THE MEANING OF 'MARKET VALUE' IN AUSTRALIA'S INCOME TAX ASSESSMENT ACT 1997

NICHOLAS AUGUSTINOS[1]

I INTRODUCTION

This paper examines the use of the term 'market value' in certain sections of Australia's *Income Tax Assessment Act 1997* (ITAA97). Although this term is used in a number of sections in the Act, the Act does not provide a sufficient definition of what the term actually means. The result is that the interpretation of the term is open to dispute between the Australian Taxation Office (ATO) and taxpayers, leading to uncertainty in the enforcement of Australian taxation law.

The paper focuses on the use of the term in the capital gains tax provisions (sections 110-25(2)(b) and 116-20(1)(b)), the trading stock provisions (sections 70-30 and 70-90) as well as in the application of the CGT small business relief concession in Division 152 (especially section 152-20(1)). It examines the guidance that might be obtained on the interpretation of the term from various court and Administrative Appeal Tribunal (AAT) decisions as well as from the ATO itself.

A number of questions arise. In determining 'market value', do we consider a seller's market or a buyer's market? Do we consider the group price which is set when a number of products are sold together or do we apply an individual product price? What about the retailer setting the price – do we take into account the price that might be offered by a new retailer entering

[1] Lecturer, The University of Notre Dame Australia School of Law, Sydney

the market or do we apply the price set by an established retailer? These are some of the questions which taxpayers have had to grapple with without clear guidance from the Act. This paper attempts to shed some light on these questions.

In doing so, the analysis conducted in this paper reveals that a significant disparity potentially arises between the hypothetical market context which established legal principle suggests should be applied to market value determinations and real world market scenarios faced by taxpayers. As shown by the court and tribunal decisions examined in this paper, inconsistency exists as to the extent to which market forces operating in the real world impact upon market value determinations. As a result, there is an absence of clear guidance from the courts and the AAT on a key issue – how market factors faced by taxpayers in the actual market in which they trade should feed into the assumptions underlying the hypothetical market by which market value determinations are made. This is the source of significant uncertainty and confusion for taxpayers. Accordingly, this paper argues for a clearer statement of principle from the courts and the AAT on the connection which should be made between the hypothetical market applied to market value determinations and the actual market faced by the taxpayer. The paper also points out that, in order for the courts and the AAT to be in a position to do so, it may be necessary for statutory valuation principles to be incorporated into the ITAA97.

II LEGISLATIVE CONTEXT

Section 110-25(2)(b) of the ITAA97 concerns the first element of cost base of a CGT asset and the way in which that element is determined when property instead of money is given in

order to acquire the relevant asset. According to the section, one must work out the market value of that property at the time of acquisition.

Section 116-20(1)(b) concerns the determination of the capital proceeds received by a taxpayer for a CGT event when property instead of money is received. According to the section, one must work out the market value of that property at the time of the CGT event.

In both instances, the sections envisage that the relevant property that is given or received has a monetary value to be determined as if that property had been traded on a market applicable to that property at the time of acquisition or at the time of the CGT event. No guidance is given in the legislation as to the features of that market.

Section 70-30 triggers a notional transaction for the taxpayer when that taxpayer starts to hold as trading stock an item that the taxpayer already owns. Under this notional transaction, the taxpayer is treated as if, just before the item became trading stock, the taxpayer had sold the item to someone else (at arm's length) and immediately bought it back for its cost or market value (whichever the taxpayer elects). This monetary amount is normally a general deduction under section 8-1 as an outgoing in connection with acquiring trading stock. The amount is also taken into account in working out the item's cost for the purposes of section 70-45 (which concerns valuing trading stock at the end of the income year).

Section 70-90 specifies that, if a taxpayer disposes of an item of trading stock outside the ordinary course of business that the taxpayer is carrying on and of which the item is an asset,

then the assessable income of the taxpayer includes the market value of the item on the day of disposal.

Once again, under the abovementioned trading stock provisions, it is envisaged that, at the time of holding the relevant item as trading stock or at the time of disposal, a monetary value for the item of trading stock is determined as if the item had been traded on a market. The characteristics of that market are not specified.

Finally, some mention should also be made of the application of the CGT small business relief concession in Division 152. Under section 152-10(1)(c)(ii), a capital gain which a taxpayer makes in respect of the occurrence of CGT event in relation to a CGT asset of the taxpayer, may be disregarded if the taxpayer satisfies the maximum net asset value test. By means of section 152-20(1), the sum of the market values of the assets of the taxpayer is taken into account when conducting the test. Despite the fact that the taxpayer does not actually dispose of or exchange any assets, the application of the test involves some consideration of the value the taxpayer would have received if the taxpayer's assets had been individually traded on a market.

