Qualifications of person undertaking valuation	Person undertaking the valuation can demonstrate few, if any, of the following attributes: <ul style="list-style-type: none"> - appropriate knowledge and industry experience - professional membership - subject to external regulation - retains specialist advice where appropriate - holds appropriate licences or authorities. 	Person undertaking the valuation can demonstrate most of the following attributes: <ul style="list-style-type: none"> - appropriate knowledge and industry experience - professional membership - subject to external regulation - retains specialist advice where appropriate - holds appropriate licences or authorities. 	Person undertaking the valuation can demonstrate all of the following attributes: <ul style="list-style-type: none"> - appropriate knowledge and industry experience - professional membership - subject to external regulation - retains specialist advice where appropriate - holds appropriate licences or authorities.
Use of supporting methods	No cross-check of valuation where it would have been appropriate.	Single cross-check of valuation where appropriate.	Valuation cross-checked with other methods where appropriate.
Integrity of process	Person undertaking valuations cannot demonstrate: <ul style="list-style-type: none"> - appropriate experience - basis of engagement subject to external regulation - professional relationship - access to information. 	Person undertaking valuations can demonstrate most of the following: <ul style="list-style-type: none"> - appropriate experience - basis of engagement subject to external regulation - professional relationship - access to information. 	Person undertaking valuations can demonstrate: <ul style="list-style-type: none"> - appropriate experience - basis of engagement subject to external regulation - professional relationship - access to information.
Information supplied in the market valuation report	Report does not include enough of the following information required by the ATO to understand the market valuation report: <ul style="list-style-type: none"> - description of the assets valued to enable identification - purpose and context of valuation - specific market value date or period to which valuation relates - date valuation was commenced and completed - details of the methods used 	Report does include most, but not all, of the following information required by the ATO to understand the market valuation report: <ul style="list-style-type: none"> - description of the assets valued to enable identification - purpose and context of valuation - specific market value date or period to which valuation relates - date valuation was commenced and completed - details of the methods used 	Report includes all of the following information required by the ATO to understand the market valuation report: <ul style="list-style-type: none"> - description of the assets valued to enable identification - purpose and context of valuation - specific market value date or period to which valuation relates - date valuation was commenced and completed - details of the methods used - information the valuation is

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	<ul style="list-style-type: none"> - information the valuation is based on - details of all assumptions used. 	<ul style="list-style-type: none"> - information the valuation is based on - details of all assumptions used. 	based on <ul style="list-style-type: none"> - details of all assumptions used.
Use of existing valuations	No documentation as to the relevance of earlier valuations or inadequate documentation of changes.	Adequate documentation as to the relevance of earlier valuations and/or adequate documentation of changes.	Complete documentation as to the relevance of earlier valuations and/or complete documentation of changes.

APPENDIX 5 – ATO RESPONSE



Australian Government
Australian Taxation Office

Second Commissioner of Taxation

Mr Ali Noroozi
Inspector-General of Taxation
GPO Box 551
SYDNEY ACT 2001

Dear Ali

Review into the ATO's administration of valuation matters

Thank you for the opportunity to comment on the final draft of your report on the review into the ATO's administration of valuation matters.

We agree with eleven of the twelve recommendations, noting that many of the recommendations have multiple parts. However we disagree with one aspect of one recommendation. I also note that recommendations 3.1, 3.2 and 3.3 are matters for Government.

Specifically, in relation to recommendation 4.8(c), while we agree with the objective of the recommendation to promote the use of Market Valuation Private Rulings, we are unable to agree to bear the cost. In this regard we are not in a position to reliably forecast costs or savings that may arise from an unknown increase in applications.

Our detailed response to your recommendations, including the updated recommendations, is attached at Annexure 1.

Finally, I would like to acknowledge the efforts of all involved in undertaking this review.

If you require further information on our response, please contact Debra Kuhne, on phone (02) 6058 7326.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Neil Olesen'.

