SOUTH AUSTRALIA

STATE TAXATION OFFICE

Stamp Duties **Circular No. 87**

VALUATIONS

This Circular is issued for the information of the members of professional bodies and persons lodging documents at the Stamp Duties Office for the assessment of stamp duty and reflects representations by and discussions with:-

- •Australian Society of CPA's.
- •The Institute of Chartered Accountants.
- •The Law Society of South Australia.
- •National Institute of Accountants.
- •The Taxation Institute of Australia.
- •Taxpayers Association of South Australia.

The following sets out in general terms the current methods and practices the Stamp Duties Office uses in valuing property of the description set out below for the purposes of determining the duty payable thereon.

This circular covers valuations with respect to:-

- real estate;
- shares;
- units in unit trust schemes;
- insurance policies;
- life interests;
- partnership interests;
- goodwill;
- leases;
- contracts for sale and purchase, and;
- businesses.

These are general principles within which each case will be examined on its own merits. On occasions it may be necessary to depart from these practices if warranted by the particular aspects of a case. This is in accordance with the philosophy outlined in the following quotation:

> "What is called a theory of appraisal is a systematic treatment of two problems that arise in the valuation of property. The first problem is to secure a definition of value acceptable for the purpose of the particular inquiry. The second problem is to determine the method by which quantum of this value is to be estimated."
>
> J C Bonbright, Valuation of Property, (McGraw Hill), 1937;10.

Section 60a(1) of the Stamp Duties Act, 1923, states:-

> "....a reference in this Act to the value of property conveyed or transferred is a reference to the market value of the property...."

The following practices are consistent with the dictum of William J in Abrahams v The Federal Commissioner of Taxation, (1944) 70 CLR 23, 29 where it was stated that market value is:-

> **"the price which a willing but not anxious vendor could reasonably expect to obtain and a hypothetical willing but not anxious purchaser could reasonably expect to have to pay ... if the vendor and purchaser had got together and agreed on a price in friendly negotiation ..."**

The Commissioner is given a discretion in Section 60a(2) to adopt the consideration for sale as being the value of the property conveyed or transferred unless it appears to the Commissioner that the consideration may be less than the market value of the property.

Section 60a(3) authorises the Commissioner to cause a valuation of the property to be made for assessment purposes where no evidence of the value of the property conveyed or transferred or comprising or forming part of the consideration for the conveyance is furnished to the Commissioner or the evidence so furnished is in his opinion unsatisfactory.

1. REAL ESTATE

Valuation and charges for making a valuation have been the subject matter of Stamp Duties Circular No. 27. For convenience the relevant portions of the circular are quoted below:

WHEN WILL A VALUATION BE REQUIRED

Where the parties are related either through a family group or through a corporate group a valuation **will be** required.

The transfer of portion of the land or a fractional interest in an existing parcel **will** require a valuation of the portion being conveyed.

A valuation is **not** required in cases where the consideration expressed in the document represents a full market price in the opinion of the parties who are unrelated and bona fide sellers and purchasers. In these cases the contracted and declared sale price will normally be accepted.

However, should the consideration or value declared be in the opinion of the Commissioner, unsatisfactory, a valuation may be undertaken.

> **Note:** The fee for a valuation will only be charged if the value determined by the valuer appointed by the Stamp Duties Office exceeds the value submitted by the taxpayer/lodging party by greater than 10% of the taxpayer's value.

TAXPAYER'S VALUATION

In cases where the taxpayer or his/her agent provide a recent valuation by a suitably qualified practitioner, that valuation will generally be used (subject to the Commissioner being satisfied) for the purpose of assessing duty.

A suitably qualified practitioner will, in the case of real estate, be a member of the Australian Institute of Valuers and Land Economists.

To be accepted by the Stamp Duties Office this valuation will need to be:-

no more than six months old at the time of lodging documentation for the opinion of the Commissioner of Stamps;

or

- made within six months from the date of the instrument.

Where the valuation is outside the periods referred to above it will be necessary for the valuer to certify that at the date of the sale and/or conveyance, the circumstances in relation to the property had not changed from the time that the valuation was performed.

ACCESS TO VALUATIONS

Where the Commissioner of Stamps appoints a valuer to undertake a valuation in respect of any property, the taxpayer may seek and be supplied with a copy of such valuation.

SOME COSTS TO BE PASSED ON

The Stamp Duties Office has been requested to pass on the cost of the valuation to the taxpayer in cases where the purchase price or value declared by the taxpayer or his/her agent is more than 10% below the market value determined by the valuer appointed by this Office.

It should be noted that where the value declared by the taxpayer or his/her agent or the consideration expressed in the transfer is within 10% of the valuation obtained by this Office **no charge will be made**.

It is therefore important for lodging parties to declare a realistic value for the property otherwise a valuation fee may be incurred.

AMOUNT OF CHARGE

Where the valuation fee is to be passed on, the actual cost incurred by the Stamp Duties Office will be charged to taxpayers.

The Valuer-General's charge for real property valuations is currently $100 per hour with a minimum charge of $50.

