

Market valuation guidelines

Introduction

Purpose and status

These guidelines have been prepared by the Australian Taxation Office to provide tax practitioners, valuers and their business clients – the market valuation users – with broad guidance on how the Tax Office will administer the market valuation provisions of the consolidation regime. The aim is to empower users to make decisions and implement consolidation in ways that optimise business outcomes and compliance with the law.

The market valuation guidelines have been extensively discussed in draft form with representatives of business and the accounting and valuation professions to ensure the provisions not only achieve the Government's policy objectives but also meet the needs of the user.

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What's new in
this version?
(May 2003)

Change to valuation short cuts

Valuation short cuts 1 and 2 (which allow adjustable values to be used as a short cut for certain depreciating assets) have been revised.

Deductibility of valuation expenses

The Tax Office has released two Tax Determinations, TD 2003/10 and TD 2003/11, which set out the views of the Tax Office as to the deductibility of certain market valuation expenses for consolidation. → 'Deductibility of market valuation expenses', p. 6

Minimising
compliance
costs and
maximising
certainty

The Government and the Tax Office are committed to minimising the cost for business of complying with the tax law and providing greater certainty in its application.

Delivery of a practical, efficient, fair and robust user pathway through the consolidation regime is part of that commitment.

The Tax Office recognises that, typically, the smaller the business the larger the cost of compliance as a proportion of total business costs. These market valuation guidelines have been designed with the aim of minimising compliance costs. For example, the number of valuations required in many business situations will be reduced by the availability of short cut options, which will allow the use of income tax values instead of requiring separate valuations for depreciating items of low relative value and certain trading stock.

In formulating these guidelines, the Tax Office aims to provide taxpayers with an opportunity to significantly reduce the risk of a market valuation review or audit. By following these guidelines with reasonable care and in good faith, taxpayers will significantly increase their level of confidence and that of the Tax Office in relation to their compliance obligations.

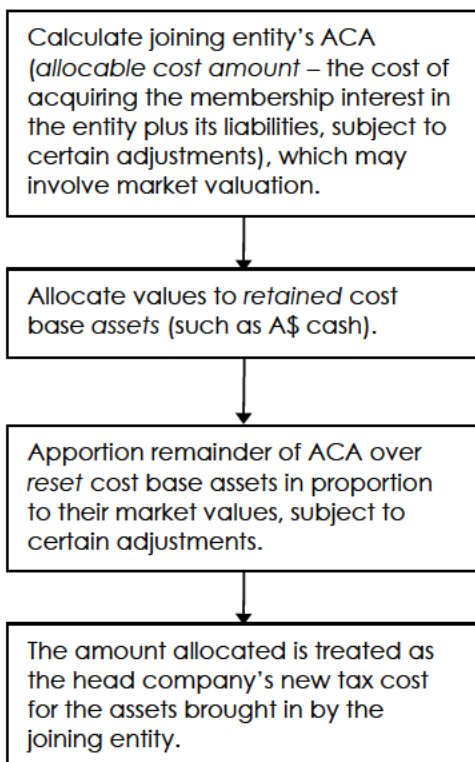
The Government and the Tax Office remain open to suggestions for further improvements in rules and processes – improvements that further promote business efficiency and certainty while protecting the community's tax base and minimising tax avoidance.

Market valuation for consolidation

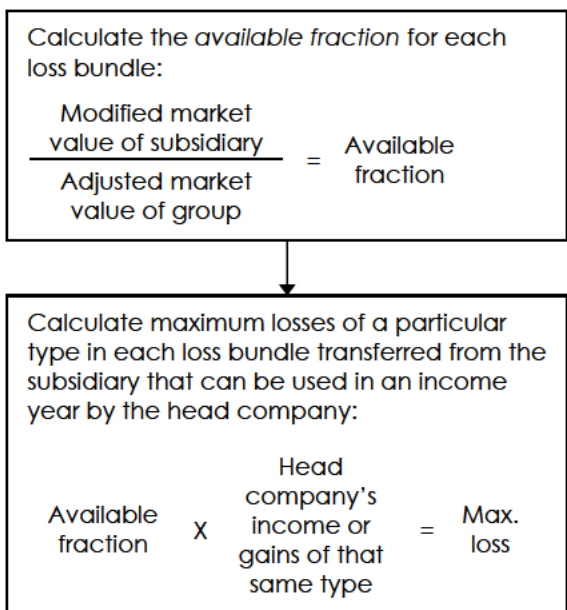
- When are market valuations required?**
- For the purposes of consolidation, market valuations will primarily be required for the following key purposes:
- 1 to determine new tax costs for the assets of a joining entity, and the cost base of membership interests in a leaving entity (the cost setting process) → 'Determining asset values', B2-2
 - 2 to calculate the amount of a loss transferred from a joining entity that can be utilised by a head company → 'Transferring and using losses', B2-3.

Figure 1: Key processes in which market valuations are required

1 Use of market valuation to determine new tax costs for the assets of a joining subsidiary (the entry cost setting process)



2 Use of market valuation to calculate the amount of a loss transferred from a joining subsidiary that can be utilised by a head company



On entry

When a consolidated group forms or one or more entities join a consolidated group, new tax costs (or tax values) for the assets of each subsidiary are calculated, based on the tax costs of the membership interests in that subsidiary*. The cost base of the membership in the joining entity is effectively transferred to the assets of the entity, aligning the tax costs of the entity's assets with the costs of its membership interests.

This calculation is made by way of the cost setting process, which allocates the cost of the membership interests in the subsidiary to the assets it brings into the group in proportion to their market values.

The entry cost setting process, illustrated in flow chart 1 on the previous page, is described in detail in section C2. → 'Treatment of assets', C2-1

In addition to the allocation step, market valuations may be required in calculating the ACA (in steps 1, 2, 3 and 5 of that calculation), the tax cost setting amount for revenue assets and the tax cost setting amount for over-depreciated assets.

(*Other than when a consolidating group exercises the transitional option of retaining existing asset values. → 'Treatment of assets', C2-1)

Valuations required for all assets

The cost setting process requires market valuations for *all* the assets (except for *retained* cost base assets) of the entity as at the joining time, including assets that are off balance sheet and those for which a tax cost has not previously been set. For example, all identifiable intangible assets must be valued, including goodwill.

Goodwill should be valued as a residual item. It is the excess of the market value of the joining entity over the market value of its net identifiable assets at the joining time. → 'Use in determining goodwill', p. 20

The goodwill of the joining entity includes synergistic goodwill that accrues to the assets or businesses of the group as a consequence of the group's ownership and control of the joining entity. All elements of this goodwill are treated as a reset cost base asset of the joining entity even though some of the added value may accrue to assets or businesses already owned by the group.

→ subsection 705-35(3), *Income Tax Assessment Act 1997*; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

The goodwill asset 'is taken to have a market value just before the joining time of an amount equal to its market value just after the joining time'.

→ subparagraph 705-35(3)(b)(ii)

On exit

When a subsidiary leaves a consolidated group, the entry cost setting process is reversed and the group's cost base of membership interests is derived from the net assets of the leaving entity. In determining the exit ACA, market valuations are required for intragroup liabilities, employee share interests and certain debt interests. Also, where there is more than one class of membership interest in the leaving entity, the ACA will be allocated to each class in proportion to the market value of membership interests in that class. → 'Treatment of assets', C2-1;

and worked example: 'Adjustment for intragroup liabilities owed to a leaving entity on exit (in exit ACA step 3)', C2-5-260

Market valuations for calculating loss utilisation

Market valuations of the loss entity (joining subsidiary) and the consolidated group will be required to determine the available fraction for losses transferred to the head company. This calculation, illustrated in flow chart 2 on page 4, is described in detail in section C3. → 'Treatment of losses', C3-1

However, a transitional concession allows certain losses transferred to the head company to be utilised over three years instead of their use being limited by the available fraction. Market valuations of the joining subsidiary and the group are not needed for these losses (although market valuations may be required to utilise other losses transferred to the head company).

Another transitional concession provides that where the available fraction method *is* used, under certain conditions it can be assumed to be 1.000 (irrespective of the actual market values of the group member entities), again avoiding the need for market valuations. This will be the case where:

- 100% of the value of all value donors is included in the modified market value of a particular real loss-maker, and
- the value donors plus the real loss-maker are all group members whose values are taken into account in determining the adjusted market value of the consolidated group.

Unlike the other transitional concessions, which are based on legislation, this concession is provided by the Commissioner under the general administrative provision (section 8) of the *Income Tax Assessment Act 1936* (ITAA 1936).

