

ASF Technical Seminar 2024

# Mastering market valuations



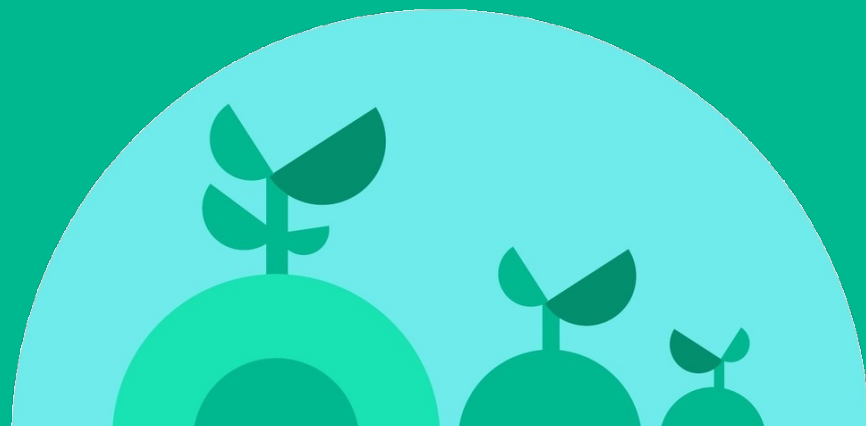
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**Prepared as of 6 September 2024**



## Session outline

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### **This session will explore:**

- Market Value considerations for an SMSF
- Market Valuations – horror stories (recent case laws)
- ATO and Market valuations
- MV related parties transactions

# Market valuation requirements

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- Early 2024 - ATO targeted campaign to 16,500 funds and 1,000 auditors regarding SIS compliance with market valuation requirements (SISR 8.02B).
  - Identified higher risk category where funds have the same market valuation for at least three income years.
  - Auditors - no ACR issued for this high-risk population in respect to potential breaches under SISR 8.02B.
- Regulator is increasingly using data to identify and deal with higher risk areas.

**Reference:** <https://www.ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/smsf-newsroom/valuing-fund-assets-correctly-for-the-smsf-annual-return>



A collage of business-related items. In the top right, a white calculator with grey and blue buttons is partially visible. A light blue sticky note is placed over a background of lined paper. On the sticky note, the word "Valuation" is written in black cursive and underlined. Below the sticky note, a white rectangular box contains the word "Why?" in bold black font. The background includes a blue line graph with a peak at 100 and a trough at 150, and a blue bar chart with a y-axis from 0 to 35. A grey marker is visible at the bottom center.

Valuation

**Why?**

## Why?

Annual statements

Pension commencement

Related party acquisitions

Arm's length

TBC & TSB

In-house asset ratio

Collectables & PUA disposal to RPs

# When good values go bad – SMSFs v the CoT

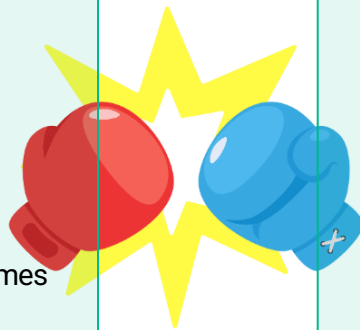


# SMSF “professionals” v ATO

## Coronica v Commissioner of Taxation x 4

*Accountant with 50 years' experience, also an experienced valuer*

- Mr Coronica was an accountant since 1970
- Sole member of the Fund
- In 2009 purported to have contravened the Act 45 times (8 different provisions – 17 separate occasions)
- In 2009 SMSF acquired 100% of the shares in G Coronica Nominees Pty Ltd
- Mr Coronica valued shares at \$100,000, ATO determined valuations to be more likely in excess of \$200,000
- **SMSF value was approx. \$2m**
- ATO position was that valuation used was used exclusively to get under 5% for in-house asset purposes



**VS.**

## WZWK & CoT [2023] AATA 872

*SMSF Auditor, Tax Agent*

- In 2010 established a 2nd SMSF – company B contributed \$20,000 to SMSF – new Fund purchased multiple unlisted entities from member's existing SMSF including Unit Trust A
- **Applicant undertook all his own asset valuations**
- From 2010/11 until 2015/16 drew over \$800,000 from SMSF – via non-commutable income stream
- SMSF wound up in 2018/19 & ATO commenced audit in 2019
- ATO determined Fund in breach of s62 (Sole Purpose Test), s65 (Financial Assistance), s66 (Related Party Acquisition) + other provisions and they disqualified Trustee



ATO previously released ATO QC 72772 – Holding professionals to a higher standard – no longer online



**What do we need to  
understand?**



# Market valuation



## SIS Reg 8.02B

### **Asset must be valued at market value**

For subsection 35B(2) of the Act, for the year of income 2012-13 and any later year of income, when preparing accounts and statements required by subsection **35B(1)** of the Act, an asset must be valued at its **market value**.

