Business Law Section

Evaluation of the 2021 foreign investment reforms

Manager
Policy Framework Unit
Treasury
Langton Cres
Parkes ACT 2600
FIRBStakeholders@treasury.gov.au

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Telephone +61 2 6246 3737 • *Fax* +61 2 6248 0639
Email Jessica.Morrow@lawcouncil.asn.au
GPO Box 1989, Canberra ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612
Law Council of Australia Limited ABN 85 005 260 622
www.lawcouncil.asn.au

Table of Contents

About the Business Law Section of the Law Council of Australia

The Business Law Section was established in August 1980 by the Law Council of Australia with jurisdiction in all matters pertaining to business law. It is governed by a set of by-laws adopted by the Law Council and the members of the Section. The Business Law Section conducts itself as a section of the Law Council of Australia Limited.

The Business Law Section provides a forum through which lawyers and others interested in law affecting business can discuss current issues, debate and contribute to the process of law reform in Australia, as well as enhance their professional skills.

The Law Council of Australia Limited itself is a representative body with its members being:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Operating as a section of the Law Council, the Business Law Section is often called upon to make or assist in making submissions for the Law Council in areas of business law applicable on a national basis.

Currently the Business Law Section has approximately 900 members. It currently has 15 specialist committees and working groups:

- Competition & Consumer Law Committee
- Construction & Infrastructure Law Committee
- Corporations Law Committee
- Customs & International Transactions Committee
- Digital Commerce Committee
- Financial Services Committee
- Foreign Corrupt Practices Working Group
- Foreign Investment Committee
- Insolvency & Reconstruction Law Committee
- Intellectual Property Committee
- Media & Communications Committee
- Privacy Law Committee
- SME Business Law Committee
- Taxation Law Committee
- Technology in Mergers & Acquisitions Working Group

As different or newer areas of business law develop, the Business Law Section evolves to meet the needs or objectives of its members in emerging areas by establishing new working groups or committees, depending on how it may better achieve its objectives.

The Section has an Executive Committee of 11 members drawn from different states and territories and fields of practice. The Executive Committees meet quarterly to set objectives, policy and priorities for the Section.

Current members of the Executive are:

- Mr Greg Rodgers, Chair
- Mr Mark Friezer, Deputy Chair
- Mr Philip Argy, Treasurer
- Ms Rebecca Maslen-Stannage
- Professor Pamela Hanrahan
- Mr John Keeves
- Mr Frank O'Loughlin
- Ms Rachel Webber
- Ms Caroline Coops
- Dr Elizabeth Boros
- Mr Adrian Varrasso

The Section's administration team serves the Section nationally and is based in the Law Council's offices in Canberra.

For Further Information

This submission has been prepared by the Foreign Investment Committee of the Business Law Section of the Law Council of Australia (the **Committee**).

The Section would be pleased to discuss any aspect of this submission.

Any queries can be directed to the chair of the Committee Wendy Rae at wendy.rae@allens.com.au or 0411 646 774.

With compliments

Greg Rodgers
Chair, Business Law Section

1. Introduction

The Committee recognises the important role that both the Foreign Investment Review Board (**FIRB**) and the Treasury play in administering foreign investment in Australia. While foreign investment often carries with it scepticism from the community, its benefit to the Australian economy is uncontentious and cannot be overstated.[1] We look forward to working with the Treasury to ensure the overwhelming benefits of foreign investment to the Australian economy are achieved.

Should a foreign person wish to invest in a similar liberal democracy, such as New Zealand or Canada, they will be tasked with positively proving their investment is in the national interest of that country.

Australia, however, imposes a threshold in which foreign investment will be welcomed so long as it is *not contrary* to the national interest, including national security.

This feature is always met with a positive response from clients and indeed - along with Australia's relative stability throughout the pandemic, its solid economic and population growth and its historically well-functioning democracy - makes us an attractive target for foreign investors. However, we cannot take this for granted.

Macroeconomic factors around the world have led to a shift in the way governments approach foreign investment. With the rise of populism and the onset of a global pandemic, countries that were once stalwart advocates of free trade and globalisation slowly began to look inward, and treat foreign investment with some apprehension.

This shift, however, has not come simply at the behest of populists with no appreciation for the nuances of economic policy. Two factors, in particular, have led to this position, namely, an attempt to:

(a) prevent opportunistic and predatory acquisitions during times of economic duress (notably, COVID); and

(b) protect domestic interests in which foreign ownership could give rise to a national security concern.

We think the concern over opportunistic and predatory acquisitions is misplaced. An assessment of an acquisition as “opportunistic” or “predatory” is highly subjective – how is the Government better placed than the market to characterise an acquisition as opportunistic and predatory as opposed to an appropriate reward for investors in an environment where there may be heightened investment risk? Why is a so called opportunistic and predatory acquisition only bad when made by a foreign investor as opposed to a domestic investor? Imposing regulatory obstacles to foreign investment risks creating situations where opportunistic and predatory acquisitions are more (not less) likely to occur to the extent that:

(c) it forces Australian businesses that are seeking equity capital into accepting debt financing because it can be obtained more quickly; and/or

(d) it cuts off, or delays, access to more foreign-sourced capital.

These are entirely legitimate concerns and should be the subject of ongoing debate. The key to success, however, lies in striking a balance between addressing these concerns and facilitating foreign investment into Australia. Unfortunately, in many respects this has not been done.

In an attempt to achieve these ends, the Government has made changes to the FIRB regime which have material adverse impacts on existing and would-be foreign investors into Australia - the

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[1] Productivity Commission, *Foreign Investment in Australia* (Productivity Commission Research Paper, June 2020) 52.

overwhelming majority of whom abide by the rules and seek to facilitate a positive relationship with Australian counterparts and contribute to the Australian economy.

In addressing these concerns, we have adopted the structure of the Consultation Paper.

Submissions

2. Implementation

2.1 Whether the updated FIRB website and Guidance Notes have aided investors' understanding of the new foreign investment framework and investors' obligations under the framework.

We recognise the enormity of administering significant changes to legislation that has remained largely the same since 1975. In light of this, and notwithstanding some communication issues, the transition itself was generally handled well, and we commend the Treasury and FIRB on how these changes have been handled.

Overall, we find the updated FIRB website and Guidance Notes to be well-considered and well-structured, and they are helpful for investors to understand their obligations in respect of relatively straightforward transactions (which form the large majority of transactions by foreign persons).

2.2 Whether the Treasury's stakeholder engagement efforts have aided investors' understanding of the new foreign investment framework and investors' obligations under the framework.

The proactive approach that the Treasury and FIRB has taken to the roll out of the new foreign investment framework has generally been well received.

Some examples of this have included:

- the 'pre-release' of updated Guidance Notes in late 2020 gave investors some insight as to the impact of the reforms, particularly with respect to sectoral guidance regarding national security actions;
- the Treasury developing an education campaign for foreign investors and their advisers to ensure compliance with the changes from 1 January 2021; and
- on 21 July 2021, Treasury released further updated Guidance Notes. Included in these Guidance Notes were contemporaneous updates to guidance on various aspects of the regime. From these updated Guidance Notes, it is evident that Treasury and FIRB have been taking in and listening to stakeholder feedback.

These proactive steps (and others) aimed at assisting stakeholders are to be commended and we hope that they continue.

2.3 Whether the *Transitional Guidance Note*, and the Treasury's implementation efforts during this period, assisted in navigating the adjustments on 1 January 2021.

