



IN ASSOCIATION WITH  Knight
Frank

Asset Purchase Price Analysis **Information Paper**

Prepared by
Bayleys Valuations Limited

Asset Purchase Price Analysis - Achieve the Right Amount of Asset Depreciation

Please find attached some detailed information on Bayleys' Asset Purchase Price Analysis (APPA), a highly specialised and professional service offered to Bayleys clients in New Zealand from our Valuations Team.

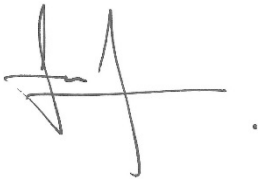
Given the New Zealand Government's recently published reintroduction of depreciation allowances for Building Structures from the commencement of a tax payer's 2020/21 fiscal year, claiming the correct level of tax depreciation on assets has become an even more essential tool for the viable economic future of any business.

Bayleys Valuations Limited can assist you no matter how the situation unfolds in terms of a property purchase.

We thank you for your interest in this matter and if we can be of any further assistance please contact the writer at any time.

Yours faithfully

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1. Asset Purchase Price Analysis

Asset Purchase Price Analysis (APPA) uses appropriate and robust valuation methodologies to analyse then allocate a total asset purchase price across its individual components. The process is generally required subsequent to a business transaction where fixed assets have changed ownership or have been purchased by a tax payer.

The allocation process allows the identification and segregation of the individual components into their appropriate tax categories as prescribed by the New Zealand Inland Revenue Department (IRD). This ensures that all tax payers claim the correct and optimum allowable level of taxation depreciation for individual assets during the period of ownership.

If a tax payer does not engage a professional firm to realistically segregate assets following a major business transaction there will be no depreciation claims allowable; subsequent to a Bayleys APPA review the tax payer's overall annual depreciation claim will be significant as all depreciable assets have been allocated individual purchase prices in compliance with current IRD guidelines.

Our APPA process has been specifically developed by current Bayleys Valuations Limited (Bayleys) consultants to meet the IRD requirements as described later in this document..

1.1 Types of Fixed Assets that Benefit from APPA

Generally, our APPA process can be utilised where the following depreciable fixed asset categories may have been involved in a business transaction requiring analysis where assets have changed ownership:

- Building Structures.
- Building Fitout Services (Lifts, Air-conditioning, Floor Coverings, Internal Non Load Bearing Walls, Plumbing & Electrical Reticulation and Fittings etc.).
- Processing, Manufacturing and Engineering Plant.
- Restaurant, Catering and Administration Equipment.
- Hospital, Rest Home and Clinical Care Facilities.
- Hotel, Motel and Retail Outlet Chattels.
- Motor Vehicles, Marine Vessels and Aircraft.

Bayleys consultants have utilised the APPA process for clients that have purchased assets involved in a vast array of commercial operations.

To date we have not found a business transaction where fixed assets have changed ownership subsequent to which our APPA procedure cannot be applied for the financial benefit of our clients.

Whilst Land is non depreciable under current IRD legislation Bayleys recommend that a realistic value is allocated for this asset if contained within any property transaction.

2. Cost Benefit Analysis

We understand the concern of all businesses in deciding whether to proceed with a project such as APPA; this generally relates to whether the professional services firm engaged will add value and if the process is cost beneficial to the business or will it merely be an added cost.

At Bayleys we carry out an initial obligation free brief “on desk” cost benefit analysis on any potential APPA project so that our clients can decide whether or not to proceed based on sound financial analysis.

In most cases our initial cost benefit analysis is utilised “pre purchase” to assist clients not only with assessing future tax implications but also with other important issues such as finance arrangements for the proposed asset purchase, annual cash flows and estimated asset yields.

3. The Bayleys APPA Procedure

3.1 Overview

The procedure for allocating the total asset purchase price to the individual components involved within the transaction must be transparent, robust and be able to satisfy any current or future IRD scrutiny or audit process.

The allocation procedure requires a detailed analysis of all of the component parts of a business transaction where assets change ownership. It cannot simply focus on one or two individual aspects of the transaction; fractional analysis of only specific parts of the overall transaction is not acceptable to the IRD.

