Valuing goodwill in a mining context

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In brief

The State Administrative Tribunal of Western Australia (WASAT) recently handed down an intriguing decision in *Placer Dome Inc (now an amalgamated entity named Barrick Gold Corporation) and Commissioner of State Revenue* [2015] WASAT 141. Broadly, the decision turned on the valuation evidence tendered by the parties who employed different methodologies. A critical outcome of the differing valuation techniques was the value ascribed to goodwill. If a significant proportion of legal goodwill existed among the assets acquired, there would have been no stamp duty liability (approximately A$54.8M) triggered by the transaction.

Broadly, the WASAT preferred the valuation evidence submitted by the Commissioner of State Revenue (Commissioner). Critically, the issue of allocating value to goodwill in a mining company has not been answered by the decision, as the WASAT was constrained by the evidence presented which was predicated on various inputs and primarily had an accounting focus.

In detail

The facts

- In 2006 Barrick Gold Corporation (Barrick) acquired 100 per cent of the shares in Placer Dome Inc. (PDI) (the Acquisition) for approximately US$10.4B. PDI was entitled to interests in 'land', in particular mining tenements, in Western Australia (WA) and various other countries.
- The Commissioner determined that the Acquisition had triggered the WA listed landholder provisions. Barrick's objection was unsuccessful and a review of the Commissioner's decision was sought in the WASAT.

The issue

- Broadly, the question of whether duty applied turned on whether the value of 'land' that PDI was entitled to (whether in WA or elsewhere) comprised 60 per cent or more of the value of all PDI's property (land rich ratio).

- Barrick asserted that significant goodwill had been acquired which meant the land rich ratio was not satisfied, and there was no WA stamp duty liability on the Acquisition.

The decision

The decision turns on the differing valuation techniques utilised by the parties, and the inputs and assumptions relied on by the different experts. The case is useful in providing an insight into valuation methodologies a Court or Tribunal will find persuasive but, in our view, does not address how to allocate value to intangible rights (e.g. goodwill) in a mining company.

This question remains important in duties law (despite most States and Territories moving to a 'landholder' model) given the preference of various Commissioners to utilise a 'top down' valuation approach where the remainder interest is ascribed to land. Further, the direct transfer of goodwill in an asset sale will also lead to a duty exposure in the mining States and Territories (i.e. WA, Northern Territory, Queensland and New South Wales). The approach taken will also no doubt have an impact on income tax, given the importance of valuation for non-resident capital gains tax.

Goodwill in mining companies

The leading authority regarding goodwill in Australia is the decision of the majority of the High Court of Australia in *Federal Commissioner of Taxation v Murry* [1998] HCA 42 (*Murry)*. The concepts developed in *Murry* were applied in *Commissioner of Territory Revenue v Alcan (NT) Alumina Pty Ltd* (2008) 156 NTR 1 (*Alcan)* where the Court of Appeal of the Northern Territory determined that a mining company could have substantial goodwill.

The majority of the High Court of Australia in *Murry* concluded that goodwill is property which has value. The majority also confirmed that goodwill attaches to a business as a whole and cannot be transferred separately from the business with which it is associated. The majority in *Murry* defined goodwill in terms of a legal right or privilege to conduct a business in substantially the same manner that has attracted custom to it in the past to illustrate that the Courts will protect the sources of goodwill of a business.

The majority recognised that goodwill may have separate sources, and that many of the sources of goodwill are neither property nor assets for accounting purposes. In particular, the majority said that manufacturing and distribution techniques, the efficient use of the assets of a business, superior management practices and good industrial relations with employees may be sources of goodwill.

The majority in *Murry* considered that a taxi business can have goodwill, even though the services that it provided were virtually indistinguishable from the taxi services of others. This is analogous to a mining company producing homogenous product. Similarly in *Alcan*, the majority regarded the identity of customers and whether the product sold is readily available at the same price elsewhere as irrelevant to whether legal goodwill exists.

In a profitable business, the value of goodwill may be measured by adopting the conventional accounting approach of finding the difference between the present value of the predicted earnings of the business (usually reflected by the purchase consideration) and the fair value (i.e. market value) of the identifiable net assets. Broadly, this is the approach employed by the valuation experts on behalf of Barrick who essentially conducted a discounted cash flow analysis drawing on forecast gold prices.

This valuation approach is consistent with *Commissioner of State Taxation v Nischu Pty Ltd* (1991) 4 WAR 437 which stands for the proposition that assets should be identified and valued on a separate basis. There appeared, however, to be a lack of substantive evidence to support a significant value of goodwill as a separate item of property. There was a lack of specific evidence focussing on the sources of goodwill (to satisfy *Murry* and *Alcan*) within PDI's operations to illustrate that Barrick acquired additional value to attract customers. Rather the goodwill figure was the remainder after other assets had been identified. The asset values were predicated on various assumptions and inputs. (The validity of various assumptions and inputs utilised by the valuation experts is open to debate and is beyond the scope of this update.)

It appears that contemporaneous evidence to support the balancing amounts for goodwill adopted by Barrick would have been helpful. This is a difficult burden for taxpayers to satisfy given the formulaic approach of valuations. It is clear that a disconnect arises for legal and accounting purposes as the valuations arguably have limited utility in assessing the market value of an amorphous asset such as goodwill. Essentially, an accounting based methodology will be insufficient to answer the legal question of whether goodwill resides within a business and how to allocate value to that goodwill.

Ultimately WASAT preferred the Commissioner's valuation evidence with a value allocated to interests in land that was closer to the deal value. The Commissioner essentially adopted a 'subtractive' or 'top down' approach where the total transaction value is reduced for the value of any 'non-land' assets (including goodwill) with the remainder being the value of the WA land interests. It is highly contentious as to whether this methodology delivers the true underlying value of the land as this methodology arguably leads to an inflated value being ascribed to interests in land. It is also far less likely to examine the sources of goodwill within a business to determine how those assets are used in combination to yield separate values for separate classes of assets.

Given the ongoing importance of valuation methodologies in resolving duty (and income tax) disputes, and the continuing relevance of the presence and value of intangible assets in a mining context it is hoped the Supreme Court of WA will be given an opportunity to provide clarity on the subject.

The takeaway

The decision illustrates several issues for taxpayers to consider (particularly in the resources industry):

- the importance of robust valuation evidence,
- the challenges implicit in valuing intangible assets of a business,
- the disconnect between legal and accounting definitions of goodwill,
- the importance of instructions to valuers and the resulting inputs that frame a valuation report.

Let's talk

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

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