Neil Olesen
Second Commissioner
Australian Taxation Office
26 September 2014

RECOMMENDATION 3.1

The IGT recommends that, in designing tax laws, the Government consider:

- (a) requiring valuations only where the relevant regulation impact statement demonstrates that it would be of the 'highest net benefit'; and
- (b) where valuation is required, provide safe harbours or allow the use of existing valuations obtained for other purposes such as accounting standards or as part of natural business systems.

ATO response

In relation to 3.1(a) – Matter for Government

In relation to 3.1(b) – Matter for Government

RECOMMENDATION 3.2

The IGT recommends that the Government consider consulting with small businesses and their representatives with a view to reducing the reliance on valuations to access the small business CGT concessions.

ATO response

Matter for Government

RECOMMENDATION 3.3

The IGT recommends that, where eligibility criteria for tax concessions or benefits require valuation, the Government should consider the use of tapering to avoid disproportionate outcomes that may arise due to minor differences in valuations.

ATO response

Matter for Government

RECOMMENDATION 4.1

The IGT recommends that the ATO:

- (a) continue consultation with stakeholders to develop and implement, where possible, administrative safe harbours that may reduce compliance costs associated with valuation; and
- (b) develop and make publicly available a tool that provides an indication as to the eligibility of a taxpayer for the small business CGT concessions through the maximum net asset value test.

ATO Response

In relation to 4.1(a) – Agree

In relation to 4.1(b) – Agree

Comments –

In relation to 4.1(b) – We agree the tool would be useful and will consider against other competing priorities.

RECOMMENDATION 4.2

The IGT recommends that the ATO:

- (a) continue to develop a strategy to identify the various valuation risks and the compliance action for mitigating those risks;
- (b) where ATO compliance officers identify valuation risks:
 - i) as a first step, use valuers to undertake a 'preliminary risk assessment' to assess such risk;
 - ii) agree or agree to disagree on relevant legal or factual issues; and
 - iii) consider whether further action, such as commissioning a critique or a full valuation, is required, taking into account factors such as the cost associated with each option as compared to the disputed amount; and
- (c) where a taxpayer's assessment is to be amended as a result of a critique or full valuation, provide the relevant details contained in the preliminary risk assessment, critique and/or full valuation to that taxpayer.

ATO response

In relation to 4.2(a) - Agree

In relation to 4.2(b) – Agree

In relation to 4.2(c) – Agree

Comments –

4.2(b) We agree with the steps outlined noting the detail and focus on each step will vary dependant on the complexity of the valuation issue and timely interaction and co-operation of the taxpayer.

4.2(c) In rare circumstances the Commissioner may not be able to provide details to the taxpayer, for example, where the release of the material could cause harm.

RECOMMENDATION 4.3

The IGT recommends that the ATO:

- (a) in consultation with stakeholders, develop a standard template for instructing valuers; and
- (b) where a material valuation risk is identified during pre-lodgement processes, conduct a risk assessment of the taxpayer's valuation instructions with a view to reaching agreement on the instructions and/or jointly instructing an independent valuer.

ATO response

In relation to 4.3(a) - Agree

In relation to 4.3(b) – Agree

RECOMMENDATION 4.4

The IGT recommends that the ATO publish more detailed guidance on the application of penalties to valuation discrepancies.

ATO Response

Agree

Comments –

We will address this action by application of Recommendation 5.3 of the Inspector General's Review of Penalties by providing explicit examples relating to valuations in our guidance products.

RECOMMENDATION 4.5

The IGT recommends that the ATO use legal and valuation expertise, including external expertise, to:

- (a) assist in areas such as identifying issues, gathering information and instructing valuers; and
- (b) provide training to staff to build capability for the long term.

ATO Response

In relation to 4.5(a) – Agree

In relation to 4.5(b) – Agree

RECOMMENDATION 4.6

The IGT recommends that the ATO:

- (a) allow taxpayer access to its instructions to valuers; and
- (b) only use publicly available information or information that can be disclosed to the taxpayer in arriving at its market valuation.

ATO response

In relation to 4.6(a) – Agree

In relation to 4.6(b) – Agree

Comments –

In rare circumstances the Commissioner may be obliged to take into account information that cannot be disclosed in order to meet his legal obligations to correctly assess.

