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20 March 2015

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Dear Sir / Madam

Strengthening Australia's Foreign Investment Framework – Submission

We thank the Government for the opportunity to make this submission in response to its options paper, *Strengthening Australia's Foreign Investment Framework*.

We are an Australian law firm which assists both foreign and domestic clients in a broad range of industries. We are often called upon to advise clients on Australia's foreign investment framework. As much as our work involves advising foreign investors, it also involves advising domestic clients on the impact the framework may have on their ability to sell assets to, attract investment from, and enter into joint ventures and other commercial arrangements with foreign investors.

Together with a number of colleagues, the author of this submission, Marcus Clark, advises Allens clients regularly about the framework. He is also an author of *Foreign Investment in Australia*, a loose-leaf service published by Thomson Reuters. This submission reflects the views of the author and does not necessarily reflect the views of Allens or its clients.

Overall, we think Australia's foreign investment framework has served Australia well over the last 40 years or so. It has its many faults, but its key attribute is that it has allowed Australia to attract foreign investment – and prosper from that investment – while providing a mechanism for successive Governments to address both economic and social concerns about some foreign investment proposals.

This outcome is all the more surprising given that the key component of the framework is the much unloved *Foreign Acquisitions and Takeovers Act 1975* (Cth) (***FATA***). More on this in the submissions below.

Much of the success is due to the spirit of bipartisanship that has, by and large, characterised foreign investment policy since the 1980s, competent administration by the Treasury and good advice from members of the Foreign Investment Review Board (***FIRB***).

Inevitably and appropriately, domestic political considerations influence the framework. In the last couple of years, concerns have arisen about foreign investment in Australian agriculture and Australian residential real estate. There are sensible changes that the Government can make to the framework to address these concerns and sensible changes should be made in order that community acceptance of foreign investment is sustained.

However, we are very concerned that some of the proposals in the options paper, if implemented, would represent the evolution of good ideas for sensible changes into overreaching policy settings that adversely affect Australia's ability to attract foreign investment. We explain why below.

New compliance and enforcement area in the Australian Taxation Office

1. The Government seeks feedback on the creation of a new compliance and enforcement area in the Australian Taxation Office, including:
   a. Is the creation of a new compliance and enforcement area required to address concerns with foreign investment framework compliance?
      i. Are there alternative approaches that should be considered?
2. Are there other legislative impediments preventing data sharing between relevant agencies?
   a. Should the Treasurer and the Australian Taxation Office have authority to obtain information, documents and evidence that relate to potential breaches of the foreign investment framework?
      i. Are there alternative approaches that should be considered?
   b. Should the creation of a new compliance and enforcement area be funded by Government revenue or through the introduction of application fees on foreign investors?
      i. Are there alternative approaches that should be considered?
   c. Do the proposed changes appropriately balance the need for additional scrutiny on certain foreign investment applications while continuing to streamline the process for approving investments in single developments?
      i. Are there alternative approaches that should be considered?

The establishment of a compliance and enforcement area within the Australian Taxation Office is not required to address concerns with foreign investment framework compliance. There are better alternatives.

The proposal, if implemented, would represent an unusual example of a departmental body that is responsible for administering a regulatory framework not also being responsible for compliance and enforcement. Think of the other Government agencies and departmental bodies with key regulatory responsibilities:

- Australian Communications and Media Authority;
- Australian Competition and Consumer Commission;
- Australian Customs and Border Protection Service;
- Australian Prudential Regulation Authority;
- Australian Securities and Investments Commission;
- Australian Taxation Office;
- Civil Aviation Safety Authority;
- Fair Work Commission; and
- Therapeutic Goods Administration –

all of them bat and bowl.

The advantage of having all functions under the one agency or body is that compliance and enforcement occurs within an overall context of the policy objectives the Government wishes to achieve.

Government doesn't pass laws so that it has laws to prosecute people with, it passes laws to achieve policy objectives. Compliance and enforcement should be focussed on ensuring that the achievement of policy objectives is not frustrated by non-compliance.

The policy objectives that Australia's foreign investment framework is designed to achieve are well summarised in the introduction to the options paper. One objective appears to be to promote foreign investment:

> The Government welcomes foreign investment because it plays an important and beneficial role in the Australian economy. [Chapter 1, paragraph 1.]

The other policy objective appears to be to weed out foreign investment proposals that are contrary to Australia's national interest (chapter 1, paragraph 2).

These objectives support each other: weeding out foreign investment proposals that are contrary to Australia's national interest promotes community acceptance of foreign investment which, in turn, helps to attract more.

A compliance and enforcement authority needs to operate within, and not lose sight of, this policy context. We think this is best achieved within Treasury.

For example, Treasury noted in its submission to the House of Representatives Standing Committee on Economics, that *it uses a compliance framework that emphasises "information and education initiatives"*[1]. Particular information and education initiatives that we know to be currently undertaken by Treasury include:

- holding formal information sessions to inform professional advisors about the framework and how Treasury administers it;
- answering questions from professional advisors and other members of the public;
- meeting with foreign investors contemplating major investments and their professional advisors to explain how the framework will be applied to them; and
- maintaining an informative website (www.firb.gov.au).

Without question, these are tasks best undertaken by Treasury as the administrator of the framework. We are particularly concerned that diverging viewpoints may emerge if regulatory responsibilities are split between the Australian Taxation Office and Treasury.

As administrator of the framework and repository for foreign investment applications, it is natural for professional advisors to seek out Treasury's views when they are unsure as to whether an application is required or how an application should be structured. Having received Treasury's views, advisors can then instruct their clients how to proceed reasonably confident that Treasury will not take a different approach. This type of engagement is common because the FATA is so difficult to interpret.

If a separate agency takes over responsibility for compliance and enforcement, then the level of faith that advisors and their clients can place on Treasury's views will be diminished because the views of the Australian Taxation Office will be just as relevant and there can be no guarantee that each agency's views will be consistent. That may lead to a reduced level of engagement between foreign investors and Treasury, which will be to the disadvantage of all.