In the majority of real property valuations, where the Stamp Duties Office appoints the Valuer-General to determine a value "for stamp duty purposes", the charge is likely to be $50.

2. PRIVATE COMPANY SHARES

Due to the complexity of the subject only a broad outline is given here. In view of the assumptions that have to be made in share valuations, the professional advisers may compute the value of a share by any standard method of valuation, such as:-

- Net Asset Basis
- Earnings Basis
- Dividend Basis

When a share transfer instrument is lodged it is expected that the following documents will be furnished.

- Memorandum and Articles of Association. (The documents need not be furnished if the company has only one class of shares.)
- Profit and Loss Statements for three prior years.
- Balance Sheets for prior years, generally three years.
- A valuation report, if one has been done by a professional adviser.

This list is not exhaustive. The number of prior years in relation to which the financial statements are required will depend on:-

- Nature of the industry to which the company belongs.
- Position of this company in the industry.
- Whether the company is service-oriented or otherwise.
- Whether the company is capital intensive, labour intensive or is asset rich.
- Any other special circumstances.

It should be recognised that when a parcel of shares is transferred, the object of the share valuer should be to value the parcel as such, as a unit of property. For example, if a parcel of 1000 shares of XYZ Ltd is transferred, the valuer should not value one share of XYZ Ltd and then multiply that value by 1000 to arrive at the value of a parcel of 1000 shares. The reason is that the bundle of shares carries with it a certain synergistic positive or negative control value and it should be recognised. The other reason is that the property transferred is a bundle of 1000 XYZ shares *per se* and the valuer should only consider the hypothetical market where parcels consisting of 1000 shares are being sold. It would be an error in principle if he/she attempts to value it in a hypothetical market where individual shares are traded. If this latter route is taken it could lead to another serious flow; that is, there will be a deluge of shares in the individual share market which would shift the supply function, resulting in a diminished share value.

The following list, which again is not exhaustive, will be useful in computing the premiums and discounts mentioned above and the share valuation in general:-

- Size of the parcel in relation to all issued shares of that class.
- Voting powers attached to the parcel.
- The restriction upon the transfer of shares.
- The nature of management.
- History of the industry.
- Prospects of the industry.
- History of the company.
- Prospects of the position of the company.
- The profit earning capacity of the company.
- Yield on quoted shares in the industry.
- The risks involved.
- Return on purchase of the investment.
- Capital position of the company.
- The basis of value of assets.

- The amount of liabilities.
- The effect of inflation and recession.

The usual practice adopted by this Office is to exclude or add back non-commercial and extraordinary items (eg, directors' fees, salaries, interest and superannuation contributions) disclosed to determine the earnings of the company for a year. The average earnings over the past three years of income with appropriate weights to each year will yield the maintainable profit for the succeeding years. A capitalisation factor will then be applied to the maintainable profits to determine the value of the business of the company as a going concern. If a company has different trading arms it would be prudent to determine the going concern value of each of these divisions. This Office has no definite position on the allocation of weights, but weights in the ratio of 1:2:3 for the past three years' earnings will be acceptable in a rising market. If not a simple average should be sufficient. As far as the capitalisation factor, it would be acceptable if the long term Government Bond Rate, plus a percentage of 10% to 20% is used depending on circumstances. These rates will eliminate the adjustments on account of income tax paid or payable by the company.

The going concern value arrived at in this manner will include any goodwill disclosed or not disclosed in the accounts.

In certain instances, the asset value of the company will be considered when making the valuation. The going concern valuation envisages that there is no supervening insolvency or that there would be no significant curtailment of activities of the company leading to insolvency and that the assets of the enterprise would be continued to be kept in the same integrated form. But if it could be foreseen that an asset rich enterprise is no longer a going concern but a "losing" concern on account of a long history of losses or subnormal profits, the going concern valuation is inappropriate and an assets basis of valuation will be adopted.

3. PUBLIC COMPANY SHARES

a) Unlisted

Unless it can be shown that there is a regular market for such shares then similar practices to those outlined in Item 2 will be adopted.

If there is a regular market for such shares then a letter from the Secretary of the company listing the shares that have been traded recently, detailing the number, dates and price paid form the basis of the valuation.

b) Listed

In the case where the listed shares are being purchased, the closing price quoted by the Australian Stock Exchange on the day of the sale will be compared against the consideration paid for the shares to ensure the purchase price is "reasonable". If the transfer is for "no consideration" the average price quoted by the Exchange will be taken to represent market value.

4. UNITS IN UNIT TRUST SCHEMES

a) Unlisted - Public

If the Manager of the Unit Trust publishes a daily buy back price that price will usually be adopted. If no such price is published then those practices outlined in Item (c) below, will be adopted.

b) Listed - Public

Treated in the same manner as listed public company shares.

c) Units - Private

A unit trust is not a legal entity and therefore the valuation of a unit takes a different tack. A unit holder has a proportional interest in each and every asset which are the subject of the trust. When a unit is transferred there is a conveyance of undivided proportional interest in every asset subject to the trust. In determining the total value of the assets to which unit holders are entitled, a deduction should be made from the total value of all assets owned by the trust on account of the trustee's right of indemnity (which generally includes all debts incurred by the trustee, as a trustee in carrying out the business of the trust or incurred in his/her performance as a trustee). Undistributed profits or reserves of the trust or distributed profits or reserves of the trust but which are not drawn by the unit holders will not be taken as part of trustee's right of indemnity. However, loans given by the beneficiaries to the trust in their individual capacity will be taken as part of the trustee's right of indemnity.

