Level 2
95 Pitt Street Sydney, NSW 2000
Telephone 02 8223 0000
Facsimile 02 8223 0077
Email tia@taxinstitute.com.au
Website www.taxinstitute.com.au
ABN 45 008 392 372

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Mr Mike Howard
Australian Taxation Office
PO Box 9990
Newcastle NSW 2300

Email: Michael.Howard@ato.gov.au

Dear Mr Howard

Draft A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination MSV 200X/1

The Taxation Institute of Australia ('Taxation Institute') is pleased to provide its comments in response to the draft *A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination* MSV 200X/1 ('MSV 200X/1') and draft *MSV 200X/1 Explanatory Statement* ('Explanatory Statement'). Our comments have been prepared by the Taxation Institute's GST Subcommittee (Appendix A).

As a preliminary note, we support and commend the efforts of the ATO in seeking to address the current uncertainties faced by taxpayers in respect of margin scheme valuations. There has been considerable ambiguity as to the consequences of a valuation not satisfying, in the Commissioner's view, the requirements set out in his margin scheme valuation determinations. We anticipate that the new determination will assist in breaking the deadlock for taxpayers who are engaged in prolonged disputes with the Commissioner over stalemate valuations.

However, we set out below a number of amendments which we think should be made to MSV 200X/1. There are also areas where further clarification should be provided.

1. Method 4: Substitution by the Commissioner

The most significant change brought into effect by MSV 200X/1 (as compared to its predecessors) is the availability of Method 4, which allows the Commissioner to obtain an approved valuation in circumstances where a valuation has not been produced by a vendor entity seeking to apply the margin scheme or the valuation produced is not an 'approved valuation' as determined by the Commissioner.

1.1 Notification by the Commissioner

Pursuant to clause 17 of MSV 200X/1, Method 4 is only applicable if:

(1) for the purposes of calculating the margin under subsection 75-10(3), a valuation has not been produced to the Commissioner or the valuation produced is not an approved valuation;
(2) the **Commissioner has provided a notification** to that effect to the vendor entity and advised that the vendor entity must produce an approved valuation to the Commissioner within 8 weeks;…

The Taxation Institute submits that MSV 200X/1 should require the Commissioner to include in his notification the reasons why he considers a valuation provided by a vendor entity is not an approved valuation under the determination.

This will provide the taxpayer with a meaningful basis on which to rectify a valuation within the requisite 8 week period. At present, the notification that the Commissioner must provide to the vendor entity, according to clause 17(2) merely states that "*the Commissioner has provided a notification to that effect*" [the valuation produced is not an approved valuation – refer clause 17(1)].

We also consider it appropriate that the Commissioner have regard to circumstances where it may be appropriate to issue the notification to both the vendor entity and the purchasing entity, for example, where the Commissioner knows that the purchaser entity obtained the valuation.

There is no requirement that the valuation be obtained by the vendor entity and, in circumstances where the relevant contract includes a GST escalation clause, the financial impact of the Commissioner applying Method 4 may well be borne by the purchaser entity.

The purchaser entity should, therefore, be made aware that the original valuation is not approved and be given the opportunity to obtain a complying valuation. If the Commissioner does not agree to notify both the vendor entity and the purchaser entity in these circumstances, then this is, at the very least, likely to be a significant consideration for the appropriate extension of the 8 week period, particularly where the vendor entity fails to promptly inform the purchaser entity that it has receive a notification from the Commissioner about the valuation not being an approved valuation.

Further, we submit that there should be some clarification as to the form of the notification that must be provided by the Commissioner; e.g. whether this notification must be in writing.

1.2 Method Chosen by the Commissioner

Pursuant to clause 18 of MSV 200X/1, the Commissioner may obtain a valuation using the equivalent of Method 1: valuation by a professional valuer (clause 13), Method 2: valuation based on the consideration provided by a purchaser in a contract of sale (clauses 14-15) or Method 3: State Government or Territory Government department valuation (clause 16).

There appears to be few guidelines as to which of Methods 1, 2 or 3 the Commissioner will consider appropriate in given circumstances. Relevantly, the Explanatory Statement states the following at paragraph 33:

> In choosing one of the alternative valuations under method 4, the Commissioner may take into account such factors as the need to provide a valuation in a timely manner and administrative costs associated with obtaining the valuation.