Both of these transitional concessions apply on formation to groups that consolidate during the transitional period (1 July 2002 to 30 June 2004) and where certain other conditions are met. → 'Treatment of losses', C3-1

For MEC groups when trigger events occur

For MEC (multiple entry consolidated) groups, market valuations of external membership interests are necessary to recalculate the cost base of external membership interests where the following trigger events occur:

- when an eligible tier-1 company leaves a MEC group, and
- a CGT event happens to the external membership interest in an eligible tier-1 company (for example, an external membership interest is transferred to a group member).

→ Worked examples: 'Events that trigger pooling in a MEC group', C10-2-410, and 'Pooling of external membership interests', C10-2-420

To maintain the pre-CGT status of membership interests

For joining and leaving entities, market valuations of membership interests and assets are necessary in order to maintain the pre-CGT status of membership interests. This is done through the calculation of pre-CGT factors that attach to assets that are not revenue assets. → 'Pre-CGT factor for assets of a joining entity',

C2-4-810 and 'Pre-CGT membership interests in a leaving entity', C2-5-710

Where a head company incurs expenditure in obtaining market valuations to comply with the income tax laws in respect of the formation of a consolidated group or entities joining a consolidated group, the expenditure is deductible as a tax-related expense for the purposes of section 25-5 of the ITAA 1997.

Similarly, where an entity incurs expenditure in obtaining valuations for the purposes of either entering into a consolidated group as a subsidiary member, or working out the future income tax liability of a consolidated group of which it would be a subsidiary member, that expenditure is deductible under section 25-5. Taxation Determinations TD 2003/10 and TD 2003/11, released on 30 April 2003, reflect the Tax Office's views on this matter. → 'Taxation Determination

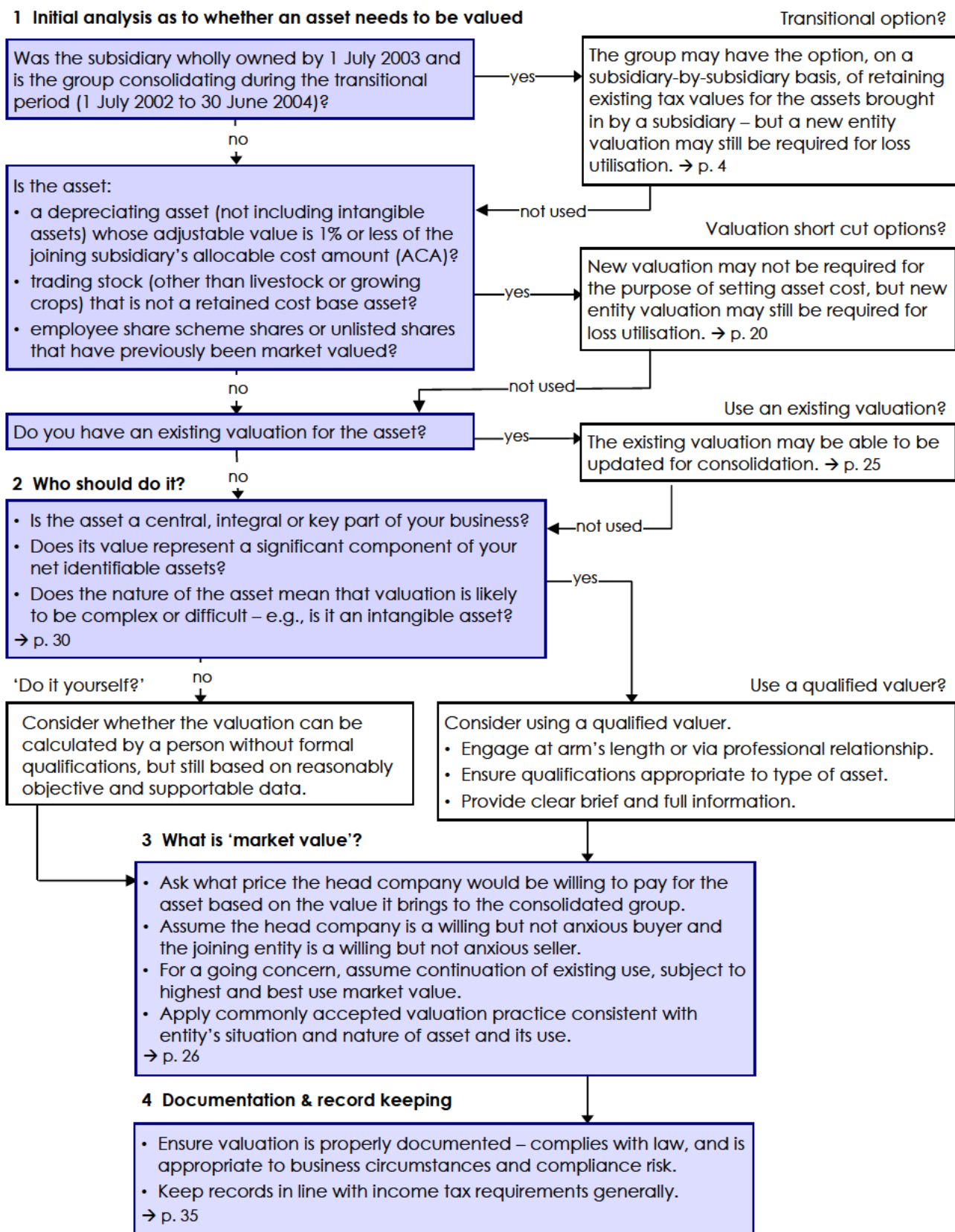
TD2003/10', C4-2-110; 'Taxation Determination TD2003/11', C4-2-120

Taxpayers' market valuation pathway

Note: The following analysis deals with the need for market valuations for asset cost setting and loss utilisation. Market valuations may also be required for other aspects of the consolidation legislation.

Figure 2: Determining an approach to market valuation for consolidation

1 Initial analysis as to whether an asset needs to be valued



Managing risk and compliance

Key points

- Taxpayers will need to exercise their commercial judgement in balancing compliance costs against the risk of non-compliance.
- By applying these guidelines, taxpayers will increase the level of confidence in relation to their compliance obligations.
- The Tax Office aims for transparency both in the criteria it uses to allocate compliance assurance resources and in the processes it follows in the use of those resources.

The taxpayer's responsibilities

As with any aspect of income tax law, the Commissioner of Taxation will have a statutory obligation to ensure compliance with the market valuation requirements of the consolidation regime and to form a view as to whether an adjustment should be made to a taxpayer's taxable income on the grounds that it has been based on an inaccurate valuation.

In the event of a dispute with the Tax Office, the taxpayer must prove that a disputed assessment is excessive. This is the case whether the taxpayer is seeking a review of an assessment or is appealing against an objection decision.

The taxpayer must not only show that the assessment is wrong, but must also positively establish what correction should be made in order to make it right or more nearly right.

In the event of a dispute, appropriate record keeping will help taxpayers meet the burden of proof. And they will be in a better position if they can demonstrate that the market valuations they have relied on were based on reports commissioned in a transparent manner from independent and qualified valuers.

The availability of such reports will help the taxpayer communicate their position to the Tax Office, establish the credibility of valuations, and reduce the risk of tax audits and adjustments.

A matter of judgement

In the light of their individual circumstances, taxpayers should exercise their commercial judgement to determine:

- whether to use the valuation short cut options that have been made available by the Tax Office
- whether to rely on updated existing valuations or commission contemporaneous valuations
- the level of independence and qualifications the persons undertaking their market valuations should have, and
- the level of information and documentation that is appropriate in recording their market valuations.

In exercising their commercial judgement taxpayers should consider the assurance they wish to achieve. They will need to balance compliance costs against the potential risks associated with those decisions (such as non-compliance with the law and the likelihood of the valuations being challenged by the Tax Office).

Where taxpayers follow these guidelines with reasonable care and in good faith to determine market values for consolidation, they will significantly increase the level of confidence in relation to their compliance obligations.

The Tax Office's approach to managing compliance

The Tax Office generally allocates its compliance assurance resources according to the risk to the revenue of taxpayer non-compliance with the law. In relation to the consolidation market valuation requirements, the more significant and the broader the scope of the market valuations, the more likely it is that a taxpayer will be subject to a market valuation review.

The Tax Office's approach to managing compliance for market valuations will be based on the cooperative, self-regulatory approaches it is developing with large business under the Cooperative Compliance Model framework → ATO publication, *Cooperative compliance: working with large business in the new tax system*. The Tax Office will ensure that there is input from large business to prevent misinterpretations and to allow misunderstandings to be resolved quickly.

The market valuation provisions apply to all levels of business. While the small to medium enterprise (SME) sector is not seen as a major area of risk in relation to market valuation for consolidation, the Tax Office is taking steps to ensure those SMEs affected are aware of the requirements and know where they can get further information and advice.

Review and audit process

In determining whether to undertake a review of a taxpayer's market valuation processes, the Tax Office will first evaluate the information available to it, including previous tax return data as well as publicly available financial and economic information. This internal Tax Office analysis would look at the size and complexity of the consolidated group and, in particular, the value of assets transferred from joining entities to the group, changes in the cost base of assets, the capital gains tax schedule and the losses schedule.

