Law Council OF AUSTRALIA

Business Law Section

# 2022 Foreign Investment Reforms – Discussion Paper

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**16 March 2022**

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# 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 Philip Argy, Chairman
- Professor Pamela Hanrahan, Deputy Chair
- Mr Adrian Varrasso, Treasurer
- Mr Greg Rodgers
- Mr John Keeves
- Ms Rachel Webber
- Ms Caroline Coops
- Dr Elizabeth Boros
- Ms Shannon Finch
- Mr Clint Harding
- Mr Peter Leech

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 Committee 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 +61 3 9613 8595) or deputy chair of the Committee, Marcus Clark (at Marcus.Clark@jws.com.au or +61 2 8274 9509).

With compliments

**Philip Argy**
**Chairman, Business Law Section**

# Submissions

The Committee welcomes the opportunity to provide submissions in response to the Government's February 2022 Discussion Paper titled 'Enhancing Australia's foreign investment framework'.

**1. Areas to reduce regulatory burden – Consultation questions**

**To help inform the Government's consideration of further foreign investment reform options, the Treasury is interested in hearing from stakeholders with regards to:**

1.1 **the types of less-sensitive transactions that could be exempted from foreign investment screening without compromising the national interest, including how this would best be achieved;**

1.2 **improving the treatment of passive-style investments and superannuation funds under the framework, including to better accommodate how entities in the financial sector operate and manage their affairs (e.g. interfunding); and**

1.3 **other opportunities to simplify Australia's foreign investment framework or reduce regulatory burden while maintaining appropriate safeguards, in line with the Government's earlier reform packages.**

### 1.1 The types of less-sensitive transactions that could be exempted from foreign investment screening without compromising the national interest, including how this would best be achieved

*Internal reorganisations*

As this Committee has previously submitted, we believe that there should be an exemption for internal reorganisations where there is no change in ultimate ownership. Requiring investors to receive a no objection notification for an internal reorganisation is inconsistent with striking an appropriate balance between welcoming foreign investment and protecting Australia's national interests. It is difficult to see how the national interest is prejudiced or compromised by a transaction of this nature – where ultimate ownership and control has not changed.

Many of the reorganisations that we see involve large multinational groups and often the need to receive a no objection notification in Australia causes significant delays and holds up global processes.

If there is a concern that internal reorganisations are impacting on tax revenue (and accordingly should continue to be regulated under the foreign investment regime), we do not think this is justified as:

- in many cases, an internal reorganisation does not have an impact on Australian tax revenue; and
- in any event, it is inappropriate to rely on the foreign investment regime to regulate tax revenue – the Australian Tax Office has sufficient powers outside of the Foreign Investment Review Board (**FIRB**) regime to do this.

If there is no appetite for broader reform to completely exempt internal reorganisations, we submit that a more streamlined approach, for example requiring just a simple notification – without a requirement to wait for or receive a no objection notification to undertake the internal reorganisation – would be an improvement on the current regime.

*Increase in shareholding where already in a position of control*

Currently, it is a notifiable action for a foreign person to increase their interest in an entity even where they may already be in a position of control of the entity.

For example, if a foreign investor holds 51% of an entity, they currently require a no objection notification to go to say 60% assuming the other thresholds are met. We believe that an increase of that nature does not prejudice or compromise the national interest, and there is an opportunity to exempt such actions from foreign investment screening. Some thresholds that could be considered to strike an appropriate balance are:

- including an exemption for increases of say 10% or less; and
- applying the exemption at least to businesses that are not national security businesses or sensitive businesses.

**1.2 Improving the treatment of passive-style investments and superannuation funds under the framework, including to better accommodate how entities in the financial sector operate and manage their affairs (e.g. interfunding)**

The Committee supports reducing regulatory burden by providing specific exemptions to cover the following areas in the discussion paper:

- 'interfunding' activities, where a fund invests in a separate fund and both funds are controlled by related bodies corporate, and for other passive-style investments; and
- acquisitions by life company, general insurer, superannuation funds and responsible entities of registered managed investment schemes regulated under Australian laws for the benefit of members primarily resident in Australia.