We submit that additional guidelines should be stipulated, within MSV 200X/1 and, in greater detail (possibly also by way of a practice statement), as to which method the Commissioner will adopt and on what basis. It is not, in our view, appropriate that the Commissioner be empowered by MSV 200X/1 to apply a method that is manifestly inappropriate in a given set of circumstances.

The lack of appropriate guidelines as to which method will be adopted by the Commissioner may lead to:

- outcomes that are not consistent with the objective of only taxing the value added to real property after 1 July 2000 or the relevant valuation date, as appropriate;
- a lack of consistency in the application of MSV 200X/1; and
- increased uncertainty for taxpayers.

For example, it would be inappropriate for a valuation under Method 2 (consideration provided by a purchaser in a contract of sale) to be adopted by the Commissioner in circumstances where the property was not acquired by the vendor entity in recent years. It is possible that the application of Method 2 may involve adopting as the value the consideration paid by a purchaser as far back as the 19th Century. Even in circumstances less extreme, the consideration method may be unlikely to reflect the value of property at 1 July 2000 (or the relevant valuation date), which is ultimately the object of the GST.

Further, it would be inequitable and inconsistent for the Commissioner to treat two vendor entities in a different manner where the circumstances of both parties are analogous. However, such an approach would be acceptable under MSV 200X/1, which provides no framework for the Commissioner in choosing which method to apply. As the determination, once finalised, is a legislative instrument which is binding on both the Commissioner and taxpayers, it is in our view imperative that it does not permit inconsistent approaches to alternate valuations.

The factors outlined in the Explanatory Statement in respect of time constraints and administrative costs to the Commissioner, while legitimate, should not compromise the fair and apt treatment of taxpayers who consider Method 1 (valuation by a professional valuer) to be more appropriate to their circumstances and who, pursuant to the self assessment system, have likely incurred costs and dedicated time, to the obtaining of a professional valuation. As obtaining a valuation will always involve time and cost, there is a patent risk that Methods 2 and 3 will be arbitrarily applied by the Commissioner, regardless of the circumstances.

In this event, considerations such as the time and cost to the Commissioner will be of little concern to any taxpayer that has elected to use Method 1 and has gone to considerable expense to obtain a valuation from a professional valuer, only to have this valuation be substituted by a consideration-based valuation by the Commissioner.

The Taxation Institute submits that where:

- the property was acquired by the vendor entity more than a significant number of years prior to the relevant valuation date say, 10 years; and

- the taxpayer has elected to use Method 1 and has obtained a valuation by a professional valuer that the Commissioner does not accept as an approved valuation,

any valuation substituted by the Commissioner should be obtained under Method 1.
Our view is that this approach will ensure greater consistency across all taxpayers seeking to apply the margin scheme and will mitigate the risk of anomalous outcomes.

1.3 Valuation Obtained by the Commissioner

MSV 200X/1 should require the Commissioner to produce a copy of any valuation he obtains under Method 4 to the vendor entity. This requirement is essential in order for taxpayers to be capable of ensuring that the Commissioner's valuation complies with the appropriate methodology.

1.4 Timing of Method 4 Valuation

Clause 22 of MSV 200X/1 states:

> Any alternate valuation must be obtained by the Commissioner before the expiration of 8 weeks from the date advised to the vendor entity by which an approved valuation was required to be produced to the Commissioner.

It is not clear on the face of the determination what the consequences will be in the event that the Commissioner does not obtain a valuation within the specified 8 week period. Where the vendor entity has provided a valuation to the Commissioner, will that valuation then be an approved valuation in the absence of the Commissioner taking relevant actions? This has the potential to be

an area of uncertainty.

We further submit that there is no reason why the Commissioner should be confined to obtaining his valuation within 8 weeks. This imposes an unnecessary fetter on his powers of administration, depending on the consequences for taxpayers in the event that a valuation is not obtained within the requisite period (which consequences are not clear on the face of MSV 200X/1). In any event, the strict application of the time limit has the potential to disadvantage all parties.