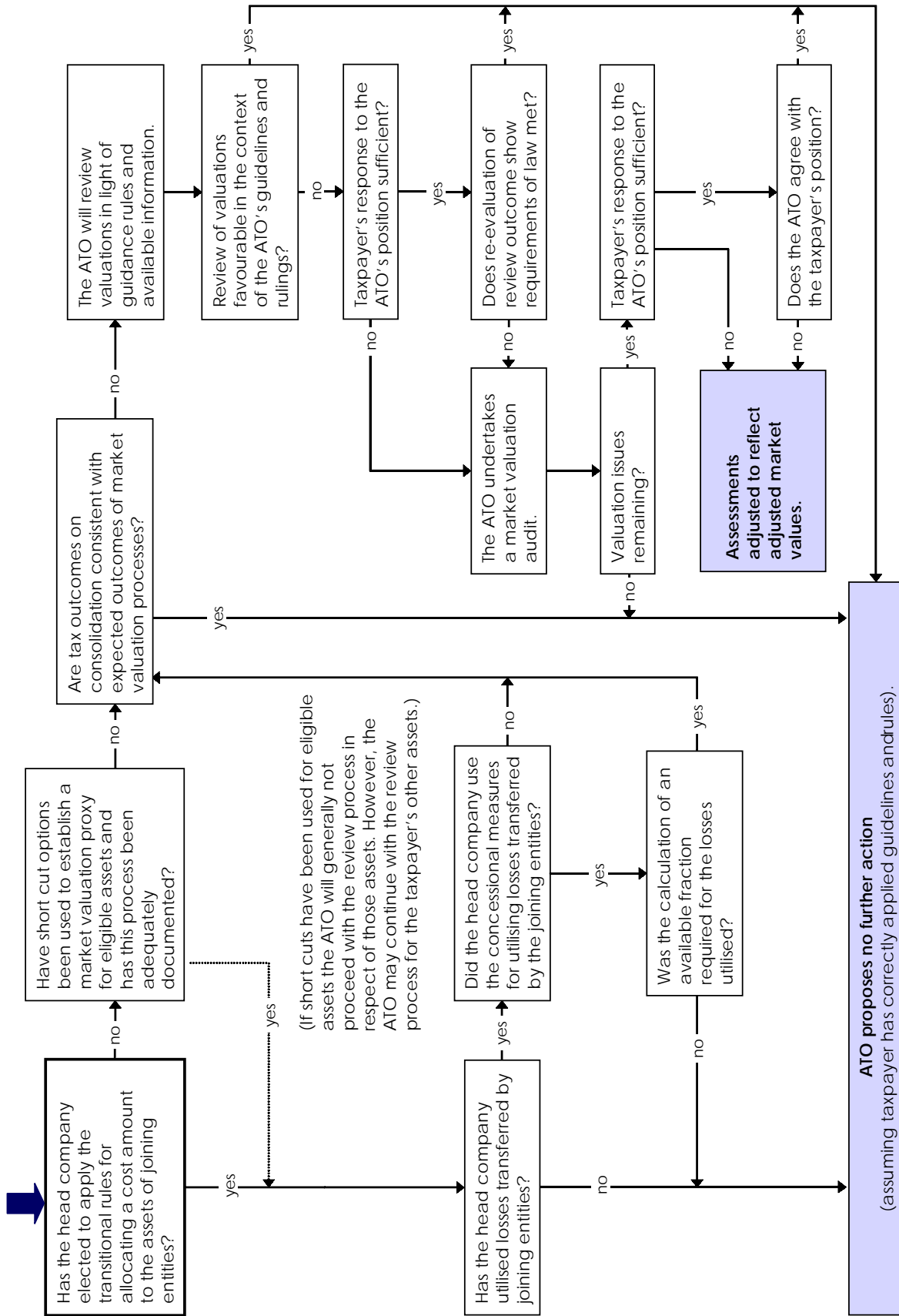
Depending on the result of this initial analysis, the Tax Office may then contact the taxpayer for additional information relating to:

- the quality of the taxpayer's market valuation processes
- the use of valuation short cut options
- the complexity of the market valuations
- the appropriateness of the methodologies and the reasonableness of the underlying assumptions
- the size of the joining subsidiary(ies) and group, and
- the income tax outcomes of the consolidation process.

Based on the analysis so far, the Tax Office will then be able to determine where the taxpayer is located on a spectrum of risk → table 1: Risk matrix for valuation factors, p. 15. This process will involve consultation with the taxpayer. Only where the outcome of this review is unsatisfactory would the Tax Office consider undertaking an audit of a taxpayer's market valuations.

Figure 3 on p. 11 illustrates how the Tax Office is likely to approach a review of a taxpayer's market valuations for the purposes of consolidation. It provides a general indication of the steps the Tax Office will take, including any escalation to an audit of the taxpayer's market valuations or a comprehensive audit of the taxpayer's income tax affairs. Exceptional circumstances, however, may require a modification or departure from the process illustrated.

Figure 3: Review and audit process – market valuation for consolidation



Risk factors

In ranking the taxpayer on the risk spectrum, the Tax Office will take the following factors into account:

- the quality of the taxpayer's market valuation processes → table 2: Risk matrix for quality of processes and documentation, p. 16.
- the use of valuation short cut options – where these options are used for eligible assets, the risk of the Tax Office undertaking a market valuation review for those assets is eliminated, providing that the short cut option is correctly implemented. In addition, the greater the use of these options the lower the overall risk of a market valuation review.
- the complexity of the market valuations – the more complex the market valuations the more likely it is that the Tax Office will undertake a market valuation review
- the appropriateness of the methodologies and the reasonableness of the underlying assumptions – these factors depend to a great extent on the taxpayer's individual circumstances
- the size of the joining subsidiary and group – the larger the business the more likely it is that the Tax Office will undertake a market valuation review, and
- the taxpayer's income tax outcomes of the consolidation process – the more favourable the tax outcomes related to market valuations after consolidation the more likely it is that the Tax Office will undertake a market valuation review.

→ table 1: Risk matrix for valuation factors, p. 15

Quality of processes and documentation

In assessing the quality of a taxpayer's processes and documentation, the Tax Office will take into account:

- the taxpayer's observance of the ATO's documentation and record keeping guidelines → p. 35
- the independence and qualifications of the person undertaking the market valuations processes → p.30, and
- the way in which market valuations have been commissioned → p. 33.

The following examples provide an indication of the key attributes of low, medium and high quality processes and documentation. See table 2, p. 16 for the detailed criteria used by the Tax Office in assessing quality.

Low quality processes and documentation

There is no process in place or documentation to support the appropriateness of the methodology, the accuracy of the values adopted or the independence of the market valuation. There is insufficient detail to enable the market valuation procedure to be replicated. Other indicators of low quality processes include a lack of documentation to establish the commissioning of the valuation, valuation documentation that is not contemporaneous with the market valuation process, and an inability to demonstrate the qualifications and independence of the person undertaking the valuation. → high risk column in

table 2: Risk matrix for quality of processes and documentation, p. 16

Medium quality processes and documentation

The processes and supporting documentation are mostly appropriate and consistent given the taxpayer's circumstances. The person undertaking the valuation is independent, professional, has relevant experience, and has access to necessary information. Most, but not all, of the information the Tax Office requires to understand the market valuation report is included in the report and supporting documentation. The report contains sufficient details to enable the market valuation procedure to be replicated. → medium risk column in table 2: Risk

matrix for quality of processes and documentation, p. 16

High quality processes and documentation

The processes in place and the supporting documentation are readily identifiable as appropriate and consistent given the taxpayer's circumstances. The taxpayer's documentation includes all information needed by the Tax Office to understand the valuation report, including the appropriateness of the methodologies used, and such information is sufficient to enable the market valuation procedure to be replicated. Indicators of high quality processes and documentation include:

- documentation is contemporaneous with the market valuation process
- all necessary information is contained in the valuation report, and
- documentation is available that records that the person undertaking the valuation was appropriately qualified and experienced, and had been commissioned in a transparent fashion and was therefore independent of the person commissioning the market valuation report.

→ low risk column in table 2: Risk matrix for quality of processes and documentation, p. 16

Complexity of valuations

The complexity of a market valuation depends in part on:

- the nature of the asset being valued – valuing intangible assets is more complex than valuing land and buildings or plant and equipment
- the underlying assumptions – complexity increases with the number of assumptions and the variability of the factors that lead to these assumptions

-
- the size and complexity of a taxpayer's business – complexity increases as the number and value of assets increases
 - the number of key or significant assets to be valued – complexity increases with the number of key assets
 - the industry in which the assets are being used – complexity increases in line with the volatility of the industry or business activity
 - the use to which the assets are being put – the valuation will be more complex if there is doubt that the asset is being used for its highest and best use.