From the above discussion it can be seen that it is only in the case of the operation of section 70-90 that a possibility exists of a monetary price being received in connection with an actual sale. According to Marks, in determining whether that monetary price was at market value, the relevant enquiry will be to determine the extent to which the actual circumstances underlying the transaction conform to the hypothetical market context traditionally applied by

the courts to determine market value. In particular, it will be necessary to determine whether the seller and buyer were willing, not anxious and properly informed arm's length parties.[2]

In the case of the operation of all the other sections mentioned above, no monetary price as such is received. Either property is exchanged for property (sections 110-25(2)(b) and 116-20(1)(b)) or the taxpayer maintains ownership of the relevant property and no actual exchange takes place (sections 70-30 and 152-20(1)). Nevertheless, despite the absence of some monetary price, the relevant sections call for an assessment to be made of that property's market value. As mentioned above, this presupposes that some assessment be made as to the monetary price that would have been received had the property been traded (notionally) on some form of market. The precise terms of the operation of that market are not specified. According to Marks, in this instance, it may be useful to consider the price at which that asset or a comparable asset was sold either before or after the relevant date in an arm's length dealing. Marks further specifies that, unless there are exceptional circumstances, such a sale price will be a good indicator of market value in the hypothetical market place traditionally applied by the courts to determine market value.[3] This conclusion has been supported by a number of cases.[4]

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[2] Bernard Marks, 'Valuation Principles in the Income Tax Assessment Act' (1996) 12 *Bond Law Review* 114, 130.

[3] Ibid.

[4] *Syttadel and Holdings Pty Ltd v Commissioner of Taxation* [2011] AATA 589; *McDonald v The Deputy Federal Commissioner of Land Tax (NSW)* (1915) 20 CLR 231, 238; *Cordelia Holdings Pty Ltd v Newkey Investments Pty Ltd* [2004] FCAFC 48, [128]; *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security* [1987] AATA 73, [31]; *Psarreas v Secretary, Department of Families, Community Services and Indigenous Affairs and Anor* [2006] AATA 670, [27]; *Kirkovski v Secretary, Department of Family and Community Services* [2004] FCA 790, [8]; *Brockhoff v Secretary, Department of Family and Community Services* [2002] AATA 234, [26]; *Orica Ltd v Commissioner of Taxation* [2010] FCA 197.

The next section of this paper will examine how the abovementioned 'gaps' in the legislation are filled in by the courts. In particular, it will examine how the courts determine the general features of the hypothetical market in which the notional trades referred to above are considered to have occurred.

III GENERAL PRINCIPLES

Although Marks conducts an extensive examination of the concept of 'market value' and the factors which make up the market place in the context of the 1996 (pre re-write) version of the Income Tax Assessment Act, it is necessary for the purposes of this paper to provide a summary of the applicable general principles underlying the interpretation and application of this concept in tax legislation. The summary is useful in that it serves to highlight one of the key points made in this paper, namely, the absence of clear guidance on the connections to be made between actual markets in which taxpayers operate and the assumptions underlying the 'market value' hypothetical.

The relevant question to be asked in determining the market value of an asset is '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?'[5] This was expanded on by Isaacs J who stated that:

> to arrive at the value of the land at that date, we have… to suppose it sold then, not by means of a forced sale, but by voluntary bargaining between the plaintiff and a purchaser willing to trade, but neither of them so anxious to do so that he would overlook any ordinary business consideration. We must further suppose both to be perfectly acquainted with the land and cognisant of all circumstances which might affect its value, either advantageously or prejudicially, including its situation, character, quality, proximity to conveniences or

[5] *Spencer v the Commonwealth of Australia* (1907) 5 CLR 418, 432.

> inconveniences, its surrounding features, the then present demand for land, and the likelihood as then appearing to persons best capable of forming an opinion, of a rise or fall for what reasons so ever in the amount which one would otherwise be willing to fix as to the value of the property.[6]

It appears then that the hypothetical market context to be applied to the determination of market value involves a notional one to one transaction between a single buyer and a single seller. This principle is not only confirmed by *Spencer*. In the High Court case of *Abrahams v FCT* it was held 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'.[7] Similarly, in *Case 2/99* the AAT held that the best evidence of market value was what parties dealing at arm's length, at the conclusion of business negotiations, have themselves agreed upon.[8]

The value of the asset must be determined by considering its optimal value, where the asset is used for its 'highest and best use'. This principle has been confirmed in a number of case and tribunal decisions.[9]

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[6] Ibid 441.

[7] (1944) 70 CLR 23, 29 (Williams J).

[8] 99 ATC 108, 132.