'Interfunding' activities are common practice in the managed fund industry, including the regulated entities in the second bullet point above. For example, such activities are carried out to:

- implement the investment and redemption requirements of hundreds of thousands of Australian life insurance and superannuation policyholders; and/or
- respond to market movements in various asset classes, and to appropriately manage investment risk.

Acquisitions as part of 'interfunding' activities need to occur, often automatically, on a daily, weekly or monthly basis. This results in significant volumes of transactions, potentially in the thousands.

Given the large volume and frequency, keeping track of and analysing each of these transactions to determine whether notification is required is near impossible without significant compliance resources. Such high compliance costs disadvantage foreign entities and ultimately are borne by the Australian policy holders. Where these are essentially "internal" transactions by already highly regulated funds within the same "group", there is no significant policy benefit in requiring mandatory notification. Foreign investment review should only occur where foreign persons invest at the top of the structure or where a foreign fund makes non-exempt acquisitions outside of the interfunding structure. A specific exemption provided for this category of interfunding activities can be carefully drafted to ensure that they are indeed "internal" in nature and do not have impact on the control profile of "external" investments in the underlying investee entities.

In addition, a simple correction of an anomaly in the existing regulation 36 of the Financial Acquisitions and Takeovers Regulation 2015 (**FATR**) could significantly reduce the unnecessary compliance burden for the interfunding activities and other acquisitions for the benefit of Australian policy holders by the highly regulated funds and schemes.

Regulation 36 of the FATR already exempts acquisitions by life companies, general insurers, superannuation funds and responsible entities of registered managed investment schemes of interests in Australian land (including land entities) from the operation of the *Foreign Acquisitions and Takeovers Act 19075* (Cth) (**FATA**). That exemption has been in place since 1989 and was recently extended to allow for acquisitions of tenements, including mining entities.

The exemption applies where the acquisition is made primarily for the benefit of members ordinarily resident in Australia where the acquirer is already highly regulated under Australia's superannuation, insurance and other financial services laws by other Commonwealth regulators.

However, there is an anomaly that this exemption does not apply to acquisition of interests in businesses and entities generally.

There is no policy reason why this exemption should not extend to interests in businesses and entities generally, as the purpose of this exemption is to exempt acquisitions made by highly regulated entities primarily for the benefit of Australians. The unnecessary cost of the FIRB screening and compliance processes, both direct and indirect, is borne ultimately by Australian members, without any policy benefit from a foreign investment perspective.

As a separate point, the reference to “an Australian business that maintains a superannuation fund for its employees…” in item 3 of regulation 36 of the FATR should be amended to “a foreign person who maintains a superannuation fund…”. Otherwise, this exemption would only apply to legacy defined benefits schemes under the old superannuation regime. It should be sufficient that the superannuation fund is maintained for the benefit of members or their dependents who are ordinarily resident in Australia or who are New Zealand investors investing in funds under the *Trans-Tasman Mutual Recognition Act 1997* (NZ). In addition, the reference to 'primarily' is unclear as to the level of membership permitted for those resident outside of Australia. A clearer approach would be to adopt the foreign person thresholds of substantial interest and aggregate substantial interest holdings.

In light of the increasingly narrow and technical interpretation of the term “Australian business” used under the FATR, the use of the term also needs to be reviewed across the FATR. The term predates the 2015 legislative rewrite and was originally intended to include “Australian trusts” as businesses in its usage, but it is now at risk of being read down to only cover a narrower concept of asset acquisition when contrasted with the wider use of “Australian entities” under the 2015 drafting.

The proposed limitation for the interfunding exemption to apply where both funds are controlled by the same responsible entity unfortunately does not address the commercial reality of interfunding activities as they often occur between subsidiaries and funds that are controlled by different responsible entities within the same group.

To fully achieve the policy objective of reducing the regulatory burden and effectively removing the need for interfunding transactions to be screened by FIRB, it is suggested that the interfunding exemption allow interfunding to occur between wholly owned subsidiaries and apply to responsible entities for both registered and unregistered schemes.

### 1.3 Other opportunities to simplify Australia’s foreign investment framework or reduce regulatory burden while maintaining appropriate safeguards, in line with the Government’s earlier reform packages

Please refer to section 5 below.