This means that every asset considered part of the transaction under review must be physically inspected and analysed. Then by utilising accepted approaches and the application of acknowledged valuation methodologies, the procedure of allocating individual prices can be accomplished.

The overall procedure utilised by Bayleys in APPA projects is fully detailed within a final client report that is prepared in accordance with current Property Institute of New Zealand (PINZ) and international valuation standards and guidelines.

Furthermore, we can confirm that approaches to be utilised for allocating purchase prices for tax depreciation purposes have been scrutinised by and proved acceptable to the IRD and many major accounting firms in New Zealand for many years.

3.2 The Expertise Required for APPA

Any APPA procedure must be independent and unbiased whilst recognising and utilising the individual and quite different skills of taxation, registered property and plant and machinery valuation consultants and advisors.

Teaming of such expertise is essential because subsequent to any business transaction where assets change ownership the following issues require detailed consideration:

- The implications of a specific acquisition date and/or the wording of the Sales & Purchase Agreement as completed by both parties.
- The implications of the timing of the initial review/allocation process in relation to the purchaser's financial year and its ability to claim depreciation for this period.
- The purchaser's intentions in relation to the future use of the assets, either in part or in whole, that may be included in the transaction.
- The Registered Property Valuer's assessment and confirmation of the most appropriate market based allocation of purchase prices to the Land and Improvements if property assets are involved.
- The Registered Plant and Machinery Valuer's detailed analysis and confirmation of a market derived individual purchase price allocation for all Building Fitout Services and Plant and Equipment assets involved that addresses all pertinent issues raised by the transaction.

The Bayleys APPA approach utilises consultants with a significant level of expertise in both the property and specialised realm of plant and machinery valuation. As a market derived approach to our APPA work is required to show a robust derivation of Opening Tax Book Values, it is absolutely essential that an asset purchaser utilises the services of appropriately qualified Valuers.

Whilst experienced in general asset taxation matters, our consultants from time to time require input from a client's tax advisors in relation to specific tax issues arising from any particular transaction.

This teaming of expertise and transfer of knowledge ensures that specific IRD requirements are fully considered and in particular a client's position regarding the future claiming of enhanced depreciation is defensible and sound.

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4. IRD Compliance

4.1 One Asset Purchase Price – What to Do?

Where a purchaser pays one total price for a collection of assets, the IRD considers this one transaction. It may contain various components in respect of the assets purchased, either nominated as one amount or in some detail within the Sales and Purchase Agreement.

Each overall transaction therefore must be fully analysed so that all of the component parts are allocated realistic individual purchase prices based on the total transaction and price paid. Fractional analysis of only specific parts of the transaction is not acceptable to the IRD just as fractional valuations are not acceptable under current New Zealand and/or international valuation standards and guidelines.

Therefore it is essential for any tax payer to obtain a fully independent and all-encompassing asset APPA report.

4.2 Future Asset Disposals

During discussions with the IRD concerning client asset "tax write-offs" it is accepted that if one figure per asset category is originally allocated without any breakdown on quantity, size, location and age, at the eventual asset disposal time it would be virtually impossible to work out what has been disposed of and assess any "tax write off" amounts.

The IRD is reluctant to allow asset tax write-offs for globally assessed assets unless compelling evidence can be produced that all assets within that category have been disposed of or removed.

The level of information initially provided by our detailed APPA projects generally negate this issue at disposal time as we compile information on a floor by floor or areas by area basis so any asset disposal and corresponding adjusted tax book value can be easily assessed in the event of such an occurrence.

4.3 Potential Penalties

The Tax Administration Act 1994 and its subsequent amendments demands stricter compliance obligations and carries significant penalties for non-compliant entities. In the current tax environment the allocation of asset purchase or sales price that is not sufficiently robust can result in a tax payer losing its legal deduction entitlement and/or incurring significant shortfall and interest penalties.

We further understand that the penalties under the current tax regime mean that, if a taxpayer incorrectly attributes a purchase price, fines of between 20% and 40% per annum can be imposed by the IRD.