Tax outcomes

Where income tax outcomes post consolidation are highly favourable to the taxpayer and where there are significant differences in tax attributes pre and post consolidation, the Tax Office will closely examine the taxpayer's market valuation processes to ensure that the tax outcomes are based on genuine and appropriate market values.

The Tax Office recognises that in many instances highly favourable tax outcomes will result from a proper application of the law and the adoption of genuine and appropriate market values. However, the Tax Office will be concerned where it is evident that the market valuation process adopted and the values derived were intended to produce certain favourable tax outcomes. Where this is the case the taxpayer will be at much greater risk of a market valuation review turning into a follow-up audit. Situations in which this may occur include:

- There are highly favourable tax outcomes where losses have been utilised. For example, the utilisation of losses appears to go well beyond the extent provided for by the rules for the available fraction calculation, which determines the maximum amount of certain losses that can be deducted.
- There are highly favourable tax outcomes in relation to cost bases for depreciable assets and trading stock. For example the uplift in the cost base of revenue assets is significant and out of proportion to the change in value of the remaining assets.
- There are highly favourable tax outcomes in relation to cost bases for CGT assets. For example, the changes to cost bases for pre CGT capital assets compared to post CGT capital assets, or changes to cost bases of CGT assets that have not been sold compared to those that have been sold after consolidation, are significant and out of proportion to the pre-consolidation position.

Table 1: Risk matrix for valuation factors

Risk → ↓ Criteria	High	Medium	Low
Asset values	Total value of assets of joining entities in an income year is over \$100m.	Total value of assets of joining entities in an income year is in range of \$10m—\$100m.	Total value of assets of joining entities in an income year is under \$10m.
Intangible assets	<i>Significant</i> proportion of intangible assets.	<i>Moderate</i> proportion of intangible assets.	<i>Insignificant</i> proportion of intangible assets.
Materiality	<i>Significant</i> difference in taxation outcomes post consolidation and a <i>very significant</i> impact on revenue.	<i>Moderate</i> difference in taxation outcomes post consolidation and a <i>moderate</i> impact on revenue.	<i>Small</i> difference in taxation outcomes post consolidation and a <i>low</i> impact on revenue.
Valuation short cut options	Failure to use valuation short cut options in any cases where eligible.	Use of valuation short cut options in <i>some</i> cases where eligible.	Use of valuation short cut options in all cases where eligible.
Complexity of business	<i>Complex</i> business group structure – e.g., more than 25 subsidiaries.	<i>Slightly complex</i> business group structure – e.g., 10–25 subsidiaries.	<i>Straightforward</i> business group structure – e.g., less than 10 subsidiaries.
Volatility of business	<i>Volatile</i> industry or business activity.	<i>Medium</i> volatility of industry or business activity.	<i>Low</i> volatility of industry or business activity.

Table 2: Risk matrix for quality of processes and documentation

Risk → ↓ Criteria	High	Medium	Low
Appropriateness of methodologies	Assuming continuation of existing use, the valuations <i>do not sufficiently demonstrate</i> that: <ul style="list-style-type: none"> methodologies are consistent over similar asset types methodologies are the most appropriate appropriate data was used in the methodology. 	Assuming continuation of existing use, the valuations <i>demonstrate mostly</i> that: <ul style="list-style-type: none"> methodologies are consistent over similar asset types methodologies are the most appropriate appropriate data was used in the methodology. 	Assuming continuation of existing use, the valuations <i>demonstrate fully</i> that: <ul style="list-style-type: none"> methodologies are consistent over similar asset types methodologies are the most appropriate appropriate data was used in the methodology.
Qualifications of person undertaking valuation	Person undertaking the valuation can demonstrate <i>few</i> , 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 <i>most</i> 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 <i>all</i> 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 methodologies	No cross check of valuation where it would have been appropriate	Single crosscheck of valuation where appropriate	Valuation cross-checked with other methodologies where appropriate
Integrity of process	Person undertaking valuation <i>cannot</i> demonstrate: <ul style="list-style-type: none"> appropriate experience basis of engagement subject to external regulation professional relationship access to information. 	Person undertaking valuation has: <ul style="list-style-type: none"> professional relationship access to information appropriate experience. 	Person undertaking valuation <i>can</i> demonstrate: <ul style="list-style-type: none"> appropriate experience documented basis of engagement subject to external regulation professional relationship access to information.
Information supplied in the market valuation report	Report includes <i>insufficient</i> quantity 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 methodologies used information on which valuation is based details of all assumptions used. 	Report includes <i>most</i> , 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 methodologies used information on which valuation is based details of all assumptions used. 	Report includes <i>all</i> 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 methodologies used information on which valuation is based details of all assumptions used.
Use of existing valuations	<i>No</i> documentation as to relevance of earlier valuation or adequate documentation of changes.	<i>Adequate</i> documentation as to relevance of earlier valuation and/or adequate documentation of changes.	<i>Complete</i> documentation as to relevance of earlier valuation and/or complete documentation of changes.

Penalties Where an audit results in the Tax Office making a tax adjustment, it must determine an appropriate level of penalty. In general, the principles outlined in Taxation Ruling 94/4 concerning reasonable care, recklessness and intentional disregard, and in Taxation Ruling 94/5 relating to reasonably arguable position will continue to apply. The General Interest Charge (GIC) is imposed by statute in all cases where there is a tax shortfall.

Most issues arising out of the determination of market value will involve questions of fact, and the issue of whether there is a reasonably arguable position (which applies to the application of tax laws) will not arise. On the other hand, questions of whether reasonable care has been exercised, or in more extreme cases, whether there has been recklessness or an intentional disregard of the law, can be expected to come into consideration where any tax shortfall has occurred. A significant factor in the Commissioner's decision on the applicable standard of care will be the extent to which the Tax Office's guidelines on market valuations have been followed and whether reasonable care has been exercised in the provision of inputs and underlying assumptions as well as in the undertaking of the valuation process.

Generally, where reasonable care has been exercised and clearly demonstrated in all aspects of the market valuation process, but a tax shortfall has nevertheless arisen, penalties beyond the GIC are not likely to apply.

Valuation short cut options

Key points

Use of specified short cut options:

- avoids the need to obtain new valuations for certain assets
- reduces the risk of the Tax Office undertaking a market valuation review in relation to the eligible assets
- but are not available for use in loss utilisation calculations.

Valuation short cut options enable businesses to avoid the need to obtain new valuations for certain assets and membership interests. These short cuts, which are provided under the Commissioner's general administrative powers, provide a reasonable approximation of the true market value of the asset.

Use of these options may avoid the need for new valuations for the purpose of setting asset costs. However, the valuation short cut options are not available for calculating a joining entity's market value for the purpose of determining the maximum use of transferred losses.

The use of valuation short cut options reduces the risk of the Tax Office undertaking a market valuation review in respect of the assets for which the short cut options have been used (as does the use of the transitional option of retaining existing asset values). → see figure 3: Review and audit process – market

valuation for consolidation, p. 11

Table 3: Valuation short cut options

Valuation short cut	Type of asset	Valuation option
1	Depreciating assets (not including intangible assets) that <i>have not</i> been depreciated on an accelerated basis whose individual adjustable values are 1% or less of the joining subsidiary's allocable cost amount (ACA)	Adjustable value (which can be revised to ignore any balancing adjustment amount that had the effect of reducing the adjustable value) may be used as market value
2	Depreciating assets (not including intangible assets) that <i>have</i> been depreciated on an accelerated basis whose individual adjustable values are 1% or less of the joining subsidiary's allocable cost amount (ACA)	Adjustable value, revised to ignore the effect of accelerated depreciation (and which can be revised to ignore any balancing adjustment amount that had the effect of reducing the adjustable value), may be used as market value
3	Trading stock (other than livestock and growing crops) that is not a retained cost base asset	Terminating value at the joining time may be used as market value except in certain circumstances
4	Employee share scheme shares	Existing market valuation updated if appropriate
5	Unlisted shares	Existing market valuation updated if appropriate

Supporting documentation required

When choosing to use a valuation short cut for a particular asset, the taxpayer must ensure that they have adequate supporting documentation that demonstrates that the asset satisfies the eligibility requirements of the particular short cut.

One in, all in – with an exception

While use of the valuation short cuts is optional, the decision to use a particular short cut must generally apply to all of an entity's assets that are eligible for the particular short cut – e.g., all depreciating assets that have not been depreciated on an accelerated basis where the terminating value is 1% or less of the allocable cost amount (valuation short cut 1).