[9] *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security* [1987] AATA 73; *Marion Elizabeth Collis v Federal Commissioner of Taxation* 96 ATC 4831; *Hustlers Pty Ltd and Anor v The Valuer-General* (1967) 14 LGRA 269.

The result of these considerations is that the actual sale price may not necessarily inform the market value of the asset where there is a disparity in the bargaining power of the buyer and seller, or where the asset is being valued considering a use other than its highest and best use.[10]

When there are buyers who are willing to pay more for an asset than its intrinsic value there is the issue as to how to deal with these special buyers. The value which they are willing to pay includes some 'special value' which is the additional value a purchaser is prepared to pay and may reflect many factors including economies of scale, reduction in competition, securing of a source of supply or outlet for products and additional value which is unique to the purchaser.[11]

How to deal with these purchasers in Australia is not entirely clear. One decision held that all possible purchasers be taken into account, even a purchaser prepared for his own reasons to pay a fancy price.[12] This is a similar position to that reached in the UK and Canada.[13]

According to Marks[14], an Australian court would both quickly and decisively recognise that the exclusion of special market value in the hypothetical market test is an economic paradox and a contradiction in terms. A question arises, however, as to whether the purchaser who pursues the special market value would make a bid which reflects that complete value or

[10] This issue is explored in further detail below in the section titled 'Scenarios for Consideration'.

[11] Marks, above n 2, 135.

[12] *Brisbane Water County Council v Commr of Stamp Duties* (NSW) 80 ATC 4051, 4054.

[13] Marks, above n 2, 135.

[14] Ibid 160.

whether he or she would bid just enough to outbid those interested purchasers for whom the asset had no special value. Marks points out that the 'one more bid' contention on the part of the special purchaser has been considered but rejected in both taxation and compulsory acquisition cases.[15]

These then are the key assumptions underlying the hypothetical market which is applied by courts to market value determinations. It is apparent, however, that these assumptions may have no grounding whatsoever in the actual real world markets in which taxpayers operate. Marks confirms that in the hypothetical market place, there is no presumption that there actually exist any willing sellers or buyers.[16] The question therefore arises - does the construction and application of this hypothetical market place allow for any input from the real world of the taxpayer?

It is submitted that the answer to this question is not entirely evident from the cases. Various principles have been stated in the cases but these do not draw a clear picture of the connections to be made between actual markets and the market value hypothetical.

Firstly, in *Commissioner of State Revenue (Vic) v Pioneer Concrete (Vic) Pty Ltd*[17] it was suggested that, where a market exists for an asset, that market is widely considered to constitute the best evidence of market value of the asset. If there is no market for the asset being valued, the courts have held that the valuer is to develop a hypothetical market. This hypothetical market will not have any of the constraints on sale which may exist on an asset

[15] Ibid 158.

[16] Ibid 124.

[17] [2002] HCA 43,44.

for which no actual market exists. This case therefore suggests that we look first to the actual market faced by the taxpayer for guidance as to market value. This approach is also supported by *BSC Footwear Ltd v Ridgway* 1972 AC 544 where the House of Lords held that 'market value' meant the price at which the stock could be expected to be sold in the market in which the trader sold; in the case of a retail trade that market must be the retail market. There is lack of clarity, however, as to the next step to be made after considering this actual market. Are we somehow called upon to 'graft' onto that existing market the various hypothetical assumptions mentioned above and to make a theoretical market value determination?

Secondly, prima facie it would appear that the *Spencer* assumptions establish a very narrow hypothetical market which does not bear much similarity with the wide and general real world markets in which many taxpayers operate. This understanding, however, is countered by *Brisbane Water County Council v Commissioner of Stamp Duties* (NSW) where it was held that market value is 'the best price which may reasonably be obtained for the property to be valued if sold in the general market'.[18] We are called upon to apply a wide and general market rather than a specialised market in which the best possible price might be limited. This understanding is also supported by Marks who points out that the hypothetical market place assumes that the seller will take all reasonable steps to attract as much competition as possible and will consider the most appropriate method of sale, such as auction or private sale.[19] Whilst this helps to shed further light on the circumstances applying on the demand side of the market, the supply side of the market is left unclear. Are we entitled to consider the possibility of a number of sellers in the market chasing a few purchasers?

[18] 80 ATC 4051, 4054.

[19] Marks, above n 2, 126.

Marks in fact suggests that the demand side of the market will be consistent with real world demand. This understanding is supported by the UK case of *Estate of Lady Fox v IR Commrs* [1994] STC 360 where Hoffman LJ held that, while the hypothetical seller was anonymous the 'hypothetical buyer is slightly less anonymous' and that he 'reflects reality in that he embodies whatever was actually the demand for that property at the relevant time'.[20] As will be shown below in the section titled 'Scenarios for Consideration', this understanding has not been consistently applied in Australian cases.