Prior to its official release, we acknowledge that the *Transitional Guidance Note* was provided to applicants who lodged an application with FIRB before 1 January 2021, but in respect of which a decision of the Treasurer had not been made. We also note and appreciate the efforts of relevant case officers making themselves available to assist applicants navigate through the transitional adjustments.

While the *Transitional Guidance Note* did assist applicants in navigating the transitional adjustments, there were issues with its implementation. For example, it should have been clarified with applicants that they did not have an option to have their applications continued to be treated as an application for a 'significant action' where the investment size was below post-1-January-2021 thresholds. We also note that there was lack of certainty in relation to obtaining a refund of application fees if the applicant withdrew such an application.

3. Macroeconomic Analysis

3.1 What are investors' key considerations when choosing to invest in Australia, and where foreign investment screening fits among these considerations.

For direct investments into Australia, the key driver is still the business fundamentals associated with the transaction. The foreign investment screening regime affects the assessment of these fundamentals in several ways.

Most obviously, an assessment of the prospects of receiving any required regulatory approvals, including under the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (**FATA**), the costs of applying and the ongoing costs of compliance (for example if conditions are imposed) can cause some investors to "self-screen" out of a transaction.

More commonly, however, foreign investors express concerns around the fact that the foreign investment screening regime puts foreign investors at a disadvantage, both in terms of a competitive bid situation and also in terms of competing with domestic-owned business going forward.

First, the unpredictability of whether a notice of no objection will be received, and how long it will take to receive it, mean that foreign investors in competitive bid situations offer less transaction certainty compared to domestic buyers.

Prospective foreign acquirers also suffer a competitive disadvantage. Timing uncertainties are exacerbated as a result of the possibility that costly conditions will be imposed, particularly in relation to data handling, even though the risks in relation to data accessed from offshore (such as by call centres) or stored offshore is the same, regardless of whether the business is foreign-owned or domestically-owned. These costs affect both investors' and targets' assessment of the benefits of a transaction.

In offshore transactions with a downstream Australian component, Australia is usually not a key component of the deal from a business perspective. However, FIRB approval is often the last regulatory condition to be satisfied. Accordingly, overseas lawyers routinely classify Australia as a "red flag" or "difficult" jurisdiction, and it is increasingly common to "carve out" the Australian portion of the transaction so as not to hold up the global deal (with FIRB approval being sought to re-acquire the Australian business at a later date, if it is not wound up).

3.2 The impact that COVID-19 and the international investment environment has had, or is having, on foreign investment inflows into Australia.

In general, investment into Australia does not seem to have been adversely affected by COVID-19, although there were temporary timing impacts, particularly during the middle of 2020 as key allocators of capital were: (a) distracted by impacts in their home jurisdictions; and (b) inclined to wait to see the outcome of developments.

Following the stabilisation of COVID-19 responses (with different levels of success), capital allocators were able to pursue investment decisions. Individual level investment decisions were affected by the impact on particular industries or entities rather than an overall unwillingness to invest into Australia. Other somewhat related factors (such as geopolitical relations with China) seem to have had more of an impact on levels of investment than COVID itself.

One industry sector where we have seen an impact on foreign investment inflows is in agricultural sector, particularly farm acquisitions. Foreign investment into the sector is now largely limited to foreign investors with an existing presence in Australia because most investors require physical inspection of acquisition targets by in-house representatives as part of their due diligence processes. Foreign investors have been reluctant to send representatives to Australia for this purpose because of the quarantine requirements in Australia, higher travel costs, unavailability of travel insurance and (in some cases) home-country quarantine requirements on return. To some extent this impact has been masked by an increase in investment activity by domestic investors fuelled by lower capital costs and better access to capital.

Australia's temporary “zero dollar threshold” and other COVID measures adversely impacted the real estate sector, with many 'vanilla' property leases requiring approval at a time when landlords and tenants were under significant pressures on other fronts. It would have been preferable for the COVID measures to have been targeted at higher risk transactions rather than adopting zero dollar thresholds for all investment proposals. The zero dollar thresholds may also have deterred some lower value transactions, but it is difficult to differentiate the impact of relevant measures from other factors. Anecdotally it was rare to hear an investor defer or abandon a transaction they would otherwise have pursued merely because of the temporary regulatory measures.

3.3 Whether, or how, the reforms have affected Australia’s attractiveness as a destination for foreign investment.

Other aspects of the reforms that contribute to the perception that Australia is a “difficult” jurisdiction include:

- It is more difficult to assess whether a transaction is caught by the legislation – particularly as a notifiable national security action – without incurring significant costs.
- The fees have increased substantially and are overly complex. In particular, the practice of assessing multiple fees for the same transaction (for example, when an investor acquires assets but the vendor retains land and then leases it to the investor / target), or assessing fees differently depending on technical differences in the structure; assessing those late in the process; and then resetting statutory deadlines is creating significant dissatisfaction among applicants.
- Multiple extensions to the statutory deadlines are almost universal for business applications, and the unpredictability wreaks havoc on business plans. Rather than retaining the fiction of the 30 day time period, it would be preferable for FIRB to set realistic deadlines for business transactions and stick to them, to at least allow transacting parties to plan.

4. Reform Analysis - national security

4.1 Whether the national security screening requirements, and the concepts of NNSA, RNSA, and national security business and national security land, are well understood.

The concept of a notifiable national security action is very difficult to apply in practice, and will become more so if and when the *Security of Critical Infrastructure Act 2018* (Cth) is amended.

The key issues are:

- The difficulty of determining when a person is carrying on business in Australia (a necessary component of the definition of national security business). Although further guidance on this has now been provided, it does not appear to reflect FIRB's position in all relevant respects. In a recent transaction, FIRB concluded that a target business was a national security business despite none of the factors listed in Guidance Note 8 being present. In particular, FIRB concluded that where a person has “access to systems and / or data”, a person will be considered to be carrying on business in Australia, yet this was ultimately not included in Guidance Note 8.
- Further, some factors that are included in the Guidance Note 8 as indicative of a business being carried on set an unusually low bar – in particular, applying for an ABN or having a website with an .au domain.
- A business can be considered to be a national security business if one part of the target’s business (not related to national security) is carried on in Australia, but

another part of the target's business (not conducted in Australia) provides critical goods, services or technology to foreign defence or intelligence agencies. There is also no "de minimis" concept, the consequence being that a single contract which is insignificant in the context of the business as a whole could technically result in the business being a national security business.

- A business is only a national security business if the applicant knows that it is, or could know this on the basis of making reasonable enquiries of publicly available information. In our dealings with FIRB, it appears that the bar for determining what are "reasonable enquiries" is very high and that FIRB takes an expansive view as to what is "publicly available" information, with investors expected to follow complicated chains of logic that are not obvious to those who do not work in government. This, together with the other issues raises above, means that the risk of inadvertent breaches of the legislation is high. At a minimum, it would be helpful for FIRB to provide non-exhaustive examples of websites that should be searched to obtain relevant information with links to that information embedded within the guidance.

- FIRB has taken the view that the acquisition of securities of an Australian land entity, where national security land forms a fraction of the entity's Australian land portfolio, will be deemed to be a notifiable national security action. The legislation basis for this conclusion is unclear. We note that for other types of land (like residential land and vacant commercial land), it is necessary for the land to comprise 10% or more of the portfolio before the securities in the land entity will be treated as residential land or vacant commercial land.

4.2 Whether the framework for defining these concepts (i.e. across the legislation, regulations and official guidance notes) is appropriate and sufficient.