For valuation short cuts 1 and 2 there is one exception to this rule. A taxpayer may generally opt to use short cuts 1 and 2 for a joining entity's eligible depreciating assets, while obtaining new market values for the assets (including those eligible for the short cut) that make up a single large functioning unit of integrated plant, such as integrated plant within an oil refinery, an oil rig facility, a communications cable, and integrated plant within a factory production line. Without this exception, the 'one in, all in' rule would preclude the taxpayer obtaining new market values for any of these assets that were eligible for the short cut.

The exception works as follows:

- A taxpayer opts to use the short cut to value their eligible depreciating assets. Among these are a number of assets that constitute one or more items of integrated plant. A market value is determined for the integrated plant and the value is then allocated on a reasonable basis among the integrated plant's constituent assets. These values may then be adopted as the market values of the constituent assets instead of the values that would be adopted for these assets under the valuation short cuts applying to depreciating assets.
- In valuing an integrated functioning unit of plant, the market value must reflect the physical value of the plant and not comprise any embedded goodwill or any other intangible value. That is, care should be taken to ensure that none of the value attributed to the asset is actually goodwill attached to the use of that asset or to any other intangible assets held by the entity.

Not available where there is an intention to sell

Valuation short cuts, with the exception of short cut 3 (trading stock), are not available for use in relation to assets where there is an intention at the joining time that either:

- the joining entity in which the asset is held
- the underlying business of the joining entity in which the asset is held
- part of the underlying business of the joining entity in which the asset is held, or
- the asset itself,

will be sold following consolidation.

This provision only applies where, at the joining time, an asset has been the subject of a fully determined specific intention to sell and the expectation is that the asset will be sold within two years of the joining time.

For example, it would apply where a decision had been taken to market an asset with the intention to sell if a suitable buyer could be found. It would also apply if a decision had been taken to accept an offer to buy an asset but the decision to sell had not yet been communicated to the buyer.

However, this provision would not apply where an entity had a history of disposing of its assets on a strategic basis but had not taken a decision to sell in relation to any particular asset at the joining time. Nor would it apply where an entity had merely fielded offers in respect of a specific asset or assets but had made no decision to sell at the joining time.

Where this provision applies to a particular asset it will no longer be treated as an asset of that particular type for purposes of applying the 'one in, all in' rule. In other words, although the intention to sell the asset prevents the use of the valuation short cut in relation to that asset, it will not prevent the valuation short cut applying to other assets that qualify for that particular short cut.

Not available for calculating the available fraction

The valuation short cuts are *not* available as a means of calculating the joining entity's market value for the purpose of calculating the available fraction used to determine the amount of a loss transferred from a joining subsidiary that can be utilised by a head company. For this purpose market valuations of the loss entity and the consolidated group at the joining time will be required.

→ 'Market valuations for calculating loss utilisation', p. 5

Use in determining goodwill

Where valuation short cuts have been adopted for certain assets, the short cut values for those assets should be used in determining the market value of the entity's goodwill (given that goodwill is determined as the excess of the market value of the entity over the market value of its net identifiable assets at the joining time). The net identifiable assets may have a mix of market values and

short cut values. Should a taxpayer market value all or any of the entity's net identifiable assets in order to determine the value of goodwill it follows that the taxpayer should not adopt any valuation short cuts for those assets that have been market valued. → 'Valuations required for all assets', p. 4

Valuation short cut 1

Depreciating assets that *have not* been depreciated on an accelerated basis

The *adjustable value* at the joining time, which may be revised to ignore any balancing adjustment amount, can be taken as the market value for all depreciating assets that *have not* been depreciated on an accelerated basis and:

- whose individual adjustable values amount to 1% or less of the joining entity's ACA, and
- which are eligible for a deduction under Division 40 of the ITAA 1997,
- *except for* the following intangible assets:
 - mining, quarrying or prospecting rights
 - mining, quarrying or prospecting information
 - items of intellectual property
 - in-house software
 - IRUs (indefeasible rights to use an international telecommunications submarine cable)
 - spectrum licences
 - datacasting transmitter licences.

The market value ascertained by applying valuation short cut 1 may be affected by a balancing adjustment event occurring under the income tax law. A taxpayer that has an assessable balancing adjustment amount because of a balancing adjustment relief has the option of revising the adjustable value. The revision ignores any balancing adjustment amount that had the effect of reducing the amount available for decline in value of the depreciating asset.

Valuation short cut 2

Depreciating assets that *have* been depreciated on an accelerated basis

The adjustable value at the joining time, revised to ignore the effect of accelerated depreciation and which can be revised to ignore any balancing adjustment amount that had the effect of reducing the amount available for decline in value of the depreciating asset, can be taken as the market value for all depreciating assets that *have* been depreciated on an accelerated basis and:

- whose individual adjustable values amount to 1% or less of the joining entity's ACA, and
- which are eligible for a deduction under Division 40 of the ITAA 1997,
- *except for* the same intangible assets that are not eligible for valuation short cut 1.

The revised adjustable value is to reflect an amount calculated as if the asset had been depreciated at normal rates in accordance with its effective life. This ignores the effect of broadbanding of effective life under the accelerated depreciation provisions and can ignore the effect of a balancing adjustment amount. The effective life is prescribed by the Commissioner, unless the taxpayer has self-assessed the effective life for depreciation purposes.

To determine the revised adjustable value at the joining time, the taxpayer is required to recalculate the asset's depreciation from the time it was first depreciated by the joining entity up to the joining time. The taxpayer can also choose to exclude from the adjustable value of the asset any balancing adjustment amount that had the effect of reducing the amount available for decline in value of the depreciating asset. The depreciation rates to be used for the recalculation are the applicable standard (i.e. non-accelerated) rates that would have applied to that particular asset for the period from the time the asset was first depreciated by the joining entity up to the joining time.

Valuation short cut 3

Trading stock

This short cut is not available in respect of a joining entity that was majority owned by the prospective head company at 27 June 2002. The trading stock of such entities is to be treated as a retained cost base asset.

Otherwise, the *terminating value* at the joining time can be taken as the market value for assets that are items of trading stock except where:

- the trading stock comprises livestock, standing or growing crops, crop-stools and trees planted and tended for sale, or
- the value of the trading stock has been affected by market volatility, market collapses, obsolescence, or any other event to the extent that its terminating value would not be a reasonable approximation of its market value at the joining time. In such cases the trading stock should be market valued appropriately at the joining time.

The market value of trading stock for the purposes of consolidation is the price that would be negotiated for the trading stock between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller where the entity or business was being sold at arms length in an open and unrestricted market.

Valuation short cut 4

Employee share interests

Although qualifying shares issued under employee share acquisition schemes (ESAS shares) that represent 1% or less of the membership interests in an entity are disregarded for the purposes of determining whether an entity is wholly owned (→ 'Choosing', B1-1), their market value is still relevant for the purposes of the head company calculating its allocable cost amount for membership interests in the joining entity.

The availability of this short cut option acknowledges that valuing minority interests is a difficult and complex process.

This valuation short cut operates as follows:

If an employee holds qualifying shares (or has previously held qualifying rights and has exercised those rights and now holds shares) and

- has elected to have an amount for the shares or rights included in their assessable income at the time they were issued, or
- has not elected to have an amount included in their assessable income at the time the shares were issued or the rights granted but the cessation time has occurred and the employee continues to hold the shares,

the shares or rights will have been market valued.

The head company may rely on this existing market valuation when calculating the employee share interest component of the allocable cost amount for the joining entity provided:

- the qualifying shares or rights were valued in accordance with sections 139FB, 139FD and, in the case of rights, 139FE of the ITAA 1936, and
- the original market valuation was appropriately documented, and
- the use of the existing market valuation is documented and, if necessary, updated in accordance with the requirements set out under 'Use of existing valuations' on p. 25.

Valuation short cut 5

Membership interests that are unlisted shares

As all membership interests in a wholly-owned subsidiary will be held by the head company or other members of the consolidated group, they will not be listed on a stock exchange. The availability of this valuation short cut acknowledges that valuing unlisted membership interests is a difficult and complex process.

Where any of the membership interests in the joining entity have been market valued for the purposes of Division 13A of the ITAA 1936 (relating to ESAS shares), the head company may rely on these existing market valuations when determining the cost of all its membership interests in the joining entity for the purposes of calculating its allocable cost amount, provided that:

- the membership interests valued for the purposes of Division 13A were qualifying shares and valued in accordance with sections 139FB and 139FD
OR
- the membership interests valued for the purposes of Division 13A:
 - arose because of the granting of qualifying rights, and
 - those rights have been exercised or the cessation time in relation to those rights has occurred and the employee continues to hold the shares, and
 - those rights were valued in accordance with sections 139FC, 139FD and 139FE*AND*
- the original market valuation was appropriately documented
AND
- the use of the existing market valuation is documented and, if necessary, updated in accordance with the requirements set out below.