Another example is in enforcement. We think the Chairman of FIRB, Brian Wilson, made an insightful comment when he informed the Standing Committee that:

> I think it is worth being a little more granular about what 'enforcement' means. It can range from criminal prosecution at one end through to working with the applicants to regularise breaches, to having an applicant voluntarily dispose of a property improperly retained, to having an applicant put in a retrospective application. So

[1] House of Representatives Standing Committee on Economics, *Report on Foreign Investment in Residential Real Estate*, p16.

> to say there has been no enforcement activity is correct in terms of the prosecution component of enforcement, but there has certainly been a lot more enforcement activity, in fact, in regularising issues to bring about compliance. [Committee Hansard, Canberra, 29 August 2014, p. 31.]

Foreign investment – even non-compliant foreign investment – isn't all bad in the same sense that fraud, tax avoidance and many other offences are all bad. Non-compliance with the foreign investment framework is bad because it may undermine the achievement of policy objectives, but it does not follow that all non-compliant foreign investment is bad nor does it follow that enforcement by prosecution is always the answer to non-compliance.

We expect that there is widespread non-compliance with the framework but that the vast majority of non-compliance is technical and involves investments that are very much in the national interest. In these cases, the solution is legislative reform. Enforcement would jeopardise, not bolster, the Government's policy objectives.

In the minority of cases where non-compliance is deliberate or the product of poor advice, again, many are likely to have involved investments that are in the national interest. Many are likely to have been made by investors who will prove to be future sources of foreign capital – if we don't turn them away. Enforcement measures that fall short of divestments and prosecutions are likely to produce better policy outcomes in most of these cases.

Even in cases where Australia's national interest is best served by divestment, it may be smarter to use the threat of divestment to achieve a voluntary disposal. For example, a voluntary disposal:

- may assist the owner to achieve a better sale price and thus avoid the adverse impact that a forced sale would have on neighbouring property values and lenders' collateral;
- avoids sending an unintended message that Australia does not welcome foreign investment; and
- avoids publicly humiliating a foreign investor who is willing to correct his or her mistake and may be willing to make future investments that are in the national interest.

We hope the above examples demonstrate that the agency responsible for enforcing Australia's foreign investment framework needs to make careful decisions about how its enforcement decisions will serve the Government's policy objectives. We think these decisions are best made by Treasury because it has decades of experience in the formulation and administration of foreign investment policy. Treasury can make sensible enforcement decisions because it has the full policy context and is judged on its achievement of policy objectives. In contrast, a dedicated enforcement agency cannot hope to have the same policy context and risks making enforcement decisions based on artificial objectives – fines collected, offences prosecuted, divestments ordered and domestic media publicity.

However, just because we think compliance and enforcement functions should remain with Treasury does not mean that there isn't room for improvement. The Standing Committee – which did not make any recommendation concerning the transfer of compliance and enforcement functions out of Treasury – has reported on a number of concerns about current compliance and enforcement practices and it is right that these be acted on.

We think the following measures should adequately address concerns with compliance and enforcement.

1. Where not contrary to overall policy objectives, flagrant cases of non-compliance are met with prosecutions and divestment orders so that foreign investors and the Australian community see that the law is being enforced.
2. Better cooperation and connectivity between Treasury and relevant government agencies to facilitate data matching for foreign investment compliance purposes. Relevant government agencies and bodies include Australian Securities and Investments Commission, Australian Taxation Office, Department of Immigration and Border Protection, and state/territory revenue and land titles offices. Relevant government agencies and bodies should be directed to design their databases with a view

to facilitating data matching for foreign investment compliance purposes. If appropriate, data matching could be undertaken for Treasury by another Government agency or body.

3 In the case of foreign investment in agricultural land, the establishment of a foreign ownership register.

4 Treasury establishes a system that will allow it to report to FIRB, the Minister and the Parliament on the extent and outcome of all its enforcement activities, both formal and informal.

5 Treasury recruits personnel with enforcement experience, which may be achieved through the establishment of ongoing secondment programmes with other Government agencies.

6 FATA be amended to give Treasury additional compliance and enforcement powers beyond the current ability to require the giving of information and the production of documents. The additional powers should include:

(a) the power to require relevant persons to appear for an examination under oath or affirmation;

(b) subject to obtaining a warrant, the power to enter premises and seize documents;

(c) the ability to share information with other regulators (Australian and foreign);

(d) the power to enter into enforceable undertakings as an alternative to prosecution and to obtain remedial Court orders if the undertakings are not complied with; and

(e) the power to conduct private and public hearings and summon individuals to appear before those hearings.

Once these measures are implemented, Treasury's compliance and enforcement performance should be assessed in the medium term against the Government's foreign investment policy objectives.

Penalty Regime

3. The Government seeks feedback on the proposed changes to the civil penalty regime, including:

a. Would a civil penalty regime be an effective addition to the rules to ensure compliance and assist with enforcement?

We do not believe a sufficient case has been made for introducing the proposed civil penalty regime.

Many of the justifications cited by the Standing Committee for a civil penalty regime are based on incorrect advice given to it as to the current state of the law.

- The Standing Committee received advice from Treasury that the criminal penalty regime under the FATA only applies to foreign investors personally and that *there are no penalties on lawyers and agents – et cetera* (para 2.96). In fact, section 11.2 of the Criminal Code (Cth) extends criminal responsibility for offences under the FATA to a person who *aids, abets, counsels, or procures, the commission of* offences under the FATA. We note that the options paper acknowledges the application of Section 11.2 of the *Criminal Code (*p11).