The connections which apply between the hypothetical market and the taxpayer's actual market were also considered by the AAT in the case of *NT1997/305 v Commissioner of Taxation*.[21] Senior Member Block conducted an examination of relevant authorities including the cases of *Inland Revenue NZ v Edge* (1956) 11 ATD 91, *Case J43 9 T.B.R.D.* (Commonwealth Taxation Board of Review No. 1), and *Charrington & Co Ltd v Wooder* (1914) AC 71. Based on these authorities, Senior Member Block applied two key principles to the market value determination.[22] Firstly, the appropriate market was the market in which the goods would normally be sold. Secondly, market value was to be determined in the light of the circumstances under which a particular sale takes place. Once again, the application of these principles suggests that real world market factors do have a role to play in the hypothetical market exercise conducted by the courts when determining market value. Whilst this role is asserted in general terms, the precise nature of the role is left unclear.

[20] Discussed in Marks, above n 2, 131.

[21] [1999] AATA 130

[22] Ibid [21]-[22].

This view is also supported by comments made in the Explanatory Memorandum to the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002*. In paragraph 10.77 of that Memorandum it is pointed out that, in working out market value, the courts will make appropriate assumptions about the market in question. These assumptions can be affected by the actual transaction under consideration. For example a large volume of goods sold could be expected to attract a discount. Each item would have a lower market value in such a situation than if it had been sold alone. Apart from this example, however, the Memorandum does not provide much detail on how circumstances underlying actual transactions under consideration will impact upon the hypothetical market assumptions.

We therefore have limited guidance from Parliament, the courts and the AAT as to how real world market factors impacting on taxpayers feed into the hypothetical market assumptions which underlie market value determinations. As will be shown below in the section titled 'Scenarios for Consideration', this understanding becomes particularly apparent when Australian case authority is examined in the context of certain specific real world market scenarios.

The final point to be made in this section of the paper concerns the jurisprudential origins and applications of the abovementioned general principles concerning the determination of market value. The *Spencer* case concerned the compulsory acquisition of property by government. The test in *Spencer* has also been applied in cases of state probate and succession duty, federal estate duty, land tax, and has long since been assumed to apply to the

valuation of property for state stamp duties.[23]It has also been applied in cases concerning the application of assets tests in the context of social security and pension entitlements.[24]As noted by Marks, the courts have intermixed valuation precedents from a variety of statutes into a single body of valuation jurisprudence, regardless of whether the relevant term has been 'value' or whether it has been qualified by the terms 'market', 'fair market' or 'open market'.[25] Principles derived from statutory interpretation conducted by the courts of a number of different statutes have all been stirred together in the same pot. Given, however, the confusion which this situation has generated for taxpayers, it may be necessary for clear and separate statutory valuation principles to be incorporated into the ITAA97.

IV VIEW OF THE AUSTRALIAN TAXATION OFFICE

Please refer to the ATO's website.[26] Some comments need to be made on the views expressed by the ATO.

Firstly, in its commentary under the heading 'Valuation Methods', the ATO confirms that market value must be assessed 'on the basis of the highest and best use of the asset as recognised in the market'. This comment suggests that the demand for the highest and best use is not a mere theoretical demand that is taken into account in the determination of market

[23] Marks, above n 2, 121.

[24] *Re Jack Woodhouse and Joyce Woodhouse v Secretary Department of Social Security* [1987] AATA 73; *Brockhoff v Secretary, Department of Family and Community Services* [2002] AATA 234; *Kirkovsky v Secretary Department of Family and Community Services* [2004] FCA 790; *Psarreas v Secretary Department of Families, Community Services and Indigenous Affairs and Anor* [2006] AATA 670; *Evans v Secretary Department of Social Security* [1993] AATA 497; *Blaszczyk v Secretary Department of Family and Community Services* [2005] AATA 1224.

[25] Marks, above n 2, 118.

[26] Australian Taxation Office *Market Valuation for Tax Purposes* (24 August 2012) < http://www.ato.gov.au/General/Capital-gains-tax/In-detail/Calculating-a-capital-gain-or-loss/Market-valuation-for-tax-purposes/ >

value in a hypothetical market. There must be actual demand for the highest and best use in order for it to be reflected in market value. This point is discussed in further detail below in the section titled 'Scenarios for Consideration'.