Subsection 35B(1) requirements:

- A statement of financial position
- An operating statement



## Definition – SIS Act 10(1)

**"market value"**, in relation to an asset, means the amount that a willing buyer of the asset could reasonably be expected to pay to acquire the asset from a willing seller if the following assumptions were made:

- (a) that the buyer and the seller **dealt with each other at arm's length** in relation to the sale;
- (b) that the sale occurred after proper marketing of the asset;
- (c) that the buyer and the seller acted knowledgeably and prudentially in relation to the sale.

# Arm's length



## SIS Act s109

S109 of the SIS Act requires the trustees to “**deal with each other at arm's length in respect of the transaction**”

- Where the parties are not at arm's length (i.e. related) trustee must deal with the other party as if they were.
- **Terms and conditions must be no more favourable to the other party**

SIS Act doesn't go far enough! Let's not forget ITAA 97 – s295-550 (and its predecessor s273 ITAA 36)



## TR 2006/7 & the evolution of s295-550

76. The Commissioner considers that parties are dealing with each other at arm's length in relation to a transaction if **the independent minds and wills of the parties are applied to the transaction and their dealing is a matter of real bargaining**. If this is not the case, the Commissioner will consider that the parties are not dealing with each other at arm's length in relation to the transaction.

77. If the relationship of the parties is such that one party has the ability to influence or control the other, this will suggest that the parties may not be dealing at arm's length, but it will not be determinative.

78. Parties that are not at arm's length can deal with each other at arm's length in relation to a transaction and parties that are at arm's length can deal with each other in a way that is not at arm's length.

## Dealing at arm's length - exercise

Bobby and Sally are members of the Salbo Superannuation Fund. The corporate trustee of the Bosa Trust is Bruce Industries Pty Ltd. Sally's brother Bruce has a 75% shareholding and is a director of Bruce Industries Pty Ltd. The Bosa Trust issues 100,000 units, 10,000 each to 10 different unit holders, including the Salbo Superannuation Fund. The investment in the Bosa Trust is less than 5% of the Salbo Superannuation Fund's total assets. The Salbo Superannuation Fund and all of the 9 other unit holders pay \$1.00 per unit, each paying a total of \$10,000. The market value of a unit in the Bosa Trust is \$1.00.

The Bosa Trust carries on a storage business. Bobby and Sally are employees of the Bosa Trust. They are paid a salary at the market rate. The Salbo Superannuation Fund owns the premises from which the Bosa Trust runs its business. The Salbo Superannuation Fund leases the business premises to the Bosa Trust at a market rate. Bruce loans money to the Bosa Trust at a market interest rate and on bona fide commercial terms. The Bosa Trust distributes an equal amount of income to all of the unit holders, including the Salbo Superannuation Fund, in accordance with the fixed entitlement. The amount of income distributed is a market rate of return, having regard to the market value of the units.

1

The Kirkpatrick Trust carries on a business of labour hire operation. The trustee is Kiz Pty Ltd. The two shares issued by Kiz Pty Ltd are held by Eddie. Eddie holds 2000 units in the Kirkpatrick Trust. The Kirkpatrick Family Superannuation Fund holds 98,000 units in the Kirkpatrick Trust. The investment in the Kirkpatrick Trust is less than 5% of the SMSFs total assets. Both unit holders pay market value for their units. The members of the Kirkpatrick Family Superannuation Fund are Eddie and Katie. The trust deed of the Kirkpatrick Trust states that the income of the trust will be distributed in proportion to the units held.

The only client of the Kirkpatrick Trust is Edward Kirkpatrick Pty Ltd. All of the income of the Kirkpatrick Trust consists of service fees received from Edward Kirkpatrick Pty Ltd. The income of the Kirkpatrick Trust last year was \$500,000. The Kirkpatrick Trust resolves to distribute all of the income that it has derived to the unit holders in proportion to the units held. The income derived by the Kirkpatrick Family Superannuation Fund from the Kirkpatrick Trust is \$490,000. Taking into consideration the operating costs and the net profit achieved by independent suppliers in respect of the provision of similar services in the market, the services fees charged by the Kirkpatrick Trust are much higher than the market rate of those fees.

2



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# Valuation requirements

# ATO and market valuation

- [Valuing fund assets correctly for the SMSF annual return](#)
- [Market valuation of assets](#) – for tax purposes
- [Valuation guidelines for self-managed super funds](#)
  - ATOs approach to valuations
  - Why assets need to be valued ✓
  - Valuer
  - General valuation principles



## Qualified independent valuer

- Collectable and personal use assets
- the value of a fund asset represents a significant proportion of the fund's value
- the nature of the asset indicates that the valuation is likely to be complex or difficult.

## General valuation principles

- Obligation on trustee to demonstrate valuation based on 'fair and reasonable' process.
- Based on objective and supportable data
- So what is objective and supportable data?