**2. Investments requiring greater scrutiny - Consultation questions**

**To help inform the Government's consideration of further foreign investment reform options, the Treasury is interested in hearing from stakeholders with regards to:**

2.1 **whether foreign investors should be required to obtain foreign investment approval before acquiring rural water entitlements, and if so, how this new policy should be designed; and**

2.2 **whether there are other types of foreign investment that warrant greater scrutiny under Australia's foreign investment framework.**

### 2.1 Whether foreign investors should be required to obtain foreign investment approval before acquiring rural water entitlements, and if so, how this new policy should be designed

It could be viewed as incongruous that Australia's foreign investment regime specifically regulates the acquisition of interests in agricultural land but not the acquisition of interests in water entitlements. It is often essential to the maintenance of economic productive capacity that rainfall on agricultural land can be supplemented with access to water from various regulated water sources including aquifers, overland flows, water courses and irrigation schemes.

However, while Australia has developed a world-leading framework for trading water entitlements, the trading of those entitlements is subject to far more regulatory oversight than is the case for trading of interests in agricultural land. In particular:

- trading is generally limited to occurring within a narrowly defined water source; and
- transfer of water entitlements generally requires government approval and, in our experience, approval can be and is withheld on hydrological and other technical grounds.

We submit that hydrological and other technical concerns that may arise out of the trading in water entitlements are adequately addressed through existing state and territory regulatory regimes and, in some cases, Commonwealth environmental laws. As such, there is no national interest imperative for the Commonwealth to concern itself with these aspects of trading in water entitlements.

Where there may, arguably, be some role for Commonwealth oversight of water entitlement trading through the foreign investment regime is at a more macro level. Two potential national interest concerns come to mind.

1. Water entitlement trading driven by non-commercial motivations. For example, private initiatives to purchase water entitlements in order to divert water resources from use in primary production in order to enhance environmental flows. While such initiatives may in some cases be consistent with Commonwealth policy, we can understand the Commonwealth wishing to exercise some oversight over private initiatives of this nature.

2. Water entitlement trading driven by anti-competitive motivations. One of the objectives of Australia's water entitlement trading systems is to ensure that scarce water resources are allocated to the most productive uses. Placing a value on water resources through a competitive market discourages waste and misallocation. Anti-competitive conduct has the potential to reduce the benefits of our water entitlement trading systems.

As trading of water entitlements is generally restricted to occurring within water systems, opportunities for a bad actor to achieve anti-competitive objectives may require less financial resources than would be the case with assets in a broader market.

A hypothetical scenario that crosses both of these concerns would be where an investor bought up water entitlements in a particular water system, withheld water under those entitlements from local farmers in order to depress land values with a view to then buying that land for a discount to ordinary market value.

However, the foreign investment regime could only regulate these concerns where foreign actors were involved. We do not see any aspect to these concerns as an inherently foreign-based problem – it would be just as possible for an Australian actor to impact the national interest as it would be for a foreign one.

In the case of water entitlement trading driven by non-commercial motivations, we think the national interest concerns could be best addressed through a ‘use it or lose it’ entitlement regime that is agnostic as to whether the holder of the water entitlement is Australian or foreign.

In the case of water entitlement trading driven by anti-competitive motivations, we think the national interest concerns are best addressed through competition law.

If the Government nevertheless believes that water entitlement trading should be afforded greater scrutiny under Australia’s foreign investment regime then we submit that the following principles are relevant.

1. There is a difference between the trading of physical water and the trading of water entitlements. We submit that there is no need for scrutiny of physical water trading under Australia’s foreign investment regime.

2. The regulation of water entitlements, including trading in them is complex with significant variations both between and within the States and Territories. Further some water entitlements are derived from private irrigation schemes. Regulation of water entitlement trading under Australia’s foreign investment regime should only occur after a careful review of the regulatory landscape.

3. Interests in water entitlements have some similar characteristics to interests in land and we think that many aspects of section 12 of the FATA could inform a definition of interests in water entitlements. In particular:

    (a) the five year threshold for regulation of leases and licences to occupy land also seems to be an appropriate point to regulate leases of water entitlements; and

    (b) water entitlements can be the subject of agreements involving the sharing of profits or income from their use or dealings in them.

4. Screening thresholds should be value-based rather than volume-based considering that water entitlements vary significantly in the security of the entitlement.

5. The Government could consider including the value of water entitlements when determining whether an entity is an agricultural land corporation or agricultural land trust.