The framework for defining these concepts across the legislation, regulations and official guidance notes is generally appropriate but we consider that the guidance should be further clarified and made more comprehensive, including:

- where possible, including more information in the Guidance Notes rather than referencing other legislation and definitions so that investors can refer to a more comprehensive source of information rather than needing to cross-refer to multiple sources – we do acknowledge that FIRB has sought to do more of this in the recent updates to the Guidance Notes but further work is required to provide clarity for foreign persons and their advisers as noted below;

- providing more comprehensive guidance in relation to widely defined or undefined concepts in the legislation and regulations. For example, in our experience investors and practitioners struggle with making an assessment of what constitutes "critical technology" or "critical services" as it involves making a judgement about what is "vital to advancing or enhancing Australia's national security" or "where ongoing access is essential to the capability advantage" of defence or intelligence agencies. We appreciate that these are difficult issues and it is important to balance national security concerns but we think that further examples and guidance could sensibly be provided (e.g. whether easily substitutable goods, technology or services would be considered critical).

4.3 What factors investors consider when deciding whether to voluntarily notify, including the effectiveness of the guidance on voluntary notification of RNSA in the National Security Guidance Note.

In our experience, some relevant factors are:

(a) investors try to assess the likelihood of the Treasurer exercising the call-in power if no voluntary notification is made – *noting there is no publicly available data on this currently*;

(b) where a contemplated acquisition is specifically covered in GN8 and voluntary notification is recommended, investors are more inclined to notify to mitigate against the risk that the Treasurer may exercise the call-in power post-closing of the transaction – though we note that there are a wide range of actions currently suggested in GN8 for voluntary notification and investors are weighing up the factors below in deciding whether to notify;

(c) in a competitive bid process, investors may not voluntarily notify as they do not want their bids to be unattractive to the vendors (as vendors tend to prefer bids with fewer conditions in order to de-risk completion) and to be competitive with domestic investors;

(d) investors may not voluntarily notify where there is a strategic advantage or a need to undertake the transaction quickly and there is uncertainty as to how long the FIRB process will take;

(e) if there are significant fees involved, investors may be less inclined to notify;

(f) where there is some uncertainty as to whether an action is mandatorily notifiable (e.g. where they are not certain whether it is "critical technology or services") , they may make a voluntary notification; and

(g) there is a higher risk of conditions being imposed if a voluntary notification is made because conditions can only be imposed otherwise if the action is actually "called-in" – therefore, there is a trade-off between:

    (i) making a voluntary notification and having a higher risk of conditions being imposed but at least the certainty of knowing what those conditions will be before taking the action; and

    (ii) not making a voluntary notification and having a lower risk of conditions being imposed because the action may not be called in but lack of certainty about what those conditions may be if the action is called in.

5. Reform analysis - compliance

5.1 Whether the new powers and increased enforcement penalties have resulted in a change in investors' attitudes and behaviours towards compliance.

In our experience, investors continue to do their utmost to comply with the framework, with any non-compliance generally being due to inadvertence or error.

However, the increase in penalties has attracted some anxiety and the penalties may, in fact, be at risk of driving individuals to not report non-compliance issues when identified.

It is to be hoped that FIRB would not take adverse action in respect of non-compliance unless there is an aggravating factor. Examples of aggravating factors would be: (a) knowingly not complying with the regulatory framework or clearance conditions; (b) repeat non-compliance; (c) failure to report non-compliance when identified or delay in doing so. Imposing penalties and infringement notices in respect of unintended or non-material non-compliance with a complicated framework, which even advisers regularly involved in interpreting the framework struggle to fully assess, would be particularly counter-productive and could have a chilling impact on foreign investment.

5.2 Whether the new compliance obligations of investors are clear and adequately explained in the available guidance material.

The publication of the guidance material is appreciated and helpful, although there is further opportunity for the guidance to be made more comprehensive.

The importance of compliance is emphasised adequately.

6. Reform analysis - streamlining

6.1 Whether the streamlining measures have reduced the regulatory burden on investment funds making investments into Australia.

We do not consider that the streamlining measures have significantly reduced the regulatory burden on investment funds making investments into Australia. First, because of the predominance of US pension fund money in private equity funds, very few funds have been able to avail themselves of the exemption set out in section 17(2) of the Foreign Acquisitions and Takeovers Regulation 2015 (Cth) (**FATR**).

Second, the regulations fail to take into account the structuring of investment funds, where most funds are comprised of separate vehicles. The true measure of the "interest" of an investor in an investment fund is their committed capital to the fund – the way that investors are grouped into different fund vehicles is completely irrelevant, because the vehicles operate as a single unit. FATA and FATR however require these vehicles to be assessed separately, vastly overstating the "interest" that a foreign person or a foreign government investor has in the fund.

For example, suppose a private equity fund (**Fund 1**) is comprised of 2 vehicles, which represent 80% (**Fund 1-A**) and 20% (**Fund 1-B**) of the committed capital of Fund 1, respectively. Fund 1-A is 80% Australian superannuation funds and 20% US public pension funds, while Fund 1-B is 100% Australian high net worth individuals. US public pension funds therefore represent only 16% of the committed capital of Fund 1, have 16% of the voting rights and receive 16% of the distributions, but because they hold 20% of the interests in Fund 1-A, Fund 1-A will be deemed to be a foreign government investor; and therefore any Bidco owned 100% by Fund 1 will also be deemed to be a foreign government investor (because Fund 1-A will hold 80% of it).

Further, private equity funds will often invest through alternative structures for given transactions. In a simple example, it is very common for Australian private equity funds to be structured as a "venture capital limited partnership" (**VCLP**) stapled to two unit trusts, with:

- all investors holding LP interests in the VCLP, and
- all investors holding units in one or the other of the unit trusts, so that taking the two trusts together, the units in the unit trusts are held in the same proportion as the limited partnership interests in the VCLP.

The manager may draw money from investors into the VCLP for purposes of making VCLP-eligible investments, and may draw money from investors into the unit trusts (which invest in lockstep) for purposes of making VCLP-ineligible investments. There are numerous examples of private equity funds that are not deemed to be foreign persons or foreign government investors when investing through their VCLPs, but because of the way investors are grouped into the two trusts, are deemed to be foreign persons or foreign government investors when they invest through their unit trusts (because a foreign person or foreign government investor holds 20% or more of one of the trusts). Yet the investors' voting power in the fund and economic exposure to the underlying asset is exactly the same whether the fund invests through the VCLP or the unit trusts.

Association rules applying between private equity fund vehicles further exacerbate the above rules, as private equity fund vehicles invest in lockstep, so even where a vehicle that is deemed to be a foreign government investor comprises only a small part of the fund, it can "taint" the entire shareholding of the fund in a given Bidco or target.

Until this structural issue with the legislation is addressed, no reforms will meaningfully address the burden on investment funds.

6.2 The expected utility and impact of the new passive foreign government investor Exemption Certificate.

There are a number of investment funds that are in the process of applying for passive foreign government investor exemption certificates. It is too early to assess whether these will be useful in practice. However, key factors to their utility will be as follows:

- To be useful, it is crucial that these exemption certificates are assessed and granted on the basis of the committed capital to the given fund, not the technical structure. All investment funds are structured to ensure that investors are only taxed in their home jurisdiction. To achieve this aim, it is common for investment funds to have the power to create “alternative investment vehicles” (**AIVs**) that are specific to a given investment. That is, although the fund may be set up in a particular way, it is possible to create entirely new vehicles and draw money from investors into those new vehicles, instead of into the main fund vehicles, for a particular investment, to ensure the above principle is upheld. The investors are still contributing to the investment in the same proportions as they would if the main fund vehicles were the investors; but they are doing so through different vehicles than the original fund vehicles and they may be grouped together in different ways.