Use of existing valuations

Where an asset has been market valued for another purpose it may be possible to use that valuation and associated documentation as the basis for ascertaining the asset's market value for the purposes of consolidation.

In these circumstances the earlier valuation should be adequately documented in accordance with the guidelines provided here → 'Documentation and record keeping', p. 35. Additionally, the earlier valuation report should be updated with a detailed statement of how the earlier valuation is relevant to ascertaining the asset's market value for the purposes of consolidation. The statement should include:

- an explanation of whether the methodology used in the earlier market valuation is aligned with the intent and framework of the consolidation provisions
- confirmation that any assumptions used are still relevant at the joining time and, if not, the changes to the assumptions that have now been made, and
- a declaration that the previous valuation is still relevant at the joining time and details of any adjustments or changes that have been made to the earlier valuation in order to meet the requirements of the consolidation provisions.

What is 'market value'?

Key points

- Ask what **price** the head company would be willing to offer for the asset of the joining entity.
- For a going concern, assume **continuation of existing use**, subject to highest and best use market value.
- Take into account impact of any **GST input tax credit**.
- For **non-cash benefits**, disregard any limitation that would prevent or restrict the asset's conversion into money.
- Apply **commonly accepted valuation practice** consistent with the joining entity's situation and the nature of the asset and its use.

However, alternative approaches may be considered appropriate if it can be demonstrated that they accord with the policy intent of the consolidation legislation, because of the circumstances associated with the use of the asset.

What price?

The term 'market value' has not been defined for the purposes of consolidation. The definition in current tax law does not specifically define market value. As a result, for the purposes of consolidation, the term takes on the meaning ordinarily applied to it when used on its own without any qualifications.

Business valuers in Australia typically define market value as:

The price that would be negotiated in an open and unrestricted market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller acting at arm's length.

In the context of consolidation and setting the costs of an asset brought into the consolidated group by a joining entity, the task of establishing the market value of an asset is approached with the typical definition in mind.

For this reason, it is reasonable to focus on the price a willing purchaser would have to offer a willing seller in order to persuade them to sell for a fair price. Consequently, to determine an asset's market value, the question to be asked is 'what price would the head company be willing to offer in order to acquire the assets of the joining entity?'. It would usually be expected that the head company would pay no more for the asset than the value it would add to the consolidated group given the continuation of its existing use.

The approach taken by the court in *Spencer v The Commonwealth* is particularly relevant to consolidation. This is because the proposed consolidation legislation focuses on the head company's cost of acquiring the joining entity's assets at the joining time.

In looking to apply the concept of ‘willing buyer and willing seller’ to ascertain the market value of land, Griffith CJ commented in *Spencer v. The Commonwealth* (1907) 5 CLR 418 at 432:

In my judgement the test of value of land is to be determined, not by inquiring what price a man desiring to sell could actually have obtained for it on a given day, ie., whether there was in fact on that day a willing buyer, but by inquiring ‘what would a man desiring to buy the land have had to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell?’

Continuation of existing use

All other things being equal, the assets of a joining entity would normally be market valued on the basis of a continuation of their existing use.

This continuation of existing use principle is based on the expectation that the assets of the subsidiary member will be employed in the same business for the same purpose post-consolidation as they were pre-consolidation – that is, the asset will continue to be used for its existing use. The act of consolidation does not of itself result in a change in the way an asset is employed. Nor will it necessarily result in a change in the way an asset should be valued or the level of valuation.

Highest and best use

A market valuation of an asset, based on its highest and best use within an ongoing operational entity and on the understanding that there is a continuing requirement for that asset, will generally result in the greatest value for the asset.

In economic terms it is assumed that generally an entity would not continue to use an asset for its existing use if that asset could realise a greater value if it were redeployed or sold, provided this did not affect the economic use of other assets dependent upon it. Consequently, it can be expected that in all circumstances all assets of the subsidiary member would be valued at their highest and best use, regardless of which market valuation method is used, as it is this value that best reflects the value the asset brings to the group joined.

Thus, where an asset is to be valued for its existing use that use can be assumed to be its highest and best use value unless circumstances indicate otherwise.

Operational and non-operational assets

Operational assets are those assets being used in the operation of the entity that are held for the continued use or service potential for the foreseeable future. In the case of operational assets such as specialised plant and machinery, their market value is based on their market value for existing use. For specialised plant and machinery this is expected to apply unless it can be clearly demonstrated that market value for existing use is not the highest and best use market value.

Non-operational assets are those assets that are not integral to the operation of the entity, and may be further classified as surplus assets or alternatively investments. If the asset is to be sold in the foreseeable future its highest and best value may well be its auction realisable value instead of its existing use value. In these circumstances this would be the market value amount that best

reflects the value to the joined group of acquiring that asset of the joining entity. In the case of a recent acquisition of a non-operational asset, that value in most cases is expected to be closely aligned to the acquisition cost of the asset.

Impact of GST

For the purposes of consolidation, the impact of GST (Goods and Services Tax) input tax credits should be taken into account in defining market value. The following definition of market value provided by section 995-1 of the ITAA 1997 takes this factor into account:

The market value of an asset (other than an asset the supply of which cannot be a taxable supply) at a particular time is that market value reduced by an amount equal to the amount of the input tax credit (if any) to which you would be entitled if:

- (i) you had acquired the asset at the time, and*
- (ii) the acquisition had been solely for a creditable purpose.*

Where an asset's market value is reduced by the amount of an existing input tax credit, the asset itself and the right to claim the input tax credit are treated as two separate assets for the purposes of allocating the head company's allocable cost amount to the assets of the joining entity. In particular, the right to claim the input tax credit is treated as a retained cost base asset.

Market value of non-cash benefits

Section 995-1 of the ITAA 1997 provides that in establishing the market value of non-cash benefits (that is, property or services in any form except money), anything that would prevent or restrict the non-cash benefit's conversion into money is to be disregarded. This applies for the purposes of consolidation.

Example

Disregard constraints on converting a non-cash benefit into money

Company A owns an item of depreciable plant, the use of which it provides free of charge to its wholly-owned subsidiary Company B for a fixed, five-year period. The right to use the item cannot be transferred or sold by B.

The right is a non-cash benefit provided by A to B, and it is also an intangible asset of B.

When A elects to form a consolidated group with B, A will need to ascertain the market value of B's assets, including the right. Company A must disregard anything that would prevent or restrict the conversion of the right to money. Consequently, in ascertaining the market value of the right, A must ignore the fact that B cannot transfer or sell the right.

Other approaches may be appropriate

Although the Tax Office would generally expect the above principles to be followed in determining market value, other approaches are not excluded where they are appropriate.

But other approaches will only be considered appropriate if it can be demonstrated that they accord with the policy intent of the consolidation legislation, because of the circumstances associated with the use of the asset.

Example

Take into account specific circumstances

At the time of consolidation, joining entity B has operational assets that, although currently being used, are as a matter of objective fact soon to become obsolete. As a result head company A intends to dispose of them soon after consolidation.

In these circumstances, head company A is able to demonstrate that the assets will not be used for the same purpose post-consolidation as they were pre-consolidation. For the purposes of consolidation, head company A should therefore market value these assets on the basis of their imminent disposal.

Which methods to be applied and how?

The Tax Office does not see its role in providing comprehensive guidance covering all aspects of the valuation process, including the use of different methods. In obtaining market valuations of assets, the head company should apply commonly accepted valuation practice in regard to:

- the subsidiary entity's situation as a going concern or otherwise, and
- the nature of the asset and the circumstances in which it is used.

Determining the market value of an asset or entity is not an exact science. The most correct result cannot be achieved by rigid and mechanical application of standardised or predetermined rules; rather it requires judgement. This is particularly so when estimating which single figure, from the range of figures, is representative of the most likely value of the asset. Approaches need to be tailored to the facts and circumstances of the case under examination. There needs to be some flexibility in applying the concepts of market valuations in order to produce a result that reflects the underlying purpose of the statutory provisions.

Who can undertake market valuations?

Key points

Depending on the situation, a market valuation for the purposes of consolidation may be undertaken by:

- an external qualified valuer
- an internal qualified valuer, or
- a person without formal valuation qualifications, but who still bases their calculation on reasonably objective and supportable data (the 'do it yourself' approach).

The choice of who is to undertake a valuation will depend on the nature of the asset and the taxpayer's business circumstances – in particular factors such as:

- the complexity of the valuation
- the value of the asset being valued relative to other assets of the taxpayer
- the availability of in-house valuation expertise, and
- the expense of an external valuation.

This decision requires taxpayers to balance the risks associated with computing their own valuations and the potential consequences of that decision (such as non-compliance with the law and the likelihood of the valuations being challenged by the Tax Office) with the costs of consulting a qualified valuer.