- The Standing Committee received advice from the Treasury, in response to a question concerning the retention of windfall gains, that *There are no economic sanctions whatsoever available to us* (Committee Hansard, Canberra, 29 August 2014, p43.) The forfeiture provisions under the *Proceeds of Crime Act 2002* (Cth), which apply to most offences under the FATA, do not appear to have been considered by the Standing Committee nor are they referred to in the options paper. We note the Act permits forfeiture to be pursued even where a prosecution is not launched.

- The Standing Committee appears to have assumed that all criminal offences require mens rea to be established. 'Mens rea' is the mental element of an offence which may be established through intent, recklessness or, in some cases, wilful blindness or negligence. For example, the Chair of the Standing Committee asked the following question at a public hearing:

> On enforcement, currently we have heard evidence that the penalties that are in place at the moment are criminal sanctions which are very difficult to prove because you have to prove intent. Do you have a view on civil penalties, so fines, on a strict liability basis? [Committee Hansard, Melbourne, 20 June 2014, p. 14.]

In fact, not all criminal offences require a mental element, namely strict liability and absolute liability offences. We are not aware of any judicial finding that the offences under the FATA require intent or another mental element in order to be established (other than accessorial offences which do require intent).

Also, it is not clear to us from the evidence given by Treasury to the Standing Committee that a perceived difficulty in securing convictions for criminal offences is the reason why it did not pursue criminal prosecutions in recent years. The minor nature of the offences that had been detected and the Treasury's preference to deal with non-compliance informally seem more likely reasons (Committee Hansard, Canberra, 29 August 2014, pp. 32 to 41).

We also think there has been a failure to acknowledge the prospect of a divestment order as the principal sanction under the FATA. In the context of a foreign investment having been made, in our experience, it is the risk of divestment on short notice that motivates compliance. For example, even when their investment falls under one of the voluntary notification categories under the FATA, most clients instruct us to make an application in order to obtain comfort that a divestment notice won't be given.

Finally, the idea that a foreign investment enforcement agency should be encouraged to run around catching investors for non-compliance so that it can fine them and use the money collected from the fine to help fund its operations (see recommendation 4 of the Standing Committee) is, in our view, completely at odds with the policy objective of encouraging foreign investment.

When foreign investors chose to invest in Australia it represents a vote of confidence in Australia over the many other countries in which they could invest. Often it represents more than a vote of confidence but a growing affinity for Australia. A foreign investor may like Australia and Australians. The foreign investor might want to move here, take holidays here, further invest and create jobs here and/or educate their children here. These are not bad people, their affinity for us should not be criminalised, and they should not be hounded by an overzealous regulator enforcing overreaching laws. They have other options, we don't.

We accept that there will be some foreign investors who refuse to abide by reasonable rules or to obtain sound advice. Australia needs an enforcement regime that can target this minority, not all foreign investors.

We think the following measures are a better alternative to the civil penalty regime that has been proposed.

1. Give Treasury the additional compliance and enforcement powers we have recommended in our submissions under questions 1 and 2.
2. If application fees are introduced, give Treasury the discretion to levy a higher application fee for retrospective applications.
3. The Government should obtain legal advice as to whether the offences under the FATA are strict liability or absolute liability offences. If there is any concern that they may not be, the Government should consider amending the offence provisions to clarify the matter.
4. The Government should investigate whether the Proceeds of Crime Act can be used to confiscate capital gains generated on foreign investments in breach of the FATA. If there is any concern about its use, the Government should consider amending the Act to enable such use.
5. Under the FATA, the Treasurer may only make a divestment order against a foreign investor who breaches the conditions of a foreign investment approval if the foreign investor is convicted of an offence in connection with the breach of the conditions: see s. 25(1D) of the FATA. The Government

should consider amending the FATA so that the Treasurer can make a divestment order without having to launch and secure a criminal conviction.

b. Are the proposed penalty amounts appropriate and likely to serve as a deterrent?

We think the proposed penalty amounts are excessive. More on this below.

The principal deterrent is and will remain the prospect of divestment. In most investment contexts, divestment has the following consequences:

- the property was purchased for a purpose – it can no longer be used for that purpose;
- stamp duty (in NSW, these can be close to 7%) and other acquisition costs such as legal fees and title fees will have been wasted;
- sale costs such as real estate agency fees and marketing and removal expenses will be incurred; and
- the fact that the property is subject to divestment is a matter of public record and likely to adversely impact the sale price.

If, notwithstanding the above, a capital gain is made then there should be an option to pursue its forfeiture under the Proceeds of Crime Act.

These together with the prospect of criminal penalties are sufficient deterrents.

As mentioned, we think the proposed penalty amounts are excessive, particularly given the following:

- the FATA is poorly drafted and difficult even for experienced legal practitioners to advise on with accuracy – therefore, there is an enhanced risk of genuine mistakes being made;
- the FATA is overreaching such that many people would be genuinely surprised to learn that they are foreign persons and many foreign persons would be genuinely surprised to learn who their associates are – therefore, there is an enhanced risk of technical violations; and
- the conditions to the exemption, which allows temporary residents to acquire one existing residential premises, are unduly restrictive – therefore, there is an enhanced risk of relatively trivial violations.

Other aspects of the proposal appear quite odd. For example, a temporary resident who does not bother to obtain approval to acquire an established property risks a substantially lower maximum civil penalty than the temporary resident who does the right thing and obtains approval but breaches one of the unduly restrictive approval conditions. This sends the wrong message.

c. Is the proposal to extend accessorial liability an effective way to increase compliance?

i. Are there alternative approaches that should be considered?

As discussed above, the Criminal Code already provides for accessorial liability. This is sufficient to ensure compliance.

If, notwithstanding our and other similar submissions, a civil penalty regime is imposed then it would make sense to provide for equivalent accessorial liability. However, accessorial liability – whether based on a criminal or civil standard – should always require intent. The Act is too uncertain and too reliant on factual matters to provide otherwise. Imposing any greater burden is likely to make things very difficult for good operators and be ignored by bad operators.