2. Method 2: Consideration

Clause 14 sets out the requirements for the making of an approved valuation based on contract price. These include the requirement that:

> (1) the valuation must be made by adopting as the value the consideration provided by a purchaser in a contract for the sale and purchase of the real property executed or exchanged before the valuation date.

It is unclear how this method will apply where the consideration provided did not include an amount of GST because the parties treated the sale as a GST-free supply of a going concern. We submit that MSV 200X/1 should specifically address the question of the value in these circumstances.

There is, in our view, a strong argument that the value is the GST-inclusive consideration, notwithstanding that the parties have agreed to apply the exemption available in the GST Act. Equally, if there are settlement adjustments pursuant to the contract, they should also be taken into account and canvassed in MSV 200X/1.

3. Prospective/retrospective application of MSV 200X/1

We note with reference to clause 4 of MSV 200X/1 that the Commissioner will be empowered to obtain valuations for "*supplies of property made **before or after** [commencement date]*" (emphasis added).

However, clause 3 indicates that the requirements for making valuations as set out in MSV 200X/1 will be of prospective application. Further, paragraph 7 of the Explanatory Statement states that **MSV 2000/1** and **MSV 2000/2** will continue to apply to supplies made prior to 1 December 2005, **MSV 2005/1** will continue to apply to supplies made on or after 17 March 2005 and before 1 December 2005, and so on. We are aware that there are a number of continuing valuation disputes in relation to valuations prepared with reference to MSV 2000/1 and MSV 2000/2.

We query how the Commissioner will apply Method 4, which restricts the available methodologies to those set out in MSV 200X/1, in circumstances where valuations have previously been obtained using the methods set out in previous determinations, e.g. "cost of completion" method for partly completed premises. Whilst the Explanatory Statement states at paragraph 6 that *"[the] requirement set out under method 4 do not displace the requirements set out in prior determinations..."*, we understand that Method 4, as it is currently drafted, will have that effect.

This degree of retrospectivity is inappropriate and inequitable where taxpayers have sought to comply with the Commissioner's own previous methodologies as published in:

- *A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination (No.1) 2000* (***MSV 2000/1***);
- *A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination (No.2) 2000* (***MSV 2000/2***);
- *A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination MSV 2005/1* (***MSV 2005/1***);

- *A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination MSV 2005/2* (***MSV 2005/2***); and

- *A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination MSV 2005/3* (***MSV 2005/3***).

Where the Commissioner has previously determined the methodology for obtaining a valuation in a previous period (i.e. prior to 1 December 2005), and taxpayers have made a bona fides effort to comply with those requirements, the Commissioner should not be empowered to obtain his own valuation using a different methodology.

We submit that any valuation obtained by the Commissioner in respect of supplies made prior to the commencement of MSV 200X/1 should be prepared with reference to the valuation requirements under the determination that was in force at the time of the supply.

4. Terminology

The Taxation Institute queries the use of a number of terms and expressions which have not been defined and which may lead to uncertainty for taxpayers.

4.1 Property valued on an 'as is' basis

We submit that the wording of clause 13 (5) requires clarification. While a brief explanation is provided at paragraphs 17 to 21 of the Explanatory Statement, we consider that the phrasing continues to be vague and unduly broad, particularly given that the terms 'as is' and 'adjustments' are undefined (see paragraph 17 of the Explanatory Statement). We note that there have been recent case developments that possibly impact the issue of the different meanings an application of the words "as is".

For example, the case of *Leichhardt Council* v *RTA* [2009] NSW LEC 3 recently looked at the implications for market valuation purposes of compulsorily acquired 'community land', being land that is usually zoned for open space. The issue in that case was whether the restriction on the sale of community land is a restriction of the kind that impacts the market valuation of the land. In the appeal to the NSW Court of Appeal, Chief Justice Spigelman found that when determining market value, the *statutory* restriction should not be taken into account. Where the restriction applies to all parties, for example, where restrictive zoning would apply to both the vendor and the purchaser of the property, the situation would likely be different. It follows, in our submission, that a market valuation on an "as is" basis may well be an area of considerable uncertainty, even for valuers.

