



**The Institute of  
Chartered Accountants  
in Australia**

11 August 2003

Senator Andrew Murray  
The Senate  
Parliament House  
Canberra NSW 2600

FOR THE COMMITTEE

Dear Senator Murray

### **Independence of external expert valuers for taxation and other purposes**

We refer to the issue you raised at the Senate Economics Legislation Committee hearings on 29 July 2003 in relation to the independence of valuations used for asset revaluation purposes in the thin capitalization amendments in *Taxation Laws Amendment Bill (No. 5) 2003*. During the hearing you commented on the use of external experts from a governance and independence viewpoint.

We provide the following information that outlines how valuation issues and the required independence of valuers are provided for in both the provisions and the administration of the income tax legislation.

While there may be issues in relation to valuation independence in a broader prudential and disclosure context, the ICAA believes that the risks in relation to valuations for income tax purposes are satisfactorily drafted and administered in relation to the thin capitalisation provisions in Division 820 of the *Income Tax Assessment Act 1997* (ITAA97).

Therefore the ICAA believes that a delay in the passage of *Taxation Laws Amendment Bill (No. 5) 2003* is not an appropriate method to promote a general review of the independence of valuers.

### **Independence of valuers and the thin capitalisation provisions**

The thin capitalisation provisions in Division 820 ITAA97 deals with the required independence of internal valuations undertaken by external experts for the purposes of revaluation of assets.

#### Section 820-680(2) ITAA97

Section 820-680(2) ITAA97 details the criteria for the relevant expert required for purposes of undertaking a thin capitalisation revaluation as follows:

*"(2) A revaluation of assets mentioned in paragraph (1)(a) must be made by a person:*

- a. who is an expert in valuing such assets; and*
- b. whose pecuniary or other interests could not reasonably be regarded as being capable of affecting the person's ability to give an unbiased opinion in relation to that revaluation."*



### Section 820-690 ITAA97

Section 820-690 ITAA97, gives the Commissioner of Taxation power in relation to asset valuations:

*"If the Commissioner considers that, in relation to a calculation under this Division, an entity has:*

- a. *overvalued its assets; or*
- b. *undervalued its liabilities (including its "debt capital);*

*the Commissioner may, having regard to the "accounting standards, substitute a value that the Commissioner considers is appropriate."*

The Explanatory Memorandum to this provision states:

*"In determining an appropriate value, the Commissioner must have regard to the relevant accounting standard. That is, the Commissioner will determine the value that would have been calculated had the relevant accounting standard been followed correctly and had the valuation been conducted on an independent basis using accurate and reliable information [Schedule 1, item 1, section 820-690]"*

### **ATO's approach to verifying valuations**

The ATO has existing processes to deal with valuations. Additionally they have announced modifications to the processes to ensure valuations are undergo appropriate verification processes. Below we outline some of these processes. The ICAA believes that these processes provide adequate verification activities in relation to valuation activities.

### Large Business Tax Compliance Program

The publication "*Large Business and Tax Compliance*" released by the Commissioner of Taxation in June 2003, details the ATO's risk management strategy in cases where market valuations have significant tax impacts and are materially different from the values used for the purposes of the business generally. Attachment A extracts some material from the document. The full document can be found at:  
[http://www.ato.gov.au/content/downloads/Large\\_business\\_final.pdf](http://www.ato.gov.au/content/downloads/Large_business_final.pdf).

### ATO Compliance Program 2002-03

This publication, released by the Commissioner of Taxation in December 2002, details the ATO's general approach to excessive valuations of assets resulting in inflated deduction claims. Attachment B extracts the relevant material. This is noted in the following discussion on page 16 of the ATO Compliance Program 2002-03:

#### ***"Aggressive Tax Planning***

##### *Our General Approach*

*Either alone or in combination, the Tax Office will look closely at excessive valuations of assets resulting in inflated deduction claims.*

*Capital gains tax planning is often associated with a business event - such as a restructure, merger, acquisition or disposal of a business or asset - seemingly designed to avoid or minimise tax. Another theme of capital gains tax planning concerns the valuation of assets (see large business, page 8)."*

The full document can be found at: <http://www.ato.gov.au/content/Downloads/ComPlan.pdf>.

ATO Consolidation Reference Manual

This technical publication for tax practitioners, released by the Commissioner of Taxation in 2003, details the ATO's approach to market valuations for those entities entering into the Consolidation regime. This can be found at:  
<http://www.ato.gov.au/content/downloads/C0401000.pdf>

**Conclusion**

Based on the above, the ICAA is of the opinion that in relation to both the legislation regulating the use of valuations for the purposes of the thin capitalisation provisions and the ATOs existing and proposed processes to deal with the verification of valuations, there are sufficient safeguards in place to ensure the independence of external valuers for purposes of section 820-680(2B) of the *Taxation Laws Amendment Bill (No. 5) 2003*.

If you would like to consider broader valuation issues, we would be interested to discuss this further. Please contact myself on 02 9290 5623 or Ken Mansell on 02 9290 5625.

Yours sincerely,



Brian Sheppard  
Tax Counsel

## **Appendix A**

### **Large Business and Tax Compliance**

**June 2003**

## WHAT WE CAN BE EXPECTED TO CHALLENGE

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**Distortions and inconsistencies in market valuations**

Market valuations have a bearing on a wide range of tax issues, including:

- values for depreciable assets
- the allocation of asset values (including goodwill) when making an election to consolidate
- the calculation of GST in certain circumstances, in particular where values are loaded to the pre-GST period of ownership when applying the margin scheme to real property transactions
- royalty rates for intellectual property
- working out capital gains and losses, including where there are taxable and non-taxable components
- the examination of transfer pricing cases
- financial arrangements, such as non-recourse financing and sale and lease-backs
- accounting for trading stock (including warehousing or holding charges), and
- core technology values for the purposes of the R&D concession.

In cases where market valuations have significant tax impacts and are materially different from the values used for the purposes of the business generally, we will check that:

- the relevant assumptions have been identified and properly taken into account
- accepted principles have been applied in doing the valuation
- the valuation method is appropriate to the case and has been properly applied
- the results are reasonable in the business context, and
- the full range of probabilities is properly taken into account, so that valuations are based on what is more likely to occur (for example, in cases where the asset is unique or there are no recent sales to benchmark against).

Where inconsistent valuation approaches are used in cross-border dealings between related parties, we will investigate cases where this results in the creation of a paper loss or tax deduction on the Australian side.

**Example**

A business (controlled by a high wealth individual) that had pre- and post-capital gains tax assets was sold. The post-capital gains tax assets were assets that had been developed in-house. The capital gains tax provisions work on the basis that the vendor's sale price becomes the purchaser's cost base (with some small adjustments). The vendor and purchaser had these assets independently valued. Normally one would expect a vendor to seek a somewhat higher value and the purchaser a somewhat lower value as part of the process

of bargaining. The vendor's valuation was significantly lower than the purchaser's because it allocated the majority of the value in the business to the tax-exempt pre-capital gains tax assets. On the basis of the vendor's valuation, the taxable capital gain is reduced almost to nil. We challenged the vendor's valuation. The issue was subsequently resolved by the vendor accepting an increased valuation and paying increased capital gains tax.