If the Government wishes to impose an accessorial standard on legal advisors and other third parties that requires them to vet investors, it should be very precise as to what a third party must do to discharge its vetting obligations. It also needs to bear in mind that many transactions will involve multiple third parties (solicitors or conveyancers, real estate agents, property sellers and lenders) – it would be overkill to require separate vetting by each third party.

The following are examples of the practical difficulties that third parties may face in vetting investors.

- A foreign person includes *a natural person not ordinarily resident in Australia* (s. 5 of the FATA). Therefore, Australian expatriates are foreign persons[2]. It is one thing for a third party to verify that an investor is an Australian citizen, it is another thing to require the third party to make a conclusive factual determination as to where the investor lives.
- The trustee of a discretionary trust will be a foreign person if the trustee has a discretion to distribute 15% or more of the trust capital or income to a single foreign person or 40% or more to foreign persons generally (s 9A of the FATA). Family discretionary trusts are used widely in Australia and often describe categories of beneficiaries (e.g. parents, children other relatives) rather than name them individually. It would be very difficult for a third party to first ascertain just who the beneficiaries are and to secondly identify who among them is a foreign person.
- A foreign person who is the spouse of an Australian citizen may purchase an interest in land zoned as residential property with his or her spouse to hold as joint tenants (s3(t) of the *Foreign Acquisitions and Takeovers Regulations 1989* (Cth)). It is one thing for a third party to verify that two people are married, it is another to verify that they have never been divorced or, in the case of de facto spouses, that the couple is in a de facto relationship.

What we think will occur is that many Australian investors may end up having to make unnecessary foreign investment applications because third parties have been unable to ascertain with complete certainty that they are not foreign persons. This would be a very unfair result for Australian investors, particularly in light of the high application fees that have been proposed.

d. Is it necessary to increase the existing criminal penalties in light of the proposed new civil penalties?

As discussed above, we think any penalty regime (whether criminal or civil) is of secondary importance as a deterrence to the risk of divestment. The current penalties do not need to be changed. We note that they include up to two years imprisonment.

4. Should the new penalty regime be extended to business, commercial real estate and agricultural applications?

No, not based on the Government's assertion that there is only *limited evidence to suggest non-compliance in these areas* (para. 38 of the options paper).

Perhaps even more so than investment in residential real estate, given the nature of most investors involved, the prospect of divestment and criminal sanctions are more than sufficient to ensure compliance.

Introducing fees on foreign investment applications

5. The Government seeks feedback on the introduction of fees on foreign investment applications, including:

a. Should the Government charge application fees on foreign investors to fund screening, compliance and enforcement activities?

i. Are there alternative approaches that should be considered?

ii. Should there be any exceptions to paying the application fee?

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[2] Section 3(k) of the *Foreign Acquisitions and Takeovers Regulations 1989* (Cth) exempts Australian expats from having to obtain foreign investment approval to purchase an interest in Australian urban land (including residential real estate) but this exemption does not apply to other transactions requiring approval under the FATA.

b. Is the level of the fees appropriate?

i. Will the fees act as a barrier to foreign investment?

ii. What might be the cumulative impact on business reinvestment?

There are a number of arguments to support the current arrangements where no fee is charged (nor, to our knowledge, has ever been charged) for foreign investment approvals:

- it encourages foreign investors to seek approval for transactions that are only subject to voluntary notifications under the FATA or unenforceable requirements under Australia's Foreign Investment Policy;
- it encourages foreign investors to seek approval when it is unclear whether approval is required; and
- as foreign investment screening is undertaken by the Government for the general benefit of the community, it is appropriate for the community to fund the process through the general tax system.

That said, it is difficult to quibble with the Standing Committee's recommendation that *the Government apply a modest administrative fee to the current screening for all foreign purchases of residential real estate…* (Recommendation 3) or with an extension of that <u>modest</u> administrative fee proposal to all foreign investment applications.

The modest administrative fee that the Standing Committee had in mind was $500, $1,000 or $1,500. This compares well with other federal government charges. For example, the Takeovers Panel charges $2,290 for an application and the Australian Securities and Investments Commission charges $1,567 for an Australian financial services licence application and $2,290 for registration of a managed investment scheme.

What has been proposed are not modest fees; but a new tax in the form of a federal stamp duty on foreign investment. The amounts proposed to be charged appear to be well in excess of necessary funding costs. It leads to the conclusion that the proposal has been put forward:

- as a general revenue measure to assist in a small way with the current budget deficit; or
- to discourage foreign investment or at least give an additional advantage to domestic buyers.

We think there are a number of problems with the proposal for a federal stamp duty on foreign investment.

- As alluded to above, currently we can encourage our clients to make applications when notifications are voluntary or the requirement to notify is unclear because no application fees are payable. A high rate of stamp duty will discourage this practice and, therefore, impact compliance.
- Stamp duty is well recognised as a tax measure that has unfavourable distortionary effects. The Productivity Commission and Treasury have both called for its removal or significant reduction (e.g. see Productivity Commission Inquiry Report No 59 dated 19 September 2012, p. 106).
- One distortionary effect, is that it may encourage a foreign property owner to hold property for longer than he or she would otherwise do. Thus, the imposition of a tax designed to advantage domestic buyers may in fact hurt them by reducing the supply of properties available for purchase.
- In the case of off-the-plan purchases, there is no guarantee that a developer will seek to recoup these stamp duty costs from foreign buyers alone rather than from both foreign and domestic buyers.
- The same rate of stamp duty is to apply to purchases of existing residential real estate and new residential real estate. This appears to be inconsistent with long standing policy to encourage foreign investment in residential real estate that increases Australia's housing stock.
- The imposition of a new stamp duty is a blunt instrument that will be difficult to modify to accommodate changing economic needs whether they are general or relevant to specific segments

of the real estate market. For example, the Government may have formed the view that the new stamp duty will reduce demand for real estate in the current market and that this is desirable. Does it follow that reduced demand will always be desirable? Does it follow that reduced demand is currently desirable in all market segments?