Clause 13 (5), as it is currently drafted, distracts from the requirement at clause 13 (4) that the valuation comply with 'professional standards'. The breadth of the drafting may lead to contradictions in circumstances where adjustments should be made in the making of the valuation. For example, the term 'adjustment' may be taken to apply to calculations of interest, holding costs, profit margins and other factors that may rightly be taken into account in valuing a property.

In addition, we consider it is inappropriate at paragraph 17 of the Explanatory Statement to refer to "adjustments made to the interest, unit or lease". The concept of a valuer adjusting an interest, a unit or a lease is nonsensical. A valuer may *assume* that the property has been adjusted to a fully remediated condition and presumably it is this assumption that the Commissioner is intending to prevent. It would be more appropriate, then, to refer to a *"notional remediation made to the interest, unit or lease…".* This may communicate the Commissioner's intent more effectively and reduce the risk of confusion or misunderstanding.

Further, it is unclear how clause 13 (5) would apply in circumstances where no actual "adjustment" is made, but the entity requesting the valuation is unaware of some defect that exists in relation to the property. This point should be clarified as "problems" (e.g. contamination) that are not apparent need not be reflected in the valuation.

4.2 An interest, unit or lease that is 'derived'

Clause 9 of MSV 200X/1 states:

> If the taxable supply of real property that you make by selling a freehold interest in land or selling a stratum unit or granting or selling a long-term lease is not the same interest, unit or lease that existed at the valuation date, but was **derived** from an interest, unit or lease that was in existence at that date, the valuation must be made as follows…

The word 'derived' is not defined by MSV 200X/1.

We submit that there should be some clarification as to the meaning of the word 'derived' in this context. For example:

- does this refer exclusively to an interest, unit or lease where the underlying real property was sub-divided subsequent to the valuation date;
- does this also apply to multiple lots where, subsequent to the valuation date, titles were consolidated; and
- in what circumstances will the assignment of a long-term lease be derived from a long-term lease that existed at the valuation date?

4.3 "Commissioner may for good reason"

Clause 21 states:

> *If the valuation is not made within the time periods specified in clauses 20 and 21, the Commissioner may **for good reason** allow an additional period within which a valuation may be made.* (emphasis added)

We submit that the words "for good reason" impose an ambiguous and highly subjective standard that is not appropriate for a legislative instrument.

There are many instances where the Commissioner is called upon to exercise his discretion and it should be taken for granted that when he does so, it will be for good reason. This need not be stated explicitly. In light of this, MSV 200X/1 should either state clear parameters as to when the Commissioner will exercise his discretion to allow an additional period to obtain a valuation or none at all (and, possibly, be the subject of a practice statement). In any case, the words 'for good reason' should be removed.

5. Typographical error

We note that there is a typographical error in clause 21, which refers to 'clauses 20 and 21' where clearly it should refer to 'clauses 19 and 20'.

If you require any further information or assistance in respect of our submission, please contact Joan Roberts on 03 9611 0178 or the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis, on 02 8223 0011.

Yours faithfully

Joan Roberts
President

APPENDIX A

The Taxation Institute's GST Subcommittee

Gina Lazanas, Chair
Balazs Lazanas & Welch LLP, Sydney, NSW

Andrew Howe
Greenwoods & Freehills, Sydney, NSW

Lachlan Wolfers
KPMG, Sydney, NSW

Matthew Nicholls
Ernst Young, Adelaide, SA

Ian Jeffrey
PricewaterhouseCoopers, Melbourne, Vic

Andrew Nutman
Deloitte Touche Tohmatsu, Melbourne, Vic

Tim Grace
Owen Dixon Chambers, Melbourne, Vic

Craig Whatman
Pitcher Partners, Melbourne, Vic

John Oesterheld
Deloitte Touche Tohmatsu, Perth, WA

Melanie Baker
Allens Arthur Robinson, Melbourne, Vic

Michael Patane
Deloitte Touche Tohmatsu, Brisbane, Qld

Damian Welshe
Damian Welshe & Associates, Brisbane, Qld

Suzanne Kneen
Blake Dawson, Melbourne, Vic

Jeremy Geale
Owen Dixon Chambers, Melbourne, Vic