- It is common for co-investors, managed by the fund manager, to come in alongside the fund. These co-investors are frequently investors in the fund, or otherwise a client of the fund manager, and generally are passive in nature. If the passive foreign government investor exemption certificates do not accommodate the possibility of these passive co-investors, then they will be of limited value, as the co-investors may cause the relevant fund manager to have to get FIRB approval anyway.

6.3 Other opportunities for streamlining the screening process to reduce regulatory burden while enabling appropriate scrutiny of risk.

The Treasury may wish to consider, at least in respect of investments by non-FGIs or a non-national security business, exempting the following transactions from the application of the FATA, or only requiring the investor to notify the transaction to FIRB (in a literal sense - as opposed to seeking approval):

- an internal reorganisation;

- an acquisition of an additional interest in securities in an entity or in an Australian business by a foreign person who already controls the entity or business; and

- increasing the percentage ownership of an interest in securities in an entity or in an Australian business without acquiring additional securities (or interests in securities) in an entity.

7. Reform analysis - fees

7.1 Whether the new fees framework affects investor decisions on investing into Australia.

We consider that the fees (which are recognised as a tax[2] rather than a cost recovery) are too high, particularly for agricultural and residential land, and should be set at a level that reflects a cost recovery.

In relation to investments into Australian assets that provide full economic value (e.g. freehold land, entities or businesses) we are not aware that the FIRB application fees have had any material impact on the willingness of foreign investors to invest into Australia. However, we note that this is in the context of a turbulent global investment landscape where the perceived security of Australian assets appears to have provided an adequate counter balancing effect to the disincentive created by high fees. We are concerned that where

[2] *Foreign Acquisitions and Takeovers Act Fees Imposition Act 2015* (Cth), s 5.

foreign investment into Australia becomes more marginal, the FIRB application fees will have a greater adverse impact.

Where transactions do not involve full economic value (e.g. lending and leases) or new investment (e.g. restructures), the fees framework certainly does impact on investor decisions, as explained in further detail below.

Secured lending in residential sector

A foreign financier (who does not qualify for the moneylending exemption) that lends money to an Australian residential property developer, and takes a mortgage over the residential land as security for the loan, is acquiring an interest in residential land and requires FIRB approval for the acquisition of that mortgage interest. The fees are based on the consideration for the acquisition of the mortgage interest in land and FIRB takes the view that the consideration is the full value of the loan. Where the interest payable on the loan is (for example) 5% p/a, a FIRB application fee of approximately 1.6% of the loan value is generally prohibitive and amounts to a re-introduction, at a federal level, of mortgage duty. While we consider that this specific situation arises from an incorrect interpretation of ‘consideration’ in this context, it is an example of a situation where the FIRB application fee materially impacts on foreign lending into Australia.

Lending syndicates operating through special purpose lending vehicles are an important potential source of alternative financing for residential development projects. Some special purpose lending vehicles do not qualify for the moneylending exemption. Taxing such lending in the residential sector through the fees framework limits access to capital and undermines the Australian Government’s objective of expanding house stocks.

Agricultural lending

Another example is in the case of leases and licences to occupy agricultural land. For example, where a foreign investor takes a transfer of a long-term lease of agricultural land (e.g. with 90 years of a 99-year term remaining) from an unrelated third party and pays a $1 premium and assumes the obligation to pay $1 million per year in rent. The fee under section 10 of the Fee Regulations is calculated by reference to the value of the consideration for the acquisition. Consideration is defined in section 14 of the FATR inclusively, so will include the common law definition of consideration (i.e. will include the value of any assumed liabilities). Guidance Note 2 states that:

> Consideration for a leasehold interest in Australian land will generally be the total of any:
>
> - up-front initial payments (other than taxes and regulatory charges) for the grant of the leasehold interest;
> - periodic payments for the benefit and enjoyment of the Australian land (for example, annual lease payments including amounts as increased in accordance with a formula over the term of the lease);
> - amounts likely to be paid for an extension or renewal of the lease (if prescribed under the lease agreement); and
> - the value of any interest in a wind or solar power station on the land.[3]

Section 14(4A) of the FATR states that, for leases in excess of 20 years, consideration will be pro-rated down to 20 years. Applying the position set out in Guidance Note 2 and specifically the example on page 37 of Guidance Note 2, FIRB assesses the fee for the acquisition based on consideration of $20,000,000.22. The fee would be $127,000. However, this is based on an incorrect understanding of the concept of consideration in the context of leasehold interests. While consideration includes assumed liabilities, the assumption of an obligation to pay rent upon the acquisition of a leasehold interest is not

[3] While not relevant to this example, there is no reference to wind or solar power stations in the definition of consideration in the FATR, and this should be deleted from Guidance Note 2. This is a reference that should be included in the concept of value – not consideration.

consideration for the acquisition of that leasehold interest in land. This was considered in *Swayne v IRC* [1899] 1 QB 335 where the court concluded that:

> *Where a lease for years subject to the payment of an annual rent is conveyed or assigned, the very property conveyed is in its nature a qualified property, and the liability to pay rent arises out of the nature of the estate conveyed. The liability to pay is not in the nature of a charge or encumbrance on the property; it does not even arise out of any independent stipulation that the money shall be paid; it is inherent in the nature of the property, and can never be extinguished so long as the character of the property remains.*

Applying this principle, the consideration for the acquisition of the leasehold interest in the above example is, in this case, $0.22, and the fee should be calculated under section 53 of the Foreign Acquisitions and Takeovers Fees Imposition Regulations 2020 (Cth) (**Fees Regulation**) to be $2,000.

Also, this misconception of 'consideration' for leasehold interests in land materially impacts on the calculation of the monetary screening threshold. Take for example the set of circumstances set out above. If the investor did not hold any other interest in agricultural land, FIRB approval would only be required if the consideration for the leasehold interest was in excess of $15 million. As shown above, the consideration is $0.22. Assuming a transaction between arm's length parties, the monetary screening threshold would not be exceeded.[4]

Restructures

A higher fee is charged on internal reorganisations involving consideration that is not more than the applicable fee constant than on equivalent transactions that are not internal reorganisations. This is because internal reorganisations attract a fixed fee of $12,700 (or $3,175 in the case of a reviewable national security action) whereas, in other transactions, consideration that is not more than the fee constant will attract a fee of $6,350 (or $1,587.50) or, if consideration is less than $75,000, a fee of $2,000 (or $500). We do not see a justification for the charging of higher fees for internal reorganisations.

Further, there are categories of restructures that fall outside of the definition of internal reorganisations that then attract a higher fee. For example, this is the case where a new ultimate holding entity is inter-posed between an existing ultimate holding entity and investors. This will not be an internal reorganisation even though the investors in the new ultimate holding entity are exactly the same as the investors in the existing ultimate holding entity and, therefore, ultimate ownership has not changed. This can even occur where the new and existing ultimate holding entities have a single investor because that investor holds the investment in a fiduciary capacity (FATA s 21(2)(a)).