For example, many of the clients that we have consulted with have expressed the view that foreign investment demand plays a vital role in underpinning farm property values in many parts of Australia. It also improves market liquidity. In turn, current farm property values and market liquidity helps support loan ratios and encourages banks to be more patient with farmers who are trying to work through high debt positions. An initiative that disrupts these settings could be disastrous for Australian agriculture.

- Many of our clients often need to make applications for trivial transactions because of the overreaching nature of the framework. This is particularly the case for clients unlucky enough to be classified as 'foreign government investors' which, given the wide definition used and the importance of sovereign investment to global funds management, can often include just about any widely held fund (even those under Australian management). As a result, such clients have been required to make applications to:
  - incorporate shelf companies;
  - lease office space;
  - take easements over small plots of land to support communications infrastructure of vital importance to rural Australia; and
  - make minor follow-on investments in existing business operations.
- We are often involved in transactions that trigger multiple notification requirements under the framework. A recent transaction required five separate notifications all in connection with the purchase of a single rural property. The stamp duty proposal may have resulted in federal stamp duty of 5% on top of 5.75% state-based stamp duty.
- Thinking back to the implementation of other new federal taxes such as income tax on capital gains, fringe benefits tax and goods and services tax, these have all required significant planning and imposed significant administrative burdens on both the Government and tax payers. We see no reason why this won't be the case here. In particular, we are concerned about:
  - the complexity that is likely to be involved in formulating appropriate exemptions, particularly an ongoing tension between the desire to avoid unfair outcomes (such as multiple stamp duty triggers in the one transaction) and the desire to avoid opening up loopholes that can be exploited;
  - the complexity of assessing the precise amount of stamp duty that may be payable such as in cases where the final purchase price can only be determined after post-completion accounting adjustments are finalised;
  - the potential for application screening times to increase because of the additional need to assess stamp duty issues;
  - the compliance costs associated with stamp duty audits and other compliance measures and the distraction this will create from the proper focus on the Government's foreign investment objectives;
  - how consortium and private equity buyers will be able to fund a large stamp duty payment that is due before the relevant transaction is completed; and

- the potential for stamp duty revenue to distort regulatory behaviour such as discouraging reforms designed to eliminate unnecessary applications.

A modest administrative fee would not trigger these complexities.

If the Government is still minded to introduce a stamp duty on foreign investment, we would urge it to limit its initial application to the purchase of established dwellings only with all other applications to attract a modest administrative fee along the lines recommended by the Standing Committee.

We also think there should be an upper cap on the amount levied.

> c. What options should be considered to ensure applicants that submit multiple applications (for example, bidders at auctions or business applicants that withdraw and resubmit) are not charged excessive fees?

In the case of auctions, it should be noted that these can be the formal auctions of real estate or the informal auctions that companies often engage in when seeking to divest a business. In both cases, it is highly desirable for a seller that bidders have obtained all regulatory approvals, including approval under Australia's foreign investment framework, so it can make an informed choice among the bids it receives. Also for a seller, the imposition of a high upfront application fee won't be in its interests if it discourages potential bidders from participating in an auction. We also think it would be very unfair for the Government to collect a high application fee from multiple bidders for the same asset.

None of this applies if a modest administrative fee is to be levied. To the extent that is not the case, the fee (or at least the bulk of it) should only be levied after an applicant has entered into a contract for the purchase of the property or business and only on that applicant.

In the case of applicants who withdraw and resubmit applications, these should not attract additional application fees in any case.

> 6. The Government seeks feedback on the proposed changes to advanced off-the-plan certificates, including:

> a. Should penalties be introduced for developers that fail to comply with obligations to market domestically?

> i. If so, what should developers be required to do to prove they have marketed domestically?

> What level of penalty would be appropriate for developers that fail to comply with obligations to market domestically?
>
> Are there alternative approaches that should be considered

Up until 1985, Australia's foreign investment framework included the imposition of an 'opportunities test' which required that specific opportunities had been provided for Australian participation in certain foreign investment targets. It is worth remembering why the Hawke Government abolished the opportunities test in 1985:

> Experience with this aspect of the policy has shown that only very rarely has it resulted in a successful Australian bidder coming forward. At the same time, however, the public announcement requirement has caused concern to both prospective foreign purchasers and Australian vendors because of its possible detrimental effects on their business interests. In this way it may also have been prejudicial to the attraction of worthwhile foreign investment to Australia. This change removes an irksome feature of the policy and represents a significant act of business deregulation.
>
> Public knowledge of takeover proposals will continue where the target is a publicly listed company, given that proposed acquisitions are required to be announced under the Companies (Acquisition of Shares) Act. <u>This should cover most major company takeovers. In many other cases, most particularly in respect of real estate and</u>

rural land, experience has shown that, through market knowledge and efforts by the vendor to interest Australian as well as foreign purchasers, appropriate opportunities already have been made available to Australians. It would normally seem to be in the commercial interests of vendors of Australian businesses to provide opportunities for purchase by Australian interests. [Press release no.136, Statement by the Acting Treasurer, the Hon Chris Hurford, MP, 29 October 1985.]

We have added emphasis on a point that is just as relevant now as it was then, plain common business sense ensures that significant off-the-plan developments of 100 or more dwellings will be marketed in Australia. This is also consistent with the evidence put to the Standing Committee.

As such, we have no objection to the Government continuing to impose conditions that require developments to be marketed in Australia and it makes sense for developers to be liable for prosecution if they fail to comply with approval conditions. In fact, it is preferable that they be liable than an innocent foreign buyer.

Also, we would encourage Treasury to maintain data that shows the proportion of off-the-plan developments that are sold to foreign buyers. This is the best way for it to assess whether properties are being marketed in Australia.