Although there are no specific guidelines issued by the IRD at present in respect of the allocation of asset purchase prices, we understand that during the course of the audit process of such matters the following issues are considered:

- Does the purchase price reflect the realistic Market Value of the asset at transaction time?
- What processes have been utilised to clarify this point?
- Have independent and appropriately qualified experts been involved in the process or is it simply an internal assessment?
- If external expertise has been utilised has the overall approach to the process been fully detailed in a report that meets appropriate professional standards applicable at the time?
- If it has been an internal assessment, are the staff utilised experienced in such matters and have the detailed and necessary knowledge of concepts such as Market Value?

We believe that, in cases where the majority of such issues are answered in the negative, the process has potential to subject the taxpayer to penalties as previously noted.

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The Bayleys APPA approach ensures parameters are met or generally exceeded and any potential penalties do not accrue. This is due to our processes of our teaming with consultants who specialise in the asset taxation area.

Bayleys notes this information not to be alarmist but has been included so that all of our clients (both existing and potential) are aware of the serious pitfalls of commissioning such APPA work, without seeking the professional advice and guidance as stated in this document.

5. The Benefits to Bayleys' Clients

The benefits that our clients receive from the Bayleys APPA process include but may not be limited to the following:

- The fee for our Professional Services is a “one-off”, but the depreciation generated continues for the period of asset ownership without the need for annual reassessments.
- The ability post 1 April 2020 for our clients to claim tax depreciation on all assets considered by the IRD to be depreciable.
- Transparent approach and documentation which have been accepted by the IRD for previous assessments on many varied types of property and fixed assets.
- The segregation of assets into the appropriate IRD depreciation categories ensuring the ability to claim higher and optimal tax depreciation amounts annually.
- The provision of a detailed fixed asset register describing assets on an area by area and/or floor by floor basis enabling accurate asset management records (either internal or external) to be maintained.
- Creation of logically analysed and assessed opening (or adjusted) tax book values for individual assets/groups of assets and the ability to substantiate those tax book values for individual assets should they be sold and/or written off in the future.
- Improved cash flow and portfolio yield.
- Fixed asset registers supplied in both hard copy and electronic disc format to assist with the company's continuing management and financial reporting strategies.
- Insurance valuations can be provided simultaneously normally at little extra cost to assist with setting realistic insurance amounts and calculating fire service levies and premiums based on researched asset segregation

6. Information Requirements

In order to complete a detailed APPA project in respect of newly purchased assets we generally require the provision of the following:

- Copy of final Sales & Purchase Agreement.
- Copy of any Appendix to this Agreement detailing fixed assets included within the transaction.
- Copy of any recent property and/or asset valuations undertaken either from a financial or insurance perspective for the property or assets under review.
- Final total purchase price (including any fees) to be capitalised, analysed, and allocated appropriately.
- A set of scaled, detailed individual BOMA layout or floor plans for any property involved.
- Copies of any leases or other documentation at a property which notes Lessors and/or Lessees fixtures and fittings.
- Client arranged unlimited access to the any premises to facilitate our asset inspection, detailing and verification process.
- Assistance from the client's tax advisors as required for us to discuss any specific issues in relation to the overall transaction.

It should be noted that if these requirements can be fully provided by our clients, our fees become even more cost effective as considerable Bayleys consultant time can be saved.

7. Project Fees & Timing

7.1 Project Fees

Our fees are based on our estimate of time required to complete the project. They are not calculated with reference to the asset purchase price or any potential scale of benefits accrued from the APPA analysis or any other financial consideration.

In the vast majority of APPA projects our fees are offset in the first full year of asset ownership because of the enhanced depreciation amounts assessed; these benefits are subsequently claimed last for the total period of asset ownership.

In some cases clients include our fees for APPA projects and capitalise them as part of the costs of acquiring assets.

No matter the project, our fees are formulated on the provision of the following sequential services:

- On Site Inspection, Counting and Notation of Assets.
- Creation of an electronically formatted Fixed Asset Register.
- Asset Analysis, Investigation and APPA implementation.
- Provision of a detailed Draft Report.
- Discussion and Amendment (if necessary) of the Draft Report.
- Provision of a fully detailed Final Report including Fixed Asset Register in both hard copy and electronic formats.