7.2 Whether the new fees framework affects when and how investors apply for foreign investment approval.

Timing of FIRB notifications

The high FIRB application fees have impacted on how investors interact with the foreign investment regime in Australia. Before fees were introduced, it was common that advisors would encourage investors to lodge an application early so that any delays in obtaining FIRB approval would not adversely impact on the completion of the transaction. The fact that the fees are non-refundable and so high (approximately 0.6% of transaction value for agricultural land and approximately 1.2% for residential land – up to a cap of $500,000) means that there is now real reluctance by investors to lodge applications before they have signed agreements in place. This, combined with the sometimes lengthy delays in the processing of

[4] The consideration for the acquisition of a leasehold interest in land that is not agricultural land is not relevant to the monetary screening threshold because section 52(3)(b) of the FATA bases the threshold in this case on the value of the interest in land, not the consideration paid for its acquisition. However, consideration is relevant to the calculation of the fee (if FIRB approval is required) and we reiterate our comments above about the proper interpretation of 'consideration' in relation to the acquisition of an interest in a leasehold premises.

applications, means that Australia is often one of the last jurisdictions for which regulatory approvals are obtained in a global deal. This has on a number of occasions led parties to consider excluding Australian assets from deals to manage that timing risk.

Following the reforms effective 1 January 2021 in relation to the fee regime, the following has been observed.

(a) Because fees are now often quite substantial, foreign bidders in competitive processes are reluctant to seek FIRB approval prior to making their bids or until there is some certainty that they have been selected. This can place foreign bidders at a disadvantage which in turn is disadvantageous to having a robust competitive process and potentially means vendors do not achieve the most competitive price. It can also result in significant delay to completion for vendors.

(b) Experience so far with the fees framework is that the Fee Regulations and calculations are complicated, and the relevant guidance note not always completely helpful. A recent example involved a multi-billion acquisition by a foreign entity of another foreign entity, which had multiple wholly-owned Australian subsidiaries. In using section 14(5) of the FATR, which apportions the consideration value based on the earnings before interest and tax (EBIT) of an Australian business / entity and the EBIT of the global consolidated group, the calculations of the FIRB fee payable resulted in three possible outcomes, as follows.

    - outcome 1: a fee of $503,000 based on the assumption that section 14(5) required only the positive EBIT figures of the Australian entities to be used in calculating the FIRB fee payable, and to ignore the remaining Australian entities with negative EBIT figures;

    - outcome 2: a FIRB fee of $203,200 based on the assumption that section 14(5) required both positive and negative EBIT figures (i.e. a consolidated Australian EBIT figure) to be used in calculating the FIRB fee payable; and

    - outcome 3: a FIRB fee $165,100 based on a removal of certain inter-group expenses from the EBIT of certain Australian entities and otherwise using the calculations employed in scenario 2 – as there is no definition or further guidance provided in relation to the meaning of EBIT, it was uncertain if the calculation of EBIT for FIRB purposes should include or not include inter-group earnings.

    We are aware that, in some cases where it was not possible to use EBIT figures, asset figures have instead been used and that FIRB has not raised any objection to that. Assuming the use of assets can be an acceptable proxy to EBIT, we submit that the FIRB's fee guidance note should deal with the circumstances in which it is permissible to use asset rather than EBIT figures.

    Another problem with section 14(5) of the FATR is that it does not link to any other provisions that deal with consideration. The section permits apportionment but nowhere else in the FATA or the FATR does it specify that only the portion attributable to the relevant Australian business or entity is to be counted.

We submit that the fees framework is currently acting as a deterrent to foreign bidders applying to FIRB at an early stage in competitive bidding processes, which is also to the detriment of ensuring a truly competitive outcome for the relevant company or assets. This could be addressed if:

- the fee, or a substantial portion of the fee, was refundable for unsuccessful bidders in a competitive process; or

- bidders paid a percentage of the fee at the time of lodgement of their notification, and, if named the successful bidder, they would pay the remaining percentage shortly after closing the acquisition – the obligation to pay being a condition to the no objection notification.

We expect the second alternative would be much preferred by bidders – many bidders, private equity funds or other financial sponsors in particular, can face internal approval difficulties and / or are often very reluctant to draw down from their funding source to pay the full fee upfront, despite the fee being refundable at a later stage, due to the opportunity cost of those funds being put to an alternative use while the sale process (and FIRB approval process) runs its course.

Exemption certificates

There is now far less benefit (from a fees perspective) in applying for exemption certificates for a program of acquisitions (under section 58 of the FATA), so these are likely to be less widely used which will lead to greater administrative inefficiency for high volume investors into Australia. Even if it is accepted that:

- the fees under exemption certificates should not be materially less than the fees for individual acquisitions (i.e. if it accepted that a simple 25% discount on fees is appropriate); and

- the fees otherwise payable for individual acquisitions is appropriate (which we do not accept – see comments above),

the new fees framework for exemption certificates still presents an unnecessary disincentive that will further reduce the utility of the exemption certificates. The requirement to anticipate the total amount to be expended on each type of land (for example) and pay the full fee up-front is, in many cases, commercially un-workable. It would make far more sense to have a flat fee payable up-front (say $25,000) and a top-up fee payable as acquisitions are made under the exemption certificate, say at 75% of the fee that would otherwise be payable on an individual application at the time each report is lodged (based on the value and type of land acquired), with the aggregate amount payable capped at $377,250. A credit for the up-front payment could be given against the per-transaction fees imposed, so that the economic outcome is the same as the current model, without the need for guesswork up front.

7.3 Whether there is a need for further guidance on the fees framework and, if so, what that guidance should address and in what format.

If the current fees framework for exemption certificates under section 58 of the FATA remains as currently drafted, there should at least be a firm commitment by FIRB (via a Guidance Note would be sufficient, so long as the Guidance was strictly adhered to as a matter of practice) to:

- (preferably) refund any unused portion of the fee (possibly except for a base fee of say $25,000); or

- (alternatively) roll any unused portion of the fee to a subsequent exemption certificate or individual application (with broad application).

The current guidance set out in Guidance Note 10 is as follows "*if a foreign person does not utilise the full financial limit of an exemption certificate, the Treasurer may consider allowing the remaining amount to be 'rolled over' to a future exemption certificate, effectively lowering the cost of a future application. This would be assessed on a case-by-case basis and roll over amounts would likely need to be more than the relevant fee constant*". We consider this does not provide sufficient certainty for investors and will provide a further disincentive to the use of these exemption certificates.

There are some anomalies arising from the new fees framework that we recommend be addressed through guidance indicating that the anomalies will be addressed through appropriate fee remissions.

(a) **Land actions**: It appears that section 51 of the Fees Regulations was drafted on the assumption that the different land actions covered by a single agreement will involve the acquisition by a person of interests in multiple land titles and/or tenements. In that context, an aggregation of the consideration for each land action makes sense.

However, section 51 also applies to different land actions that involve the acquisition by a person of multiple interests in a single land title and/or tenement. For example, where there is an agreement involving the sharing of profits or income from the use of, or dealings in, Australian land and the land owner's payment obligations under that agreement are secured by a mortgage.

An application of section 51 in the latter circumstance results in the effective doubling of the consideration and, therefore, the official fee. Particularly in the context of one of the land actions being the grant of a mortgage to secure interests acquired under the other land action, this involves a double counting of the same consideration. This should be addressed by a variation to the Fee Regulations to prevent such double counting of consideration.

8. Other matters

8.1 Whether any other elements of the reforms, which are not already discussed at a consultation question above, have had a significant impact on stakeholders and, if so, what those impacts are.

Land subdivisions and amalgamations

There is significant concern among foreign investors regarding the position taken by FIRB in Guidance Note 2 that land subdivisions and amalgamations "will generally result in the extinguishment of the old title and the creation of a new title or titles resulting in an acquisition of a new interest in Australian land that can constitute a significant and notifiable action under the Act".