Secondly, the points made by the ATO under the heading 'Special Value' appear to conflict with those made above concerning special purchasers. According to the ATO, if a special value is known and available only to one potential buyer and not known or available to the wider market, it will not be reflected in market value. This appears to be an acceptance of the 'one more bid' approach mentioned above in connection with special purchasers, which Marks confirms has been rejected by case authority. It will also be shown below that even if one special value buyer is assumed to exist in the hypothetical market, the seller would hold out and would not sell to that buyer until an offer was made which reflected the special value.[27]

Thirdly, under the heading 'Prospective Market Value' the ATO points out that, because of the effect of economic fluctuations and other market changes, it does not rule prospectively on market value if there is no reliable method for approximating the market value at the future time. The commentary under this heading in fact makes clear that the ATO makes a determination after the event giving rise to the market value has occurred. The commentary suggests that this post event determination will take into account the effect of any underlying economic fluctuations. As will be shown in the discussion below in the section titled 'Scenarios for Consideration', this approach potentially conflicts with case authority

[27] Refer to discussion of *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security* [1987] AATA 73 in section titled 'Scenarios for Consideration'.

suggesting that market value determinations are to be made on the basis of a stable market in which major economic fluctuations in the economy are ignored.

Finally, the comments made by the ATO under the heading 'Who May Undertake a Market Valuation?' confirm that the ATO envisages that, except for the most straightforward valuation processes, the taxpayer will need to utilise the services of experienced valuation experts when making market value submissions, a process that imposes significant administrative cost on the taxpayer.

V SCENARIOS FOR CONSIDERATION

In the discussion above under the heading 'Legislative Context' it was pointed out that the specific sections of the ITAA97 which are the focus of this paper call for market value determinations to be made following an actual or notional trade on a 'market'. The characteristics of that market and its general relationship to the real world market faced by the taxpayer were considered above under 'General Principles'. The next part of this paper will examine the likely determinations of market value to be made when the real world market in which the taxpayer operates is characterised by certain specific scenarios.

The first scenario is that of a 'buyer's market'. Such a market would exist when there are many sellers willing to sell the property but few willing buyers. Should this real world feature of the market be allowed to impact upon the determination of market value?

The second scenario is similar to the first but considers the reverse side of the coin – a 'seller's market'. This would be one where there are few sellers willing to sell but many

willing buyers. Does the concept of 'market value', as applied by the courts and the AAT, take into account this supply/demand equation?

The third scenario considers the question of how market value is to be determined when in the real world applicable to the taxpayer the relevant property is ordinarily traded on a 'group discount' basis. Do we apply the discounted group price in determining market value or do we set an individual product price which does not take into account the volume discount?

The fourth scenario examines the final question raised in the introduction to this paper – should the identity of the seller (whether an established market player or new seller keen to enter a market) be allowed to impact upon the market value determination?

A *Scenarios 1 & 2 – Buyer's Market/Seller's Market*

Ordinarily, the market price of an item reflects the price point at which demand meets supply. Therefore, one would expect a higher market value to apply in a seller's market and a lower market value to apply in a buyer's market.

There is, however, conflicting authority on the question of whether effect should be given to the interplay of real world market supply and demand forces when determining market value.

On the one hand, Isaacs J's comment in *Spencer* refers to the 'then present demand for land'.[28] This implicitly suggests that the contemporaneous state of demand at the time of valuation should be taken into consideration when determining market value. This view is

[28] (1907) 5 CLR 418, 441.

also supported by the *Estate of Lady Fox* case referred to by Marks.[29] In addition, cases such as *BSC Footwear*, *Edge* and *NT1997/305* all suggest that market value is to be determined in light of the particular circumstances under which a particular sale takes place. On the basis of these authorities one could conclude that if the normal market in which the taxpayer would trade the relevant asset is affected by market factors such as those pertaining to a buyer's market or to a seller's market, then these factors are to be given effect in the market value determination.

On the other hand, it would appear that these understandings were not applied by the AAT in the case of *BHP Australia Coal v Federal Commissioner of Taxation*.[30] In that case, the AAT was required to determine the market value of the housing fringe benefits provided by the taxpayer to its employees. The taxpayer provided housing for its mining workers in a variety of towns, including that of Emerald. The AAT agreed with the taxpayer that in Emerald, normal demand conditions for housing did not exist as a result of the electrification of the railway and the construction of the TAFE College. Accordingly, the AAT found that, due to these factors, rental market demand in Emerald was temporary inflated and consequently disregarded market prices when determining the market value of the housing fringe benefit.[31] Figures from markets where normal supply and demand conditions were in operation were applied.[32]

[29] Marks, above n 2, 131.

[30] [1993] AATA 156.

[31] Ibid [25].

[32] Ibid [28].