We do not see the need for prescriptive requirements to be developed as to what constitutes appropriate domestic marketing. This is best left to the experts, the developers themselves.

If, notwithstanding this, the Government wishes to impose specific marketing requirements then we think the best approach would be to establish a safe-harbour (at say 50% of dwellings). If domestic sales are at or above this level then the developer should be deemed to have complied with the condition. If domestic sales are below this level then the developer may be required to show the extent of its domestic marketing activities.

Implementation of Agriculture Commitments

Agribusiness Investments

Before we address the specific consultation questions, we think it is important to state our view that the implementation of a new $55 million screening threshold (based on the value of the investment) for investments in agribusinesses should not proceed.

We hold this view for the following reasons.

1 **Exceptionalism.** Currently, as with all other businesses, the acquisition of an agribusiness is generally subject to a $252 million notification threshold based on the total value of assets in the business. In the context where any acquisition of shares or assets is prohibited if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in any market[3], we believe it highly unlikely that the acquisition by a private foreign investor of an agribusiness with total assets of less than this amount could be contrary to Australia's national interest given the overall size of our economy and the agricultural sector within it.

Australian agribusinesses are important to our economy and national character, but so are many other businesses. Creating a legislative exception for Australian agribusinesses raises the prospect of other special cases. Inevitably, the result will be piecemeal and confusing foreign investment framework.

We acknowledge that the FATA designates some industries as prescribed sensitive sectors but this is for a very limited purpose, namely to reduce the $1,092 million notification threshold for Chilean, Japanese, Korean, New Zealand and United States investors back to the standard $252 million notification threshold.

[3] Section 50 of the *Australian Competition and Consumer Act 2010* (Cth).

2 **Complexity.** The creation of specific notification thresholds for particular businesses should be avoided wherever possible because it adds additional complexity to Australia's foreign investment laws, which are already very complex. For example, in the case of a company that operates agribusinesses and other businesses, a foreign investor in that company is unlikely to be able to determine the value of the assets attributable to the agribusinesses as companies do not typically report asset values in their financial accounts on a segment basis. Further, we expect that this asset allocation exercise would be difficult even for the company itself, particularly when it comes to apportioning the value of shared assets and many intangible assets.

3 **Adverse impact on listed Australian agribusinesses.** It is unclear whether the normal 15% substantial interest threshold will apply in the case of this threshold. We are concerned that the non-application of the 15% substantial interest threshold may have an adverse impact on the value of shares in listed Australian agribusinesses and discourage new listings.

Our concern will be relevant whenever an agribusiness is worth more than A$366 million. Using GrainCorp as an example, the purchase of not much more than a 2.5% stake in that company would trigger a notification requirement[4]. This is less than the 5% threshold at which a shareholder would be required to file a public substantial holder's report under the Corporations Act and it is even less than the 10% direct investment threshold at which foreign government investors require foreign investment approval. We expect foreign portfolio investors would be generally surprised that an investment below 5% could trigger a notification requirement let alone the need to obtain prior approval. It is also important to note that portfolio investment decisions will often need to be made much more quickly than a FIRB clearance timeframe would allow.

If foreign portfolio investors are unable to make meaningful investments in GrainCorp and other listed agribusinesses without first having to obtain a foreign investment clearance, the liquidity of share trading in these companies may be adversely affected and, as a consequence, the value of their shares impaired. In turn, this may discourage other Australian agribusinesses from listing.

4 **Adverse impact on listed offshore agribusinesses.** It is unclear whether the new threshold will be applied in the case of indirect acquisitions offshore. Assuming it is so applied but without the normal 15% substantial interest threshold, then we question how the threshold can be implemented in an offshore context. For example, Glencore operates significant Australian agribusinesses but they represent a very small component of its global business operations. Just how would the new $55 million threshold be applied to an investment in Glencore? If there was a full attribution then the purchase of a 0.075% stake in Glencore would trigger a notification requirement. Therefore, a full attribution creates a ridiculous result, but on what basis could a partial attribution be made? A partial attribution runs into the problems mentioned in item 2 above – an investor is unlikely to have access to the information it would need in order to make a determination of the appropriate attribution.

5 **Avoidance.** Whereas the application of the $252 million threshold is difficult to avoid because it is tested on the acquisition of a substantial interest (15%) based on total asset values and again on any incremental increase in that substantial interest, the new $55 million threshold may encourage avoidance through the splitting of an investment into smaller tranches. This may have any number of unintended consequences including increasing the complexity of our laws (as attempts are made to curb avoidance practices) and delaying the deployment of capital.

If the Government is still minded to implement the new $55 million threshold for agribusiness then we recommend that its impact be ameliorated by only applying it in situations where a 15% substantial interest is acquired, and by exempting offshore acquisitions from its application (noting that offshore acquisitions will still be subject to the $252 million notification threshold).

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[4] Based on GrainCorp's closing share price of $9.53 on 11 March 2015.

7. Should the definition capture all primary production businesses as well as certain first stage downstream businesses beyond the farm gate (for example, meat processing, sugar milling and grain wholesaling / storage / milling)?

8. If it is decided that the ANZSIC codes be used, which divisions (or sub-divisions, groups) of the ANZSIC codes should be included in the definition for 'agribusiness'?

9. Is there an alternative approach that should be considered to define agribusiness?

We think the formulation of a definition of agribusiness should involve a two-step process:

1 first, settle on a definition that encompasses land uses that would commonly be considered upstream farm gate production-based agricultural pursuits and use this as the basis for the definition of 'agricultural land'; and

2 second, to obtain a definition of agribusiness, add to the above activities any additional downstream activities that are closely associated with production-based agricultural pursuits and which the Government wishes to more closely regulate foreign investment in.