From a legal perspective, it is difficult to understand how a subdivision or amalgamation constitutes the acquisition of a new interest in land, given that it relates to the same land. The land has not changed its character as a result of the sub-division or amalgamation, and we consider that section 12(3) of the FATA is directed at acquiring different types of interests in land (for example, moving from leasehold to freehold, or moving from mortgage interest to freehold).

There are significant practical complications for foreign investors with the Government's view that a subdivision or amalgamation constitutes the acquisition of a new interest in land. If subdivision or amalgamation does not occur for several years, that would unlikely to be covered by an exemption certificate and, therefore, there is uncertainty for the foreign investor. However, the foreign investor could have already entered into contracts with third parties. There is a risk of projects not being bankable if potential financiers do not have certainty that a FIRB approval for a subdivision or amalgamation will be forthcoming in the future. The Government's suggestion in Guidance Note 2 that the matter can be dealt with in no objection notification or exemption certificates is feasible only if foreign investors have certainty that an objection notification or exemption certificate will have a life span that is sufficient to cover a subdivision or amalgamation that could occur several years in the future. However, Guidance Note 2 does not provide any assurance on that point.

We query the national interest concern with subdivisions and amalgamations given that there is no change in landowner, and that any sale of part of the land will be subject to its own FIRB approval process if the purchaser is a foreign person and if the relevant FIRB monetary thresholds are exceeded. Given the absence of a national interest imperative, we do not understand why interpretations are being advanced that treat amalgamations and subdivisions as acquisitions of interests in land. If there is a concern about conditions not being brought across to land resulting from a sub-division or amalgamation, this should be fixed by an appropriate regulatory amendment to clarify that any conditions applying to land that is subdivided or amalgamated, will automatically apply to the sub-divided or amalgamated land unless otherwise approved by the Treasurer or his or her delegate.

We recommend that the Government consider urgently an exemption for amalgamations and subdivisions for foreign persons who have interests in the subject land prior to amalgamation or subdivision provided that they acquire no greater interest in land as a result of the amalgamation or subdivision. The urgency stems from the potential this issue has to significantly disrupt the expansion of Australia's housing stock and reduce competition within the residential development market given the significant competitive disadvantage suffered by foreign-owned developers.

8.2 Whether any other elements of the foreign investment framework, which are not already discussed at a consultation question above, have a significant impact on stakeholders and, if so, what those impacts are and how they could be addressed.

In addition to the topics raised in the submissions above, we request Treasury to take into account the following further submissions:

Carrying on business in Australia

The term "carrying on business in Australia" is defined in the *Corporations Act 2001* (Cth) (**Corporations Act**) (section 21). "Business" is also defined in section 995-1 of the *Income Tax Assessment Act 1997* (Cth) (**Income Tax Assessment Act**) with the phrase "carrying on a business" defined in section 328-110 of the Income Tax Assessment Act and "carrying on business in Australia" further defined in Tax Ruling TR2019/1[5] (combined, referred to as the Tax Legislation).

In the FATA, the term "Australian business" is defined as a "business that is carried on wholly or partly in Australia".

The FATA and Guidance Note 7 further defines "starts an Australian business" (section 8B) and "starts a national security business" (section 8A).

There needs to be greater consistency between these similar definitions.

For example, section 21(3) of the Corporations Act states that the following activities, if conducted in Australia, do not constitute carrying on business in Australia:

- becoming a party to a proceeding or effecting settlement of a proceeding, claim or dispute;
- holding a meeting of its directors or shareholders or carrying on other activities concerning its internal affairs;
- maintaining a bank account;
- effecting a sale through an independent contractor;
- creating evidence of a debt, or creating a security interest in property;
- securing or collecting any of its debts or enforcing its rights in regard to any securities relating to such debt.

Further, Tax Ruling TR2019/1 (at paragraphs 53 and 54) states "whether a company carries on a business must be assessed based on its activity and status at that time.

A company may not be carrying on a business if its activities are preliminary to the carrying on a business and are merely carried out to determine whether it is feasible to carry on a business."

[5] https://www.ato.gov.au/law/view/document?DocID=TXR/TR20191/NAT/ATO/00001

Based on the definitions in the Corporations Act and Tax Legislation, we submit that the following activities should not be treated as starting "an Australian business" or "a national security business" as they are activities which are preliminary to starting that business:

- registration of a company under the Corporations Act;
- applying for an Australian Business Number;
- opening a bank account;
- applying for a website address;
- entering into a lease or licence for office space with a term of less than 5 years;
- making an application for a regulatory approval;
- entering into a contract with advisers or an independent contractor;
- the business receiving payments into an Australian bank account for goods and services rendered outside of Australia; and
- entering into a business contract (including an employment contract) that is subject to FIRB approval.

These activities are all preliminary activities to the establishment of a business, and do not mean business has started. Some leeway should be given for entities to explore whether they wish to start an Australian business or national security business before having to apply for FIRB approval. The current test requires a FIRB approval at a stage well before a business is actually started.

A solution would be to draw from the Corporations Act and Tax Legislation and state activities which do not constitute starting "an Australian business" or "a national security business" in the FATA.

Alternatively, Guidance Note 7 could be amended to clarify the position.

In addition, the tests for an FGI starting an Australian business (Reg 56(1)(b)) or national security business need to be aligned with that of a non-FGI foreign person starting a national security business.

Change of trustee

It is clear and not contentious that, on a change of trustee of a trust, an incoming trustee who is a foreign person might need FIRB approval to acquire legal interests in trust assets. However, the FATA does not deal directly with the situation where an incoming trustee is not itself a foreign person but a foreign person has a 20% or greater interest in the trust, or two or more foreign persons together have a 40% or greater interest in the trust.

There has been general consensus among practitioners that the assumption of trusteeship on a change of trustee is undertaken by the incoming trustee in its personal capacity, and therefore if the incoming trustee is not itself a foreign person, FIRB approval would not be required for the assumption of trusteeship. However, there has been a divergence of views among practitioners in relation to the steps needed to vest the trust assets in the incoming trustee. One view is that an incoming trustee acquires legal title to trust assets in a personal capacity to perfect its assumption of the trusteeship, rather than in its capacity as trustee – such that if the incoming trustee is not a foreign person then the FIRB rules cannot apply. An opposing and more conservative view is that the incoming trustee acquires legal title to trust assets in a trustee capacity, and therefore the foreign ownership of interests in the trust determines whether or not the incoming trustee is to be treated as a foreign person (even though there is no change to the beneficial interest held by the beneficiaries).

In the updated FIRB Guidance Note 7, the conservative view is adopted, and consequently created a potentially significant issue for local funds managers and local professional trustee companies. Such persons who become trustees of trusts with foreign beneficiaries will now need to undertake their own analysis of whether FIRB approval is required, and where approval is required the exercise of identifying all trust assets that trigger a FIRB approval requirement may not be a straightforward one.

This view appears to be based solely on the definition of 'foreign person' in the FATA, which refers to a trustee of a trust. However, the updated FIRB Guidance 7 neither mentions, nor expresses, any view on, the fine distinctions between assuming and perfecting trusteeship on a change of trustee.

The Government notes that the passive foreign custodian corporation exemption might apply, but this is not a complete solution given it would only apply where the incoming trustee acts as a custodian or bare trustee. In addition, this exemption does not extend to the reviewable national security action concept.