This approach was also followed in the AAT decision of *Marion Elizabeth Collis v Federal Commissioner of Taxation*.[33] In that case it was suggested that where anxious prospective purchasers are in heated competition, leading to an inflated result, then this should be disregarded when determining market value of the relevant asset. Compelling evidence of the existence of such a situation, however, is required.[34]

It would appear then that there is no clear direction from the courts/AAT as to the weight to be given to the contemporaneous state of demand and supply for a particular asset when determining its market value. It is submitted, however, that there may be a way in which the abovementioned apparently conflicting decisions might be reconciled. This becomes apparent when one considers the NSW Court of Appeal decision in *MMAL Rentals v Bernard John Bruning*.[35]

It was mentioned above in the discussion on 'General Principles' that the valuation jurisprudence applying to the interpretation of market value in the ITAA is derived from a variety of statutory contexts where differences in wording such as 'market value' and 'fair market value' have been glossed over. In *MMAL Rentals*, however, the NSW Court of Appeal drew a distinction between the concepts of 'market value' and 'fair market value'. That case concerned the interpretation of a contract under which the majority shareholder in a car rental business could exercise a right in certain circumstances to purchase the shares of the minority shareholder for 'fair market value'. In making this distinction, the court implicitly acknowledged that 'market value' may reflect the effect of certain market factors

[33] 96 ATC 4831

[34] Ibid 4843.

[35] [2004] NSWCA 451

such as whether a particular asset is thinly traded or the effect of market distortions, whilst such factors would not be taken into account when determining 'fair market value'.[36] Accordingly, the case suggests that whilst the operation of a buyer's market or seller's market should be taken into account when determining 'market value', such factors should perhaps be ignored in the determination of 'fair market value'. On the basis of this approach, one could perhaps argue that the AAT's thinking in *BHP Australia Coal Limited* and in *Collis* reflected a 'fair market value' interpretation rather than a 'market value' interpretation.

A qualification needs to be made, however, to the understanding that existing market demand and supply forces should be given effect in determining 'market value'. What if all buyers are not aware of the asset's highest and best use and consequently, the price set in the market place does not reflect the asset's optimal value? Would a court intervene in this instance to set a value which reflects a hypothetical market whereby all buyers are fully informed? The High Court case of *Marks and Others v GIO Australia Holdings Limited and Others* suggests that a court should intervene in this way.[37]

This is also confirmed by the AAT decision in *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security*.[38] That case concerned the value to be placed on land held by aged pensioners for the purposes of the application of the assets test under the Social Security Act 1947. The pensioners had in fact gone "to market" and had attempted to sell the land by public auction. They refused to sell the land, however, as they did not receive

[36] Ibid [57]-[58].

[37] (1998) 196 CLR 494, 514 (McHugh, Hayne and Callinan JJ).

[38] [1987] AATA 73.

an offer which was anywhere near the valuation which the government[39] had placed on their land for the purpose of the assets test. Various offers and bids were made but the AAT found that the highest of these did not represent the 'market value' of the land.[40]

So what did the AAT find was the market value of the land? In setting the market value, the AAT relied on the theoretical market constructed by the ATO's valuation expert. That theoretical market was based on the ATO's understanding of the highest and best use of the land (a multi-dwelling development) and the existence of a willing but not anxious seller who is not forced to sell but who can hold on and negotiate with an interested buyer so that buyer in fact ends up making an offer which approaches the value reflected by the highest and best use of the land. The AAT in fact ignored the outcome suggested by actual demand forces operating in the relevant real estate market at the time and instead applied a theoretical demand (based on an understanding of the highest and best use) to set the market value, irrespective of whether that theoretical demand bore any connection with actual demand.[41] The AAT further concluded that demand is not required in order to determine a market value.[42]

This conclusion, however, is contradicted by the Federal Court decision in *Marion Elizabeth Collis v Federal Commissioner of Taxation*.[43] In that case, two adjacent blocks of land were

[39] It is interesting to note that in this case The Department of Social Security submitted valuation evidence utilising the services of an ATO valuer.

[40] *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security* [1987] AATA 73 [33].

[41] Ibid [23].

[42] Ibid [32].

[43] 96 ATC 4831.

sold by the taxpayer to the same purchaser under two separate contracts. A question arose as to whether the price set for one of the blocks of land reflected an arm's length transaction and the Commissioner applied the former section 26AAA ITAA36. The Federal Court found that a consideration of the block's highest and best use would take into account the special development potentialities that would come into play if the block was amalgamated with the adjacent block. The Federal Court further found that in applying such a consideration to the determination of the block's market value, there had to be evidence of the existence of demand for such a use in that area at that time.[44] In affirming this principle, the court applied the case of *Hustlers Pty Ltd and Anor v The Valuer-General* (1967) 14 LGRA 269 where it was held that there needed to be actual demand in existence for an asset's special potentialities, if such potentialities were to be taken into account in determining the asset's market value.[45]

There is therefore a contradiction in the case authorities as to the necessary connection to be made between real world market demand and the theoretical demand for highest and best use to be applied when determining market value. Given that *Collis* is a Federal Court decision, it would override the conclusion drawn by the AAT in *Woodhouse*.