At present, the definition of a 'primary production business' under the *Income Tax Assessment Act 1997* (Cth) provides the basis for the current definition of 'Australian rural land' under the FATA. It is defined as follows:

> ***"primary production business"***: you carry on a ***primary production business*** if you carry on a business of:
>
> (a) cultivating or propagating plants, fungi or their products or parts (including seeds, spores, bulbs and similar things), in any physical environment; or
>
> (b) maintaining animals for the purpose of selling them or their bodily produce (including natural increase); or
>
> (c) manufacturing dairy produce from raw material that you produced; or
>
> (d) conducting operations relating directly to taking or catching fish, turtles, dugong, bêche-de-mer, crustaceans or aquatic molluscs; or
>
> (e) conducting operations relating directly to taking or culturing pearls or pearl shell; or
>
> (f) planting or tending trees in a plantation or forest that are intended to be felled; or
>
> (g) felling trees in a plantation or forest; or
>
> (h) transporting trees, or parts of trees, that you felled in a plantation or forest to the place:
>
> (i) where they are first to be milled or processed; or
>
> (ii) from which they are to be transported to the place where they are first to be milled or processed.

We think it is desirable for some consistency to be maintained between the Tax Act and the FATA.

The definition of agribusiness should focus on Subdivision 01 (Agriculture) of Division A (Agriculture, Forestry and Fishing) but note a careful review of groups and classes within that subdivision would need to be undertaken. For example, cat breeding, dog breeding and pet breeding, while unlikely to ever trigger the $55 million threshold, should nevertheless be excluded.

The Government should consider whether it is necessary to include Subdivision 02 (Aquaculture). Even in the case of onshore aquaculture, such businesses are different in many respects to traditional farming pursuits more so when they are undertaken offshore. For similar reasons, the Government may wish to exclude Subdivision 04 (Fishing, Hunting and Trapping).

In Subdivision 03 (Forestry and Logging), Class 0301 (Forestry) should be included because of the land-intensive nature of timber plantations and the fact that they are often a competing land use to other primary production businesses. Class 0302 (Logging) should not be included.

We think the real debate is over the inclusion of:

- Subdivision 05 (Agriculture, Forestry and Fishing Support Services); and
- some parts of Division C (Manufacturing).

It is difficult to provide an unbiased view on the merits of inclusion given our view that the new $55 million threshold should not proceed. However, putting that to one side we are concerned that any extension of the definition to first stage processing, while easy to say, would be very difficult to define in detail.

For example, the ANZSIC Code includes 'Beer and Malt Manufacturing' as a single class. Malt manufacturing would appear to meet the definition of a first-stage downstream business but brewing does not.

Another example is 'Sugar Manufacturing' (Class 2171). Among other things, it encompasses the manufacture of both raw and refined sugar. The manufacture of refined sugar is not a first-stage downstream business.

In each case, an appropriate definition would have to go beyond the smallest classification available in the ANZSIC Code.

If the ANZSIC Code is used, we recommend that the definition be open to amendment by regulation in order to make it easier to reflect future changes to it.

10. The Government seeks feedback on the proposed definition for 'agricultural land':

a. Is the proposed definition of 'agricultural land' consistent with common understanding of the term?

i. Are there alternative approaches that should be considered?

b. Would the proposed definition provide sufficient clarity as to what constitutes 'agricultural land' for the purposes of Australia's foreign investment framework?

The definition of 'agricultural land' should be limited to land uses that would commonly be considered upstream farm gate production-based agricultural pursuits and not to broader agribusiness pursuits. As such, it should not refer to 'Australian agribusiness' as this is likely to have a broader meaning. Land used for broader agribusiness purposes will be considered as part of the new $55 million application threshold for agribusiness.

The definition should not include a reference to *otherwise supplying, an Australian agribusiness* because this has the potential to capture land that is not agricultural in character. For example, lands used by utilities that supply an agribusiness should not be classified as agricultural land.

Also, we recommend replacing the reference to *land likely to be used* and the five year look-back with a focus on land that is 'intended to be used or is capable of being used primarily for the purposes of carrying on a business of primary production'. There is no point continuing to assess as agricultural land a former orchard that has been converted into a residential subdivision. Conversely, we recommend including potential agricultural land even if the proposed buyer does not intend to carry on a business of primary production on it.

The Government should consider expanding the definition of agricultural land to encompass long-term water rights that are available for irrigation purposes.

11. The Government seeks feedback on the proposed definition of urban or 'residential land', including:

a. Is the proposed definition of 'residential land' consistent with a common understanding of the term?

i. Are there alternative approaches that should be considered?

b. Would the proposed definition provide sufficient clarity as to what constitutes 'residential land' and related subcategories (such as new and existing dwellings) for the purposes of Australia's foreign investment framework?

Vacant land that is zoned for residential use should also be caught by the definition of 'residential land'.

The FATA will need to elaborate on what constitutes 'residential dwellings' in order that hotels, motels, serviced apartments and caretaker accommodations are excluded as are accommodations associated with educational facilities and mines.

12. The Government seeks feedback on three possible options for the screening of 'other land':

a. 'Other land' be defined as all land that is not 'agricultural land' or 'residential land' and continues to be screened from dollar zero;

b. 'Other land' is not defined and any land that is not 'agricultural land' or 'residential land' no longer requires foreign investment approval; or

c. 'Other land' is defined as a subset of what is left over from 'agricultural land' or 'residential land' capturing land that remains of interest while excluding some land from screening.

i. If option c is pursued, what types of land should continue to be screened?

We support the first option but note that the option paper is incorrect when it states that most of this land (other than that captured by the existing definition of 'rural land') is subject to foreign investment screening from dollar zero (para. 69). On the contrary, the acquisition of developed commercial property is subject to a $55 million notification threshold ($5 million for heritage-listed property and $1,094 million under some free trade agreements).

We recommend extending the notification thresholds for developed commercial property to all 'other land'.