The Government recognises, in the updated FIRB Guidance 7, that an incoming trustee that is considered a foreign person would only need FIRB approval if 'the relevant threshold is met'. However, no guidance has been given as to how to value a trustee's legal interest in trust assets for this purpose. Normally the full value of trust assets is attributed to the beneficial interest held by beneficiaries (such as unitholders in a unit trust). That said, an incoming trustee will be automatically subject to a nil dollar threshold to acquire interests in residential land, vacant commercial land, mining or production tenements and direct interests in national security businesses. A nil dollar threshold will also apply where the incoming trustee is considered an FGI by reason of beneficiaries being FGIs.

In light of the foregoing, we recommend that the Government adopt the view that an incoming trustee acquires legal title to trust assets in a personal capacity to perfect its assumption of the trusteeship, rather than in its capacity as trustee – such that if the incoming trustee is not a foreign person then the FATA cannot apply.

New conditions for renewables

FIRB Guidance 4 now provides that the land development conditions that usually apply to no objection notifications for acquisitions of vacant commercial land will also apply to acquisitions of agricultural land and vacant commercial land for the purpose of operating a wind or solar farm.

According to Guidance 4, the usual land development conditions will be that:

- a wind or solar farm must be developed on the land;

- continuous construction of the proposed development must commence within five years of completing the purchase of the land; and

- the land must not be sold, transferred, or otherwise disposed of prior to the development being completed (the “no pre-completion sale condition”).

The no pre-completion sale condition is problematic as it is inconsistent with how wind and solar farm projects are usually financed and undertaken. Given the high development costs and lengthy timelines associated with such projects, it is common for interests in project land to be transferred prior to completion of construction, sometimes more than once.

For instance, a common structure is for a developer (who may have limited ability to raise substantial project finance on its own) to acquire land for the purposes of a wind or solar project, and to sell all or part of the land to another developer during the development process so that the second developer can finance or contribute to development costs. The second developer (whether alone or together with the first developer) would then take the project to financial close and then sell all or part of the land at financial close or prior to completion of construction.

This project structure would no longer be permitted by the new standard land development conditions. Given that many wind and solar farm projects in Australia have involved foreign investors, the Government's proposed conditions have the potential to significantly impact the commercial feasibility of such projects. If this results in fewer wind and solar projects than would otherwise be the case, this would not be in the national interest. These conditions also would have the perverse outcome that if a foreign developer proposed to sell the project to an Australian party prior to completion, it would effectively need to seek FIRB approval via waiver of the no pre-completion sale condition.

In light of the foregoing, we recommend that standard land development conditions not apply to acquisitions of agricultural land and vacant commercial land for the purpose of operating a wind or solar farm.

Exploration tenements (FATA s 27B)

The exclusion of foreign government investors from the exemption in section 27B of the FATR applies to foreign government investors as both acquirers and targets. We do not think there is a justification to apply the exclusion to foreign government investors as targets. The consequence of doing so is to apply a different test to other target entities when determining whether they are land entities.

Revenue streams from mining or production tenements (FATR s 27A)

The introduction of this exemption is of little benefit because it is market practice to secure the grant of revenue streams from mining or production tenements with a mortgage over the tenement. As a mortgage in this case does not have the benefit of the exemption in section 27 of the FATR for moneylending agreements, a FIRB clearance is still required.

We recommend that an exemption be adopted for security interests over tenements that are taken for the purposes of securing revenue streams from tenements that are the subject of the exemption in section 27A of the FATR. The exemption could be adopted on similar terms to the exemption in section 27 of the FATR for moneylending agreements.

Internal reorganisations (Fees Regulation s 41)

There is currently no exemption for internal reorganisations even if they do not cause any change in ultimate ownership. This seems inconsistent with the stated policy of welcoming foreign investment whilst protecting Australia’s national interest as it is difficult to see how the national interest is prejudiced or affected by transactions of this kind. It has also resulted in restructures involving multinational groups:

- being delayed because of a requirement to obtain a no objection notification; or
- not being notified because overseas advisors were (somewhat understandably) not aware that internal reorganisations could trigger FIRB notifications.

In circumstances where there is no change in ultimate ownership or control, this has caused questions and concerns from international organisations who regard it as excessive “red tape”. This is exacerbated because inevitably FIRB processes have continued to be delayed.

By way of example:

- in a group of companies where a subsidiary is transferred from one entity to a sibling entity (i.e. an entity in the group that is neither a parent nor a subsidiary) and where the other FIRB conditions, such as thresholds, are met, there is a requirement to make a FIRB notification despite the fact that the ultimate holding company remains the same; and
- where a new ultimate holding company is inserted, but the shareholders (i.e. of the previous ultimate holding company) remain the same, and therefore ultimate ownership has not changed.

FIRB are also uncertain at times as to whether a transaction is an internal reorganisation or a standard application, attracting higher fees, which has also resulted in delays to the transaction's timeline (refer to our additional comments on internal reorganisations under section 7.1 in the context of the fees framework).

We submit that:

- the current FIRB regime for internal reorganisations is disproportionate in that it is subjected to the full application processes, fees and time requirements of a standard application and as such is inconsistent with striking an appropriate balance between welcoming foreign investment and protecting Australia's national interests;

- where there is no change to ultimate ownership in an internal reorganisation it is difficult to see why there is a requirement to have such a transaction scrutinised by FIRB; and

- there are many forms of internal reorganisations which do not involve any true third party (as opposed to a new corporate entity under the same ownership and control) obtaining an interest or control, and therefore an exemption should be created for internal reorganisations where such reorganisation does not create a change in ultimate ownership – this should include both where the ultimate holding company remains the same, or where a new ultimate holding company is created but the shareholders (and therefore ultimate ownership) remain the same.

To the extent that potential tax revenue impacts are driving retention of internal reorganisations, we think this is unjustified because:

- investors should be able to structure investments in any way they choose if the structure complies with tax laws;

- the Australian Taxation Office has sufficient powers outside of the FIRB regime to monitor and investigate internal reorganisations that may not comply with tax laws (more than most revenue authorities around the world);

- concerns about tax revenue impacts of utilising particular investment structures should be addressed through engagement with the ATO directly;

- it is forcing internal reorganisations into a review process regardless of whether there is an Australian tax revenue impact; and

- reliance on the FIRB framework to safeguard tax revenue impacts is inappropriate given the huge variation in monetary screening thresholds and that the ATO is the agency that should assess tax risks and compliance through its own processes and programs.

Foreign custodian corporations (FATR s 30)

This exemption is only available to foreign custodian corporations when they acquire a legal interest, not when they acquire an equitable interest. There are some difficulties with this limitation.

- A unit in a unit trust is an equitable form of ownership. It is not possible to hold a legal interest in a unit trust – an equitable interest is the only interest that can be held. As such, a foreign custodian corporation cannot rely on the exemption to acquire interests in listed managed investment schemes.

- The constitutions of most Australian corporations provide that the corporation is only obliged to recognise the legal holder of a share (i.e. the registered holder). When an investor holds an equitable interest in shares held by a foreign custodian corporation they are relying on the foreign custodian corporation being recognised as both the legal and beneficial holder of the share.