Table 4: Valuation decisions should be based on business circumstances and nature of asset

Circumstances → ↓ Options	Relative value of asset / level of certainty required	Complexity of the valuations
<ul style="list-style-type: none"> • External valuer • In-house qualified valuer • Self-calculation 	<ul style="list-style-type: none"> • The higher the asset's relative value and the more central it is to the taxpayer's business the higher the risks in getting the valuation wrong. 	<ul style="list-style-type: none"> • More complex valuations (e.g. intangible assets) require higher levels of skills and experience. • Less complex valuations (e.g. property or vehicles where comparable valuations are readily obtainable) may be self-calculated using reasonably objective and supportable data

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- Attributes** If a taxpayer decides to engage a person to value a particular asset:
- the person undertaking the valuation should act independently of the person commissioning the valuation report
 - the person undertaking the valuation should be appropriately qualified and experienced in relation to the asset being valued, and
 - there must be transparency in the commissioning of the valuation report.

Independence It is highly desirable that the person undertaking a market valuation is independent of the party who commissions the valuation. That is, the person undertaking the market valuation can be seen to be acting independently of the authority, control or influence of the person commissioning the market valuations.

The Tax Office is more likely to consider the report to have been prepared on an unbiased and objective basis if independence has been established.

The person undertaking the market valuations should be independent at all times – from when they are first approached to prepare the market valuation until the final report is completed.

Generally, to be considered independent, the valuer must be at arm's length and must not seek to achieve a tax-favourable result for the person who commissioned the valuation. A person perceived to be acting in a non-arm's length capacity or in a position to influence the outcome may, for example, include:

- a director, secretary or employee of the company
- a partner, employer or employee of a director or secretary of the company
- an associate of an employee of the company, or
- another associate (such as a supplier to the company).

However, there will be times when associates such as those listed above may provide high quality market valuations. For example, a large corporate group may employ qualified valuers in house. Or the taxpayer's existing audit provider may be qualified to value a particular asset. Such a person or party may be considered sufficiently independent of the person commissioning the report if it can be established that:

- a professional relationship exists between the associated person and the commissioning person
- the associated person acts strictly in a manner that is independent of the commissioning person, and
- the associated person is a member of a professional body and is liable to professional discipline and subject to ethical constraints.

The taxpayer must be able to demonstrate that the valuation was determined on an objective basis and not as a result of some predetermined outcome.

The closer the relationship between the associated person and the commissioning person, the less objective and unbiased the report will appear to be and the greater the onus on the associated person to demonstrate the absence of bias.

Documenting independence

A market valuation report should:

- clearly set out the nature and details of the relationship that exists, has existed or is intended to exist at some future time, between the person preparing the report and the person commissioning the report, and
- disclose information that would assist in assessing the independence of the report's author. For example, it would be expected that any business relationship between the author and the commissioning person be disclosed. This would include any intention to establish future business relationships between the author and the commissioning person or their associates.

The independence of a person undertaking a market valuation is more likely to be brought into question if their report restates, without question, information provided to them by the commissioning person. Authors should therefore carry out sufficient inquiries or examinations to establish reasonable grounds for believing that:

- information provided to them by the person commissioning the report is accurate and unbiased, and
- all information used or produced in obtaining a valuation complies with a recognised valuation methodology and is available for review – if there are material variations in method or presentation, the person preparing the market valuation report should adjust for or comment on them in their report.

Taxpayers may rely on a combination of in-house and external valuation expertise. If so, the taxpayer should fully document which work has been undertaken by which party. As discussed above, the taxpayer should also ensure that either they or the person commissioned to undertake the market valuation provide a statement detailing the reasonableness and objectivity of the work undertaken in-house, as this work is for these purposes considered to be information provided by the taxpayer. → 'Commissioning of reports', p. 33

Qualifications

The level of qualifications and experience of the person undertaking the valuation should depend on the nature of the assets being valued, the industry in which the assets are employed, the complexity and importance of the market valuation and the level of assurance taxpayers wish to achieve.

A person would be regarded as sufficiently qualified if their profession, reputation or training gives authority to their statements in relation to the assets or entities being valued. The level of qualification or expertise needed will vary depending on the relative importance of the market valuation in

question and what a reasonable business person might be expected to do in similar circumstances.

The person commissioning the market valuation should ensure that the person undertaking the valuation:

- is a member of a profession, or has a reputation or training that is relevant to the matters on which they report
- holds the licences or authorities, where necessary, for providing the type of advice sought
- states in their report their qualifications and experience or, if the report is made by a corporation or firm, the qualifications and experience of the individuals responsible for preparing the report
- retains specialists to advise on any technical matters that are relevant but on which the person undertaking the market valuation report is not personally authoritative
- complies with any other minimum record keeping requirements set out under 'Documentation and record keeping', on p. 35, and
- signs the report and consents to its use for the purposes of consolidation.

Commissioning of reports

The quality and accuracy of a market valuation report can be seriously undermined if there are unreasonable constraints placed on the person preparing the report. This can happen even if the person is both independent and suitably qualified. For example, the person preparing a report would need to have access to certain information about the taxpayer's business, including financial information, the use to which the asset is put, and access to view the asset in-situ. If this information and access is not made available or is inadequate, the accuracy of the final market valuation would be questionable.

The taxpayer should not prescribe what data or information is required for the preparation of the report. They should make available all the information they are aware of that relates to the asset being valued, as well as access to the taxpayer's premises and other necessary information.

Similarly, questions of independence and bias may be raised if the report is not commissioned in an open and transparent manner.

In this context, the person commissioning the report should be able to demonstrate that they provided the person preparing the report with written instructions in advance that clearly:

- set out the scope and purpose of the report
- ensure the author's independence in writing the report and in drawing their own conclusions
- recognise the author's right to refuse to provide an opinion or report, if not provided with the information and explanations they need
- grant the author access to the taxpayer's premises and the necessary records

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- ensure the author is provided with all necessary assistance in order to complete the report, and
 - provide for a fee that is in no way contingent on the outcome of the report.

The Tax Office would expect that, if the person undertaking the report is not provided with the access to the taxpayer's records or premises to the extent mentioned above, or is given an unduly short time relative to the volume of work to be undertaken, they should consider refusing to provide a report. This would be preferable to providing an unsatisfactory report or attempting to deal with its deficiencies by disclaiming responsibility for them.

The commissioning party should document at the commissioning time information that demonstrates that the valuation was commissioned in a transparent manner from an independent and suitably qualified person.

Documentation prepared in accordance with the generic information requirements of market valuation reports (→ p. 37) is likely to be sufficient for these purposes.

If a taxpayer commissions an external market valuation report or uses in-house valuation expertise and instructs the author to base their report on information supplied without further investigation, the taxpayer should include in the supporting documentation a statement detailing the reasonableness and objectiveness of the information supplied. The inclusion of such a statement should enable taxpayers to minimise their compliance costs and associated risks in cases where they are readily able to demonstrate the veracity of the information supplied. In particular, a taxpayer would need to highlight the reasons for using any information or assumptions that were the subject of a qualification in the report from the person undertaking the valuation.

Where a market valuation report relies on assumptions that in the opinion of the person undertaking the market valuation are likely to result in a valuation that does not reflect the true market value of the asset being valued, they would be expected to qualify the report to that effect. For example, where the taxpayer required a valuation based on a clearly inappropriate discount rate, the report should be qualified to reflect this distorting effect.

Documentation and record keeping

Key points

- Market valuation documentation requirements for the purposes of consolidation are generally based on the **generic documentation requirements of the ITAA**.
- As with decisions on market valuation processes, decisions on the extent of documentation require the taxpayer to exercise **commercial judgement**.
- Requirements for how long records must be kept are mandatory (the ITAA **five year rule**).

Existing provisions of the ITAA impose obligations on taxpayers to keep records of business transactions. The following provisions are of particular relevance to consolidation:

- Section 262A of the ITAA 1936 requires a taxpayer carrying on a business to keep records that record and explain all transactions and other acts that are relevant for any purpose of the 1936 Act.
- Section 121-20 of the ITAA 1997 requires taxpayers to keep records of every act, transaction, event or circumstance that can reasonably be expected to be relevant to working out whether they have made a capital gain or loss from a CGT event.

The extent of information and documentation that a taxpayer creates, obtains and keeps should depend on:

- the complexity of the market valuations involved
- the value of the asset being valued relative to other assets of the taxpayer, and
- the degree of judgement or subjectivity inherent in the market valuation process.

Taxpayers should exercise their commercial judgement to determine the level of information and documentation that is appropriate to their particular circumstances.

Taxpayers need to balance the risks associated with the extent to which market valuations are documented (i.e., relating to the consequences of non-compliance with the law and the likelihood of the valuations being challenged by the Tax Office) with the costs of substantiating their market valuations and any associated calculations.