# Market valuation guidance for real property



## Acceptable

- independent appraisals from a real estate agent (kerb side), with supportable evidence
- contract of sale if the purchase is recent and no events have occurred to the property that could materially impact its value since the purchase
- recent comparable sales results
- rates notice (if consistent with other evidence on valuation)
- net income yield of commercial properties (not sufficient evidence on their own and only appropriate where tenants are unrelated).



## Less acceptable

- Real estate agent/online valuation service appraisal stating what likely to sell for (should stipulate supportable data)



Generally, a single item of evidence (as listed) will not be sufficient on its own unless the property has been recently sold

## Assets without a ready market

The ATO has recently updated its market valuation guidance in respect to investments without a ready market

*“When making investment decisions on behalf of the fund, you have certain duties and responsibilities which are designed to protect and increase a member's benefits for retirement. It is expected that you would be aware of the value of an asset at the time of acquisition, its potential for capital growth and its capacity to produce income.*

*It's unlikely that an asset with no known value or potential for capital or income growth **would be considered a prudent investment to support members' retirement goals.***

*It's acknowledged that there may be instances where investments fail and there is neither a current value nor a ready market. This may mean the asset is held and recorded in the financial reports and statements at a nil or nominal amount.”*

(QC 26343)





# Market valuation guidance for unlisted entities

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## Acceptable

- independent appraisals of investments held within the co. or trust, with supportable evidence
- Property valuation if only asset of entity
- recent comparable sales results between unrelated parties
- Evidence of how directors/trustees substantiated valuation; and
- valuation method i.e. Coronica case



## Not acceptable

- Co. or Trust financials that are signed and audited unlikely to be sufficient on own as assets may be recorded at cost

# Significant events

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## What to do when there is a significant event

- Obtain new valuations
- Use valuations obtained after the significant event occurred
- Obtain alternative evidence to support the value of the fund assets

Significant events can have a meaningful detriment to such matters as pension commencement and calculations (including actuarial requirements for DBPs) but also to in-house asset values (i.e. Covid)



## Significant events

- Natural disaster
- Global pandemic
- Macro-economic events
- Market volatility
- Changes to the character of assets

# MV & Related party transactions



## Non-arm's length asset acquisition & in-house asset considerations

- It's a SIS Section 66 requirement that all related party acquisitions are undertaken at market value
  - Consider the in-house asset issues corresponding to the Coronica case
- Where fund purchase an asset at < \$MV under a scheme not at arm's length, the fund incurs NALE for the purposes of applying 295-550(1), ITAA 1997.
- Any shortfall **cannot** be treated as an in-specie contribution (TR 2010/1\*) where sold under terms of a contract
  - being difference between consideration and market value
- Contract would specify the component of the acquisition that is:
  - Purchased under the terms of the contract; and
  - The amount of the in-specie contribution for the remaining interest
- NALE provisions will apply, regardless of whether the shortfall was recorded within financials as an in-specie contribution
- Results in all income from the asset, including capital gains subject to NALI (TD 2024/5)

\* TR 2010/1 is still in draft format awaiting finalisation



## SMSF Acquisitions & Market Valuations

Nadia owns a commercial premises, leased to a third party to carry on a business. Current market value of the property is \$500,000. Nadia wants to transfer the asset into her SMSF but only has \$400k. Nadia's SMSF agrees to purchase 50% of property under a contract from her for \$250,000 and Nadia makes a NCC for the remaining 50%. The acceptance of the in-specie contribution is recorded and reported within the fund's accounts and to the ATO. The SMSF continues to lease the premises on same terms

1

Russell (as trustee of his SMSF) purchases listed shares from a related entity and pays \$500,000, which was the lowest value Russell could see had occurred in the previous 2 months. The transfer of shares is done via an off-market transfer. The consideration on the OMT is listed at \$500,000. The market value of the shares at the time Russell executes the OMT was \$600,000. Russell pays the \$500,000 and makes an adjustment in the accounts to treat the balance as a NCC.

2

3

Kellie (as trustee of her SMSF) entered into a LRBA with herself in her individual capacity to purchase a commercial property valued at \$2 million. Her SMSF borrowed 100% of the purchase price and the terms of the loan included interest being charged at a rate of 1.5% per annum and repayments only being made on an annual basis over a 25-year period. Kellie's SMSF received a commercial rate of rent from the property of \$12,000 per month.

## Key takeaways

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- All investment transactions must be undertaken on arm's length terms which requires, amongst other things, that market valuation requirements are adhered to
  - What supporting documentation might be required to substantiate valuation used
  - If all else fails ask your auditor →
- Valuations are going to become a significant compliance and tax consideration if Division 296 is introduced and growth (based on valuations) becomes the divisive trigger to paying additional tax
  - Also has ramifications for NCC capacity, asset segregation, carry-forward unused concessional etc
- Understand the transaction being undertaken to have an appreciation and be able to explain the valuation requirements – where they exist.



# Thank you!

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