- Custody is a form of trusteeship, foreign custodian corporations will typically seek indemnification (including out of assets they hold on trust) for liabilities they properly incur as custodians. To address these issues, we recommend that section 30(c) of the FATR be deleted and that paragraph (d) be amended to read as follows:

  (d) *no interest in the securities, assets, trust, land or tenement is held by the foreign person for its own benefit except only to the extent of any indemnity it obtains in good faith, on ordinary commercial terms and in the ordinary course of carrying on a business of providing custodian services; and*

Negative veto power (FATA s 22(4)

Section 22(4) of the FATA is one of the least understood provisions in the FATA, partly because FIRB has never issued any guidance on it. There are a number of matters on which guidance or legislative change is needed. For instance:

- Exactly when is a person "in a position to veto any resolution of the board, central management or general meeting of an entity" (ie. "veto power")? Only if the person has such a right enshrined in a constitution or other constituent document? Practitioners have taken a purposive approach and considered that the source of a person's veto right does not matter – it could be a consent right in a constitution, shareholders' agreement or other document. We assume the Government has the same view – if so, this should be reflected in FIRB guidance.

- We assume that a person can have veto power even without having an interest in securities of an entity. If the Government has the same view it should be reflected in FIRB guidance.

- The test should not operate as a hair-trigger. The reference to "any" resolution means that veto and consent rights which do not go to operational matters are caught, for example, where a constitution or shareholders' agreement provides that the board of a company cannot resolve to issue shares in a manner not specified in the shareholders' agreement, other than with the consent of all shareholders, that could be regarded as conferring a right of veto on every shareholder, irrespective of the size of their shareholding interest. This can result in investors seeking to acquire very small shareholding percentage interests being subject to a mandatory FIRB approval requirement where the investor is an FGI, or where the target company is an Australian land entity, or where the target entity carries on a national security business – notwithstanding that the investor has no or extremely limited influence over the company. We recommend that section 22(4) be amended to introduce a materiality test, which can be supported by FIRB guidance. Standard minority investor protections that do not relate to investment decisions or operational matters should not be considered to constitute negative veto powers. Such amendments are consistent with other recent changes made in relation to passive investments.

- It is not clear whether customary conduct of target business restrictions in a conditional purchase agreement covering the period between signing and completion can constitute veto power of the type described in section 22(4). If it does, then many conditional purchase agreements that have such restrictions would have conferred on the purchaser deemed 20% potential voting power in the target and possibly have triggered a mandatory FIRB approval where the investor is an FGI, or where the target company is an Australian land entity, or where the target entity carries on a national security business. But foreign investors do not generally seek FIRB approval for such conduct of business restrictions. We assume that the intention of section 22(4) is not to capture customary pre-completion conduct of business restrictions. Otherwise many foreign investors would be forced to enter into purchase agreements only after obtaining FIRB approval or enter into purchase agreements without the customary restrictions – both options are unworkable for foreign investors. We submit that either section 22(4) should be amended so as not cover these types of restrictions, or that FIRB guidance should be published to achieve the same position.

- We submit that a person who has deemed 20% potential voting power in an entity by reason of section 22(4) should not be taken to have a traced interest in securities held by that entity. The combined operation of the tracing rules and section 22(4) can result in a foreign investor needing to seek FIRB approval for traced interests in downstream entities where the foreign investor has either minimal or no influence over the downstream entities.

Variations

We submit that variation applications should be subject to a decision period regime in the same way as applications for no objection notifications and exemption certificates. The absence of a decision period for variation applications has invariably resulted in lengthy assessment periods, which is not appropriate given that in many cases the requested variation is urgent. For instance, a variation might be sought to vary a condition, such as an operational obligation that the applicant did not know at the time of grant of the no objection notification could not be complied with, and it is important that the condition be varied as soon as possible in light of penalties for non-compliance with conditions.

FIRB's application checklist

There continues to be uncertainty on how to interpret FIRB's application checklist. Of particular concern is how to interpret the requirement to disclose interests of greater than 5 per cent. There is no explanation of what 'interest' means for this purpose, nor how high up the chain of ownership one must go. The approach taken by FIRB case officers has not been consistent – some are satisfied with disclosure of direct interests in the applicant entity, whereas others have required disclosure of interests in upstream entities even where the look-through interest of upstream investors in the applicant entity has been substantially less than 5%. We recommend that the FIRB application checklist be modified to provide more specificity, as well as worked examples.

Various technical matters

(a) **Foreign person definition:** It is not clear why paragraphs (c) and (e) of the definition of 'foreign person' do not refer to 'separate government entity' in addition to 'foreign government', whereas the definition of 'FGI' in section 17 of the FATR does do so. We recommend that the foreign person definition be amended to include references to 'separate government entity'. Addressing this discrepancy will ensure that sub-5% holdings by FGIs (on account of being 'separate government entities') in an ASX-listed entity are not counted for the purposes of determining whether such entity is a foreign person, based on section 47 of the FATR.

(b) **Acquisition of interests from government:** Section 28(2) of the FATR (on a technical reading) results in all acquisitions of interests in land from government being excluded from the exemption in section 31 of the FATR (as all acquisitions of land are reviewable national security actions under section 55F of the FATA, and therefore excluded from Division 3 of the FATR under section 28(2)). The same consequence arises in relation to acquisitions of interests in Australian businesses or entities from government where that constitutes a reviewable national security action under section 55D or 55E of the FATA). It would be desirable that section 28(2) is amended to clarify that acquisitions falling with section 31 of the FATR are not significant, notifiable or notifiable national security actions (but remain subject to the call-in power).

(c) **Complexity and overlapping concepts:** The current regulatory regime is very complex. The patchwork of different rules introduced over the years since 1975 does not present a coherent and easy to understand policy framework, but instead is evidence of ad hoc decision making, political negotiations with various interest groups and the fear of letting through an investment considered to be risky (often with hindsight), however minimal.

    For example, the various percentage and monetary thresholds (and the different ways of measuring them) have been attributed to political and free trade agreement negotiations, and are therefore impossible to change. Further, the introduction of the new national security business and national security land concepts could have replaced the older concepts of sensitive business, public utility and public infrastructure but they were left in place, creating duplicated diligence issues.

The complexity does not facilitate compliance and creates substantial additional transaction and compliance costs for investors.

We encourage the Australian government to simplify the regulatory regime and remove redundant rules where the compliance costs created for the majority of investors outweigh the benefits of being able to pre-screen the investments.

The new national security powers given to the Treasurer should give significant comfort that the Treasurer is able to take action if the rare investment turned out to be contrary to national security, while streamlining the pre-investment screening process for the large majority of investments that are benign and beneficial to Australia.

(d) **Distinction between significant action and notifiable action:** The distinction between significant action and notifiable actions is starting to become immaterial, especially in light of the new reviewable national security action. Consider removing the significant action category or merging it into the notifiable action category, to simplify the rules.

(e) **Section 15 – Interests acquired by entering agreements or acquiring options and conditional agreement or conditional options:** Given the negligible practical distinction between a condition to the agreement becoming binding or to the grant of option, and a condition to completion or exercise of the option, the policy distinction is hard to understand, explain and justify. If there is a condition that remains unsatisfied, no actual underlying interest can be acquired. It is hard to see what mischief the distinction is trying to address. We suggest that all conditions, including conditions to exercise an option, be able to delay the acquisition of the underlying interest under section 15.

(f) **Devolution exemption** (FATR s 29): Arrangements under Part 5.1 or 5.3A of the *Corporations Act 2001* are excluded from the “devolution by operation of law” exemption – this exclusion should be extended to cover equivalent processes under other Australian laws (e.g. state-based co-operatives legislation) and foreign laws.

(g) **Aquaculture** (FATR s 44): The combined effect of the definition of ‘commercial land’ in section 4 of the FATA and section 44(13) of the FATR is that land in Australia that is used wholly and exclusively for aquaculture and cannot reasonably be used for any other primary production business is not ‘Australian land’.