B Scenario 3 – Group Price/Individual Product Price

There are conflicting views on how market value is determined when the seller has the option of trading the relevant property on a group basis.

[44] Ibid 4832.

[45] Ibid 4841.

According to Marks, 'the hypothetical market place assumes that the particular asset will be sold in the best possible way, that is, to obtain the best price for the seller. Thus two or more items may be sold either together or separately to ensure the best price'.[46] If the group sale does not secure the best price for the individual item, then in Marks' view the item's market value will not reflect the group discount price.[47]

This understanding is contradicted by the Explanatory Memorandum to the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002*. In paragraph 10.77 of that Memorandum it is stated that the assumptions made by a court when determining market value would be affected by the actual transaction under consideration. Accordingly, a large volume of goods sold could be expected to attract a discount. Each item would have a lower market value in such a situation than if it had been sold alone. This view is also supported by the AAT case of *NT 1997/305*.

C Scenario 4 – Identity of Seller – New Entrant or Established Participant?

Where one of the market participants is willing to lower the price of the item it is selling into the market in order to increase its market share, that participant should be regarded as a 'special value' participant and the comments made above under 'General Principles' concerning the determination of market value in markets involving such participants would

[46] Marks, above n 2, 125.

[47] Ibid.

apply. Marks is supportive of the inclusion of special value participants in the hypothetical market.[48]This of course would lead to a lower market value determination in this context.

VI RELEVANCE OF OFFERS

Another feature of real world markets is the making of offers by interested parties to owners which do not necessarily lead to an actual sale. Should such offers be accepted as an indication of market value? This question is particularly relevant to the interpretation of market value in those provisions where the taxpayer maintains ownership of the relevant property and there is no actual exchange or trade involving the property (section 70-30 and Division 152 ITAA97).

From 1915, there was clear authority from the High Court that offers are not to be taken into consideration when assessing market value.[49]Given the absence of a concluded transaction, there is no basis upon which to find that the offered price is in fact the market price. This principle has in fact been upheld in a number of court and tribunal decisions.[50]

At the same time, there are court and tribunal decisions which, without referring to *McDonald*, have given considerable weight to evidence of offers.[51]

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[48] Marks, above n 2, 160.

[49] *McDonald v The Deputy Federal Commissioner of Land Tax (NSW)* (1915) 20 CLR 231, 238.

[50] *Cordelia Holdings Pty Ltd v Newkey Investments Pty Ltd* [2004] FCAFC 48, [128]; *Re Jack Woodhouse and Joyce Woodhouse v Secretary, Department of Social Security* [1987] AATA 73, [31]; *Syttadel and Holdings Pty Ltd v Commissioner of Taxation* [2011] AATA 589.

[51] *Venturi v Commissioner of Taxation* [2011] AATA 588, [72]; *Marion Elizabeth Collis v Federal Commissioner of Taxation* [1996] FCA 1717, [18] citing *Hustlers Pty Ltd and Anor v The Valuer-General* (1967) 14 LGRA 269, 274-278.

The *McDonald* decision was examined by Wilcox J in *Goold & Rootsey v The Commonwealth*.[52] In his judgment, Wilcox J points out that the abovementioned principle from *McDonald* is derived from obiter comments made by Isaacs J and that Isaacs J should not be understood to have intended to exclude all offer evidence in all cases.[53] According to Wilcox J:

> But it seems to me that, once the court is satisfied about genuineness, an offer made by an arms-length party to purchase the land under valuation is something that the judicial valuer ought to take into account in considering the possibility of a sale at a price different from that indicated by conventional evidence, such as an analysis of comparable sales, or of a hypothetical development, or a calculation of the capitalised value of the rental return. How much weight should be given to such an offer is a question to be determined by reference to the facts of the particular case. In some cases, the appropriate weight may be minimal; in others considerable. [54]

Wilcox J's reasoning was considered and supported by the NSW Court of Appeal in *MMAL Rentals*.[55] In that case the court also indicated that it was not entirely convinced by the Full Federal Court's interpretation of *McDonald* in *Cordelia Holdings*.[56]

From the above examination of case authority, it can be seen that we do not have clear guidance as to whether offers are relevant indicators of market value.

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[52] [1993] FCA 157, [28]-[32].

[53] Ibid [32].

[54] Ibid [30].

[55] [2004] NSWCA 451, [86]-[87].