7.2 Project Timing

Timing is a crucial aspect of the APPA process that requires discussion and clarification so that the benefits from this work flow through to our clients from the very earliest date of asset ownership.

Therefore we do strongly recommend that APPA projects should be undertaken as soon as the purchaser takes ownership of the assets.

This ensures that the benefits of such an exercise are available from the very earliest point in time and records can be established confirming asset ownership not only from a tax depreciation perspective but also from an asset management viewpoint.

8. Client Referrals

Current Bayleys consultants over the past 35 years or so have provided APPA services to some of the country's most prominent property investment organisations and private investors. Such projects have included fully detailed analyses of hotels, motels, commercial, retail and industrial properties, airports, aged care facilities, private clinics, manufacturing and processing plants.

Bayleys consultants are acknowledged by the property industry to be at the leading edge of APPA work in this country. Our current consultants originally created the methodologies used today and continually strive develop ways in which to improve this service to facilitate on-going client and legislative requirements.

Much of this work has been undertaken in conjunction with many of New Zealand's leading taxation and accounting practices with whom we regularly liaise on such issues. Many of these practices recommend the independent expertise needed for such APPA work in their general day to day company publications and on company websites.

In addition to this other national and international valuation firms who do not have the required expertise for such work internally recommend our APPA services to their client and we work on several joint venture assignments every year with such firms.

We would be most happy to furnish your company with individual and company referees for our professional services and consultants should you so desire.

9. Getting the Right Proposal?

A standard feature of all Bayleys service proposals is a high level of disclosure and professional service. We see it as an absolute duty of care and responsibility to our clients to prepare fully informative and helpful proposals so that our clients know the level of service they are going to receive before they even receive it.

Our fully professional and cost beneficial services not only meet but generally exceed current client internal and external legislative requirements.

We advise clients that they should ensure that the following issues are comprehensively addressed if they wish to consider alternative proposals from other consultants for the APPA process:

- A brief “on desk” cost benefit analysis should be provided highlighting the potential benefits tenderers’ believe will accrue from their work, together with a fully detailed explanation of the approach that will be taken for the project.
- Confirmation that any valuation approach utilised during the project will be in accordance with current valuation standards and guidelines in New Zealand and/or internationally and are acceptable to the IRD.
- Confirmation that all assets subject to the particular transaction will be fully inspected.
- Names of the major accounting firms in New Zealand that engage the tenderers’ services for such detailed analysis projects.
- References from tenderers’ clients owning the same or similar types of assets.
- Consultants who will be utilised have the necessary valuation qualifications (both Registered Property and Plant and Machinery Valuers) to undertake the work.
- How the provision of final data will be made and its compatibility with the client’s existing internal management and accounting systems.

We would advise caution should these basic details not be provided or confirmed in any proposal received.

In our view the required level of expertise, service and acceptability of the project results (particularly from the IRD) referred to throughout this document is far more important than any fee levels proposed.

Clients are entitled to the peace of mind that specialised tax depreciation analysis work undertaken for them will prove acceptable to the IRD so that, in real terms, the fee charged for such work becomes a minor not major consideration.

10. Conclusion

Bayleys has the unique combination of skill sets required to successfully complete such important projects as APPA for its clients.

Our consultants are at the leading edge of such work in New Zealand as they have many years of experience of completing such work for a large cross section of the corporate, private and public sectors of commerce in this country and overseas.

By teaming these skills with your own in-house expertise or that of your external tax advisors, the result will be a detailed analysis and purchase price allocation, which will prove acceptable to the Inland Revenue Department.

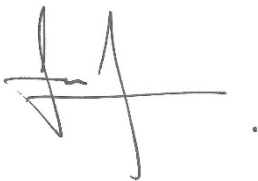
Our approach is basically “do it once, do it right” ensuring that our clients receive the best possible advice and services in the most cost effective manner.

We are happy to provide our clients with an obligation free APPA proposal in respect of any asset/business transaction.

10.1 Signatory

We thank you for your interest in our APPA services and if you require any further assistance or wish to discuss your requirements further, please contact the undersigned.

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