RECOMMENDATION 4.7

Where a valuation dispute is primarily due to the professional judgement of valuers engaged by each party, the IGT recommends that the ATO provide guidance to its staff on when they should accept the taxpayer's point estimate. Such guidance may provide a number of methods and when each may be appropriately used. Examples of these methods may include applying a 10 per cent tolerance to point estimates or obtaining an opinion from the ATO's valuer as to the reasonableness of the taxpayer's point estimate.

ATO response

Agree

RECOMMENDATION 4.8

The IGT recommends that the ATO:

- (a) promote the availability of Market Valuation Private Rulings (MVPR);
- (b) jointly appoint valuers with taxpayers for MVPR purposes and allow the taxpayer greater access to the valuer; and
- (c) consider bearing some of the valuation costs of MVPR to reflect potential ATO savings.

ATO response

In relation to 4.8(a) – Agree

In relation to 4.8(b) – Agree

In relation to 4.8(c) – Disagree

Comments –

In relation to 4.8(c) – While we agree with the objective of the recommendation to promote the use of Market Valuation Private Rulings, we are unable to agree to bear the cost. We are not in a position to reliably forecast costs nor savings that may arise from an unknown increase in applications.

RECOMMENDATION 5.1

The IGT recommends that the ATO:

- (a) ensure that it facilitates taxpayer requests for expert valuer conferencing on competing valuations to reach a common understanding of inputs and methodologies used by each valuer, the resulting valuation and the reasons for it;
- (b) make taxpayers aware that they can request expert valuer conference as mentioned at (a) above; and
- (c) in its guidance relating to valuations, update the range of dispute resolution approaches that may be used to include joint instruction of separate valuers, joint appointment of valuers and expert valuer conferencing.

ATO response

In relation to 5.1(a) – Agree

In relation to 5.1(b) – Agree

In relation to 5.1(c) – Agree

Comments –

The ATO agrees that more may need to be done to improve awareness and facilitate access. Taxpayers may already request expert valuer conferencing. Paragraphs 57-59 of Practice Statement PS LA 2013/3 Alternative Dispute Resolution (ADR) in ATO Disputes covers the process of expert valuer conferencing to discuss how their different valuations were obtained.

ABBREVIATIONS

AAT	Administrative Appeals Tribunal
ACA	Annual Compliance Arrangement
ADR	Alternative Dispute Resolution
AGS	Australian Government Solicitor
APESB	Accounting Professional and Ethical Standards Board
APRA	Australian Prudential Regulation Authority
ATO	Australian Taxation Office
ATO ID	Australian Taxation Office Interpretative Decision
AVO	Australian Valuation Office
CAANZ	Chartered Accountants Australia and New Zealand
CGT	Capital Gains Tax
ENE	Early Neutral Evaluation
FOI	Freedom of Information
GAVP	Generally Accepted Valuation Principles
GST	Goods and services tax
HMRC	Her Majesty's Revenue and Customs
IGT	Inspector-General of Taxation
IGT Act	<i>Inspector-General of Taxation Act 2003</i>
IPA	Institute of Public Accountants
IRS	Internal Revenue Service
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
IVSC	International Valuation Standards Council
MNAV	Maximum Net Asset Value
MOU	Memorandum of Understanding
MVPR	Market Valuation Private Ruling

PCR	Pre-lodgment compliance review
PGH	Private Groups and High Wealth Individuals
PG&I	Public Groups and International
PRA	Preliminary risk assessment
PSLA	Law Administration Practice Statement
RDR	Review and Dispute Resolution
RIS	Regulation Impact Statement
SAV	Shares and Assets Valuation
SBE	Small business entity
SBIT	Small Business and Individual Taxpayers
SMSF	Self-managed superannuation fund
SIS Act	<i>Superannuation Industry (Supervision) Act 1993</i>
SME	Small and Medium Enterprise
TAA 1953	<i>Taxation Administration Act 1953</i>
TARP	Taxable Australian Real Property
TD	Taxation Determination
TOFA	Taxation of financial arrangements
VGU	Valuation Gatekeeper Unit
VOA	Valuation Office Agency