Note that, while these information and documentation guidelines are generally not intended to be prescriptive, requirements relating to record keeping are based on the existing regulatory regime and are consequently mandatory.

Head company must retain records

The single entity rule imposes all the income tax obligations of subsidiary members on the head company, which is regarded as the taxpayer for all income tax purposes, including the obligations to keep records.

Period of record retention

Generally, a person must keep the records for five years after the person prepared or obtained them, or five years after the completion of the transaction or acts to which they relate (whichever is the later). In the context of consolidation the relevant transaction is not that which is undertaken at the joining time, but the eventual disposal of the asset by the consolidated group.

In addition, section 121-25 of the ITAA 1997 requires a taxpayer to retain records until the end of five years after it becomes certain that no CGT event (or no further CGT event) can happen.

For the purposes of consolidation, the taxpayer should retain all records relating to the determination of an asset or entity's market value, as well as documentation explaining the use of these values in calculating the cost for an asset brought into the consolidated group and an entity's available fraction for loss utilisation purposes. This is because:

- the amount treated as the cost for the asset is relevant for all future income tax purposes including the CGT, capital allowances and trading stock provisions, and
- the available fraction calculated for each bundle of losses transferred to the consolidated group by a joining entity determines the maximum amount of losses from that transferred bundle that can be used by the group in an income year.

For the purposes of consolidation, section 262A of the ITAA 1936 effectively requires taxpayers to retain records created in the process of ascertaining an asset's market value and the calculations that flow from this culminating in the amounts reported in the taxpayer's return.

For example, where a taxpayer ascertains the market value of an asset, the application of section 262A would require retention of the relevant documentation created or obtained in arriving at a range of values and determining which of those values is representative of the most likely value. The type of information and documentation that the Tax Office would expect to find supporting the determination of a market value is outlined below.

As a guiding principle, a market valuation report should contain sufficient detail to enable the market valuation procedure to be replicated and the valuation to be assessed by another qualified valuer.

Contemporaneous documentation

The Tax Office recommends that the best way to reduce the risk of its intervention is for taxpayers to create or obtain contemporaneous documentation supporting their market valuation processes. Whether calculated by the taxpayer or commissioned as part of an external market valuation, market valuations to determine the market value at the joining time should be contemporaneously documented in accordance with these guidelines.

Documentation is contemporaneous if it is existing or brought into existence at the time the taxpayer undertakes their market valuations or commences the process of commissioning an external market valuation report.

In practice this means that market valuations for the purposes of consolidation will need to be completed before the group's first consolidated return after the joining time. The relevant date for these market valuations (i.e. the date for which the asset's market value is ascertained) is the joining time.

Guidance on the use of existing valuations obtained for other purposes is provided under 'Use of existing valuations'. → p. 25

Generic information for market valuation reports

This section details the information and documentation that the Tax Office considers necessary for a taxpayer to provide in order to enable Tax Office staff to understand and check the accuracy of a market valuation.

The Tax Office acknowledges that the amount of information retained in order to satisfy the requirements of sections 262A of the ITAA 1936 and 121-20 of the ITAA 1997 will always depend on the circumstances of each particular case. However, it should be noted that the level of detail necessary to document the calculation of an asset's market value for the purposes of consolidation is such that the asset register entries envisaged by section 121-35 of the ITAA 1997 would usually not be sufficient – unless the taxpayer is using a short cut valuation option for the asset in question. → p. 18

As a general principle, the Tax Office would expect that a market valuation report for consolidation purposes would contain, as a minimum, no less information than a market valuation report prepared on similar commercial terms. The amount and nature of additional information provided will ultimately be a matter of judgement in each particular circumstance. In making this determination the person undertaking the valuation should consider how problematic are the valuation outcomes, the methodologies used, the assumptions relied upon and the information provided.

As a minimum, any market valuation report and supporting documentation should contain:

- a description of the asset valued that is sufficient to ensure the asset can be easily identified
- the purpose and context of the market valuation, and in particular the relevant provision under which the valuation is required
- a specific market value

-
- the date (or period) to which the market valuation relates, including the date the valuation was commenced and completed (to assist in establishing whether the market valuation was contemporaneous, or otherwise)
 - details of the methodologies employed, including:
 - the basis for determining any range of values and consequently the selection of a specific point within that range
 - sufficient details to enable the procedure to be replicated and an assessment of the valuation made, and
 - a statement of reasons as to why the methodologies were the most appropriate in the circumstances
 - information on which the market valuation is based, including:
 - details of the source of information created or obtained and the adequacy or otherwise of that information, and
 - a statement of the reliability of any prospective information used, such as financial forecasts
 - details of all assumptions relied on in the market valuation and the reasons for making the assumptions.

Reports by qualified valuers

If the report has been prepared by a qualified valuer (either in-house or external), it should also contain, in addition to the items listed above:

- the name of the person preparing the report
- the qualifications of the person preparing the report including details of any relevant:
 - work experience, including any specialisations
 - licences, registrations or authorities, and
 - memberships of professional associations
- the terms under which the person preparing the market valuation has been engaged and any instructions, either written or oral, they have received in relation to the valuation process
- details of any information that would assist the Tax Office to assess whether the valuer has prepared a report in an independent manner
- details and explanations of any disclaimer to the report
- an evaluation of the information provided for the purposes of commissioning the report, including:
 - the origin of the information used
 - details of the inquiries made by the valuer to establish reasonable grounds for believing that the information provided to them is accurate
 - for each assumption relied on, details of the actions undertaken by the valuer to ensure the assumption was correct

- the time or any other constraints under which the valuer worked, and
- a statement to the effect that the valuer believes the information used was adequate, complete and appropriate for assessing the market value of the asset – or if not adequate, complete and appropriate, the reasons why
- the signature of the person preparing the report and the date it was signed
- a ‘declaration of veracity’, which would generally include statements to the effect that:
 - the above report is a true, full and accurate account of the basis for determining the market value of the asset, and includes all relevant information, evaluations and assumptions, and
 - except to the extent indicated in the report, all information and explanations requested and required to prepare the report were available and used subject to satisfactory verification to the extent set out in the report.

Reports by external parties

If the report has been prepared by an external valuer, it should also contain, in addition to the items considered necessary for an in-house qualified valuer:

- a statement of the nature and details of the relationship that exists, has existed or is intended to exist at some future time, between the person preparing the market valuation report and the person commissioning the report
- details of any other information that would assist the Tax Office to assess the independence of the report’s author
- details and an explanation of any indemnities given in respect of the valuation
- the amount of the fee charged by or paid to the person undertaking the market valuation
- a statement specifically authorising the use of the report for the relevant taxation provision
- in the evaluation of the information provided to them by the person commissioning the report (→ ‘Reports by qualified valuers, p. 38) a statement as to whether the person undertaking the valuation was satisfied or dissatisfied with the quality of the information used for the report, including acknowledgment of any case of the taxpayer failing or refusing to make data or information available to the person commissioned to prepare the report;
(This information will assist the Tax Office to determine the accuracy or otherwise of the market valuation report. Failure to demonstrate the reliability of such information is likely to increase the compliance risk for the taxpayer.)
- in the ‘declaration of veracity’ (→ p. 39) a statement to the effect that payment was in no way contingent upon the outcome of the report.

In considering whether all the above information should be provided, and to what extent in a particular circumstance, a guiding principle should be whether the omission of the information is likely to lead to the integrity of the valuation being questioned. For example, where unusual market conditions prevailed at the time the valuation is applicable (e.g. the joining time), the omission from the report of this information would be likely to bring into question the integrity of the market valuation.

Commissioning of other experts

Where a person commissioned to prepare a market valuation report is not personally authoritative on a particular important matter, it would usually be necessary for them to retain an appropriate specialist to complete the valuation report.

Consequently, where another person is relied upon, the person commissioning the specialist report should ensure that it contains sufficient detail to establish reasonable grounds for any conclusion or opinion stated. It would be usual to expect that such details would enable the person commissioning the specialist report to establish to their satisfaction, and provide a statement to the effect that the specialist:

- is competent in the field
- has used assumptions and methodologies which seem reasonable and has drawn on source data that appears appropriate, and
- is independent of, and is perceived to be independent of, interested parties, or the specialist's lack of independence is clearly and prominently disclosed.

It would also be expected that any specialist's report would contain details similar to those required generally of reports by external parties.

Working papers

In practice, the working papers associated with the preparation of a market valuation report do not form part of the final report. However, the report should contain sufficient details to enable the market valuation procedure to be replicated and the valuation to be assessed by another qualified valuer.

If such information is contained in the working papers but not in the final report it would be prudent for a taxpayer to retain the working papers in addition to the final market valuation report. Where those working papers are the property of an external market valuation consultant, the taxpayer should ensure, as part of the commissioning process, that the external consultant is obliged to retain their working papers in accordance with these guidelines.