The importance of timing and methodology in tax valuations

15 March 2016

In brief

With the end of the tax year approaching for many taxpayers, the Administrative Appeals Tribunal has given us a timely reminder of the critical importance of having tax valuations done at the effective time that transactions occur, and using a valuer with the experience and knowledge to interpret the relevant facts of your circumstances.

In this article, we discuss the implications of the 'control premium' in tax valuation disputes, as recently stated in *Miley v Commissioner of Taxation* [2016] AATA 73.

In detail

On 15 February 2016, Deputy President Frost of the Administrative Appeals Tribunal (Tribunal) set aside a decision of the Commissioner of Taxation (Commissioner) and substituted it for a decision to reduce to nil the capital gains tax (CGT) resulting from a sale of shares held by one of the three shareholders in a company. The case turned on the value of the shares immediately before the sale being lower than the consideration that was received for the shares.

The taxpayer in this case, Mr Miley, was one of three equal shareholders in a private company. During the year ended 30 June 2008, the three shareholders sold their shares in the company to a single arm's length purchaser for a total consideration price of $17.7 million. As Mr Miley had held his shares for more than twelve months, the sale of his shares automatically entitled him to the fifty per cent CGT discount.

The issue in this case was whether Mr Miley was entitled to a further fifty per cent reduction (which would reduce any potential CGT liability to nil) under the 'maximum net asset value' (MNAV) test for holding assets with a total net asset value of less than $6 million immediately before the time of the sale. Broadly, the MNAV test requires determining the total market value of all assets held by an individual, less any relevant provisions or liabilities. The issue for determination before the Tribunal was the market value of the shares held by Mr Miley in the company, immediately before the sale.

In determining the market value of the shares, the Tribunal referred to the valuation principle that has been applied since the case of *Spencer v The Commonwealth* (1907) 5 CLR 418. The relevant inquiry is a hypothetical inquiry and involves considering:

> “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?”

The Commissioner’s primary argument was that the market value of Mr Miley’s shares in the company immediately before the sale was equal to the consideration received in respect of the shares (i.e. $5.9 million, being one third of $17.7 million).

The Tribunal noted however that while the consideration price is often a common starting point for valuation purposes, the hypothetical inquiry requires isolating the value of the shares from factors that are extraneous to the purpose for which such a value is to be ascertained.

In this case, the Tribunal held that the hypothetical inquiry must disregard any special circumstances surrounding the transaction, namely that the shares owned by the other two shareholders were also sold to the same purchaser, allowing the purchaser to obtain full control of the company for the total consideration of $17.7 million (giving rise to the ‘control premium’). If an arm’s length purchaser only purchased one-third of the shares in the company, it would not enjoy total control as the purchaser in this case did.

The Tribunal accepted the valuation expert briefed by Mr Miley who determined the market value of Mr Miley’s shares to be $4.91 million by applying a discount of 16.7 per cent to the sale price to account for the relative lack of control by Mr Miley as a result of owning just one-third of the total shares in the company. As a result, Mr Miley’s total net asset value did not exceed $6 million and he was entitled to the further fifty per cent reduction in any CGT liability (in this case resulting in a CGT liability of nil).

The Commissioner had until 14 March 2016 to file an appeal should he wish to do so.

The takeaway

This decision demonstrates the importance of precise valuation exercises in tax matters. It also demonstrates the importance of ensuring that any valuation exercise is based on a methodology that takes into account the relevant factual and taxation considerations that require solving.

Let’s talk

For a deeper discussion of how these issues might affect your business, please contact:

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