[56] Ibid [95].

VII PROCEDURAL FACTORS

A final point to be made concerns the underlying evidentiary process adopted in the court and tribunal decisions. The onus is on the taxpayer to prove that the Commissioner's valuation is incorrect. Failure to submit sufficient evidence as to the unreliability of the Commissioner's valuation will ensure that the taxpayer would not have discharged the burden of proof.[57] Any technical flaws in the taxpayer's valuation (such as lack of valuation experience on the part of the taxpayer's valuer[58] or accounting errors[59]) will often lead to a finding for the Commissioner by default. As a result, there is little analysis in the decisions as to the appropriate principles that taxpayers should adopt when conducting their valuations and especially on the question of the relationship between real world market factors and the assumptions underlying the hypothetical market.

The significant reliance on evidence given by expert valuers raises a further issue which is relevant to the development of valuation principle by the courts and the AAT. Expert valuers belong to professional bodies which have developed their own valuation standards and

[57] *Brockhoff v Secretary, Department of Family and Community Services* [2002] AATA 234, [23]-[25].

[58] *Psarreas v Secretary, Department of Families, Community Services and Indigenous Affairs and Anor* [2006] AATA 670, [32]; *BHP Australia Coal Limited v Federal Commissioner of Taxation* [1993] AATA 156, [28].

[59] *Ciprian and Ors v Commissioner of Taxation* [2002] AATA 746, [17].

especially their own interpretation of how 'market value' determinations should be made.[60]Whilst these standards provide a more detailed explanation of the market value concept and how it is to be applied, the relationship between these standards and applicable Australian case authority is not entirely clear. It appears that we may have a situation where, rather than the standards adapting to developments in established Australian legal principle, the AAT may be simply confirming the views of the expert valuer who, on the day, is most convincing in applying the separate standards developed by his or her own professional body.

VIII CONCLUSIONS

The analysis conducted in this paper has highlighted a number of problems in the way the term 'market value' is interpreted and applied in the context of the ITAA97. Using specific real world market scenarios as a starting point, the paper has shown that case authority does not provide clear guidance as to how market value is to be determined when such scenarios impact on taxpayers. In addition, the paper has shown how the views of the ATO on the application of this term not only impose significant administrative cost on taxpayers but also are not entirely consistent with case authority. The absence of clear guidance from parliament, the courts and the AAT on how real world market factors should feed into assumptions underlying the hypothetical market by which market value determinations are made has been a recurring theme of the analysis.

[60] See for instance The International Valuation Standards which have been developed by The International Valuation Standards Council and which are applied by the Australian Property Institute and the Property Institute of New Zealand (2007) < http://propertystandards.propertyinstitute-wa.com/documents/InternationalValuationStandards-4_000.pdf >. Please note that the website reference is based on IVS 2007 which has since been superseded by IVS 2011.

In light of this situation, a key question arises – given the varied contextual origins and applications of valuation jurisprudence, can we rely on the courts and the AAT to continue to develop this jurisprudence in a way which will provide, for the purposes of the ITAA97, a clearer statement of principle which will resolve the inconsistencies highlighted by this paper?

As pointed out by Marks, taxation and rating statutes in Australia, the United Kingdom, the British Commonwealth and the United States have traditionally provided the barest of valuation criteria and legislators have consequently relied on judicial common sense for establishing valuation rules.[61]Administrators in the United States, however, have taken this one step further and have actually codified judicially developed taxation rules into regulations.[62]Would application of this approach in Australia help to resolve the problems this paper has highlighted? It is the author's view that incorporation of statutory valuation principles into the ITAA97, especially principles that expressly address:

(a) the question of how real world market factors should impact upon market value determinations and the distinction to be made between 'market value' and 'fair market value';

(b) the effect that should be given to market demand and supply forces;

(c) the influence on market outcomes of particular market participants; and

(d) the weight to be given to unaccepted offers made to sellers by interested parties,

represents a possible solution which would be of assistance to taxpayers and which would help to reduce the administrative cost imposed by the current regime.

[61] Marks, above n 2, 115.

[62] Ibid.

In developing these statutory valuation principles careful consideration will need to be given to the role to be played by the valuation standards developed by professional bodies. While they provide some guidance with respect to the issues mentioned under (a) to (d) above,[63] it would be important to ensure that application of these standards results in the de-mystification of the market value determination process for ordinary taxpayers, rather than in greater confusion and administrative cost.

[63] For example, The International Valuation Standards mentioned above in footnote 60 provide some limited comment on how market valuations are to be made in the context of changing conditions, the distinction between 'Fair Value' and 'Market Value' as well how 'Special Value' should be treated as being outside 'Market Value'.