13. The Government seeks feedback on implementation issues around the foreign ownership of land register, including:

a. the foreign ownership details that would be collected and published by the register;

b. the two-stage implementation approach to information collection (through self-reporting then through state and territory land titles processes); and

c. how lawyers or register conveyancers would verify whether their client is a foreign person?

The foreign ownership details collected by the register should be as limited as possible. The Queensland Foreign Ownership of Land Register and the foreign ownership oversight exercised by the US Department of Agriculture's Farm Service Agency[5] are both good examples of simple collection arrangements that satisfy a clear objective of helping the community understand the true extent of foreign ownership.

In keeping with those examples, we recommend that information only be made available to the public on an aggregated basis.

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[5] Pursuant to the *Agricultural Foreign Investment Disclosure Act of 1978* (7 U.S.C. §§3501 *et seq*.

We have no particular objections to a two stage process as long as it doesn't involve double handling of information. It is also important to recognise that, even after data connections are achieved with land titles offices, there will remain a need for a direct reporting channel to accommodate changes in a person's status.

We have already mentioned our concerns about the imposition of vetting obligations on legal advisors in our submissions under question 3(c).

Modernising and Simplifying the Foreign Investment Framework

14. The Government seeks feedback from interested stakeholders on options to modernise and simplify the Act, Regulations and Policy and streamline interaction between applicants and the Foreign Investment Review Board.

We welcome the Government's desire to modernise and simplify the FATA and associated regulations and policy. The FATA has everything that one would normally associate with bad legislation: it is incomprehensible, out-of-date, contradictory, convoluted, over-reaching, impractical and riddled with drafting errors. It is the bane of those who are called upon to administer it or advise on it.

Its genesis was the *Companies (Foreign Takeovers) Act 1972* (Cth), hastily drafted temporary legislation enacted to address concerns about foreign investment ahead of the 1972 federal election. The FATA, which replaced it in 1975, took on many of its elements. Not particularly well drafted to begin with, the various amendments made since then have made matters worse.

Specific areas for reform include:

- replacing the associates provision with one that is less over-reaching (see discussion below);
- revising the definition of 'foreign person' to exclude all Australian citizens;
- expanding the definition of 'moneylending agreement' so that it applies to secondary trading in debt;
- raising the threshold for a 'substantial interest' from 15% to 20% so that it is consistent with Australia's takeover laws;
- in circumstances where a foreign person does not 'control' an entity (control to be defined on a similar basis to the definition used in section 50AA of the Corporations Act) revising the tracing provisions so that they only focus on the extent of economic ownership e.g. where A holds a 40% interest in B and B holds a 25% interest in C, A should be regarded as holding a 10% interest in C rather than a 25% interest as is currently the case;
- removing the distinction between compulsory and voluntary notifications – if a notification applies, it should be compulsory;
- applying a substantial interest threshold to acquisitions of shares in Australian urban land corporations and trust estates;
- formalising and expanding annual programmes;
- revising the requirements for valuing assets for threshold purposes so that they are easier to apply and avoid double-counting of consolidated assets (as appears to be currently required in the case of foreign corporations with Australian assets);
- providing a general exemption for the acquisition of shares or units where the ownership level does not increase;
- allowing the Treasurer to dispense with the need to publish interim orders and divestment orders in the Gazette where they have been sent to the applicant and the applicant has acknowledged receipt;

- imposing a specific requirement on the Courts to have such regard to the interests of tenants, secured lenders and other persons with an interest in land the subject of a divestment order as is just and equitable in the circumstances; and
- revoking the *Foreign Acquisitions and Takeovers (Notices) Regulations* 1975.

15. Are there harmonisation opportunities with other Acts (e.g. the operation of the *Insurance Acquisitions and Takeovers Act 1991* or the *Financial Sector (Shareholdings) Act 1998*? Should the definition of 'Associate' in the Act conform with the definition of 'Associate' in the Corporations Act 2001?)

We support harmonisation across the legislation mentioned. In addition, we recommend that shareholding restrictions in the following legislation also be harmonised:

- *Air Navigation Act 1920* (Cth);
- *Airports Act 1996* (Cth);
- *Qantas Sale Act 1992* (Cth);
- *Medibank Private Sale Act 2006* (Cth); and
- *Telstra Corporation Act 1991* (Cth).

Harmonisation is particularly important for custodians and lenders.

We think the definition of 'associate' under section 12 of the *Corporations Act 2001* (Cth) and the exclusions under section 16 are an appropriate basis for the definition of 'associate' under the FATA. Importantly, it incorporates an 'acting in concert' component which is a good solution for much of the over-reach in the current definition of associate under the FATA.

16. Is the current regime for enforcement of FIRB conditions effective? What alternative measures could be considered?

One improvement we think is necessary is to provide that the breach of an undertaking given in support of a foreign investment application is an offence. In our experience, it is often helpful for applicants to use undertakings to encourage a favourable assessment of some foreign investment proposals. In some cases, a third party may be the most appropriate person to provide an undertaking (eg. the parent of an applicant or a company in which the applicant is proposing to invest). At present, Treasury is often reluctant to accept undertakings (particularly from third parties) because of concerns about whether they can be enforced if breached.

17. Should FIRB provide specific regulatory guidance on approaches to applications and difficult interpretation issues like Australian Securities and Investments Commission and the Takeovers Panel do?

FIRB should not provide guidance on interpretation issues. The danger with it doing so is that it may be motivated to adopt interpretations that support its policy objectives rather than the most likely meaning the legislature intended. It may also discourage ongoing reform of foreign ownership laws with the FIRB adopting interpretations as a band aid solution for a defect in those laws. FIRB is not a Court, nor is it the legislature.

That is not to deny the useful role that regulatory guidelines could play if they focus on non-interpretative issues including guidance on the following matters:

- content requirements for applications; and
- common national interest considerations.

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Please contact the author if you would like to discuss any aspect of these provisions.

Yours sincerely

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