A trading trust may also have goodwill which may not be disclosed in the accounts. The goodwill will be ascertained by determining the going concern value of the business of the trust in the manner set out at Item 2 and then deducting from the value arrived at the net asset value of the business of the trust.

5. LIFE INSURANCE POLICIES

A statement as to the surrender value of the life insurance policy from the insurance company which holds the policy is accepted by this Office in situations where the beneficial interest passes by assignment.

6. LIFE INTEREST AND REMAINDER INTEREST

Where a life interest or a remainder interest in property is to be conveyed, the value of the underlying property will be ascertained in accordance with the principles and practices outlined in this circular. The value of the interest passing will be determined with reference to tables produced by an actuary. For example:-

Value of life interest of 52 year old female
Property Value = $50,000
Life Tenant Factor = .75776 (from Actuarial tables)
Life Interest = $50,000 x .75776 = $37,888
Remainder Interest = $50,000 - $37,888 = $12,112.

7. PARTNERSHIP INTERESTS

Please refer to Circular No. 86.

8. GOODWILL

Goodwill that is sought to be valued is the business and site goodwill. Personal goodwill cannot be conveyed except when the person's services are contractually bound for a period of time.

Goodwill is paid for the super efficiency of a going concern. The quantum of goodwill is the excess of the value of the going concern over the net assets value of the enterprise. In a trading or manufacturing situation almost the entire excess could be attributed to site and business goodwill.

However, in the case of the service oriented industry (generally in law, accountancy, medical or other similar professions) the major portion of the excess could be due to personal goodwill. Invariably most of these professions are carried on as a partnership concern.

For a trial period this Office will apply the following method of determining goodwill of a service enterprise. If the name(s) of the partners are not associated with the trading name of a partnership, it is considered that the personal goodwill will be up to a maximum of 50% of the excess quantified. If the name(s) of the partners are associated with the trading name of the partnership the personal goodwill will be up to a maximum of 80% of the excess quantified.

Generally goodwill is computed by the capitalisation of maintainable profits, or by the capitalisation of super profits or by rule of thumb methods which use gross fees received, net income received, number of clients, number of articles sold, etc, each of which has peculiar merits. However, all these methods except the first one (that is the capitalisation of maintainable profits) involves using more than one variable which will not be conducive in arriving at a satisfactory figure for goodwill that will be acceptable to both the taxpayer and the State Taxation Office. It is on account of this factor that this Office seeks to adopt the maintainable profits approach for a trial period.

9. LEASES

On the assignment of a lease where there is no other property passing and it is not a part of a sale of a business or wider transaction and no consideration is paid, it will generally be accepted that the lease has no inherent value. However, in accordance with Section 71 of the Act a value must be declared in the instrument, albeit nominal.

If in any case it appears that there is a site value or a value by reason of its advantageous terms, then a valuation will be required.

10. CONTRACTS FOR SALE AND PURCHASE

On an assignment of a contract for sale and purchase of any property this Office will usually value the property on the amount of deposit paid. If the contract is an old contract then in addition to the amount of the deposit this Office will value the property having regard to any appreciation in the property since the date of the contract.

If a development approval or other advantage has enhanced the value of the property that is the subject of the contract then those matters are to be disclosed and will be considered in assessing the value of the property.

11. BUSINESSES

It is usual to expect to find that a business is made up of a number of separate items. In many cases those items include a leasehold interest in land, plant, fixtures and fittings, stock in trade and debtors. There are many other items making up a business including intangibles, such as business names, trademarks, copyrights and other forms of intellectual property.

In most cases if the parties are dealing with each other at arm's-length then the consideration being paid or given will generally be accepted as representing the appropriate value of the business. If there is any assumption of liability then it will be appropriate to add to the consideration actually paid the amount of the assumed liability.

Where stock in trade is involved either a certificate of a valuer as to the value of the stock on hand, at the date of the conveyance, or evidence that both parties have agreed to the value of the stock is required. The latter is usually provided by a letter or letters signed by all interested parties.

Goodwill is usually treated in the manner previously described.

In situations involving the conveyance of intellectual property it is generally accepted that the consideration being paid by the parties for the intellectual property represents its market value. If this Office is dissatisfied then a valuation of such property from an independent valuer who is familiar with the appropriate methods of valuation of that property will be required.

In respect of tenants' fixtures and fittings, again this Office will usually accept, in an arm's-length transaction, that a proper price is being paid by the purchaser. If this appears unsatisfactory, again a valuation by a suitable valuer is required.

12 October, 1993 COMMISSIONER OF STAMPS