6. Water entitlements that are attached to land and can only be transferred with the land do not need to be separately regulated. For example, riparian rights to water for stock and domestic purposes.

7. The exemption for acquisitions from government in section 31 of the FATR should apply to the acquisition of interests in water entitlements. However, we are concerned that foreign government investors do not have the benefit of this exemption.

8. As with interests in agricultural land, acquisitions of interests in water entitlements are conducive to having an aggregated monetary screening threshold. The $63 million agribusiness threshold (with indexing) may be appropriate. However, we submit that there should be some scope for a foreign person to accumulate additional interests in water entitlements beyond this threshold without compulsory notification based on an annual incremental threshold, eg. 5% of the aggregate threshold per annum.

**3.2 Whether there are other types of foreign investment that warrant greater scrutiny under Australia's foreign investment framework.**

The Committee has no submissions to make on this point.

**3. Exemption certificates - Consultation questions**

**To help inform the Government's consideration of further foreign investment reform options, the Treasury is interested in hearing from stakeholders with regards to:**

3.1 **whether exemption certificates are striking an appropriate balance between facilitating investment and protecting the national interest, including whether the scope, timeframes and financial limits for exemption certificates are appropriately targeted; and**

3.2 **whether there are other types of exemption mechanisms that could be valuable for investors.**

**3.1 Whether exemption certificates are striking an appropriate balance between facilitating investment and protecting the national interest, including whether the scope, timeframes and financial limits for exemption certificates are appropriately targeted**

*Passive government investor exemption certificate*

The principle behind the introduction of the passive foreign government investor exemption certificate was welcome. However, in practice these have been difficult to apply for and rely on as it does not currently cater for very common fund structures. For example:

- private equity and other investment funds regularly use structures that involve multiple investment vehicles, including to accommodate the various legal, tax and regulatory considerations or limitations of its investors. It is also very common to create entirely new vehicles (rather than the main fund vehicle) and to also bring in some of its investors as passive co-investors through different vehicles, to undertake a particular acquisition – the current regime does not cater for all of these different vehicles to be covered by the exemption; and

- private equity and other investment funds also frequently use bolt on strategies and have multiple portfolio companies. At present, it is not clear that a single exemption certificate can apply to each portfolio company held (and it would be burdensome for each such entity to have to make an application for a separate exemption certificate).

In order to improve the value and practical utility of this type of exemption certificate, we submit that it should be broadened to cater for common fund investing structures including, in particular, that the exemption needs to apply to the tracing provisions in section 19 of the FATA.

*Exemption certificates generally*

More generally, the exemption certificate regime could work more effectively, including:

- more discussions upfront between more experienced FIRB officers and investors regarding the required certificate (and providing guidance early to avoid lengthy delays in processing exemption certificates) and allowing for more flexibility in scope;

- reducing the breadth of the conditions applied to be more targeted and tailored; and

- further flexibility in relation to monetary limits set for exemption certificates.

**3.2 Whether there are other types of exemption mechanisms that could be valuable for investors**

We think that an 'investor specific' exemption certificate would be very valuable and is not currently captured by the existing exemption certificate regime.

As indicated above, the current exemption certificate regime does not provide the type of breadth and flexibility that an investor may require to undertake a program of acquisitions over a long period of time, particular where the nature of those acquisitions is unknown and it is difficult to place limits around the acquisitions.

It would be very useful, and allow for greater flexibility, to have an investor specific exemption certificate that:

- focuses on making an assessment of a particular investor (rather than the nature of investments made); and
- where it is determined that the particular investor does not pose a risk to national security, effectively deems the investors not to be a 'foreign person' for the purposes of the FATA.

We anticipate that this could be useful for investors, including those who:

- make frequent acquisitions in Australia, are well known to FIRB and do not pose a risk to national security; or
- are only a 'foreign person' due to technical reasons e.g. an Australian family trust with potential passive beneficiaries who are foreign.

If an investor specific exemption certificate of this nature is introduced, it will be important that it is sufficiently broad to cover various vehicles through which the investor may make an acquisition.

**4. Compliance and enforcement - Consultation questions**

**To help inform the Government's consideration of further foreign investment reform options, the Treasury is interested in hearing from stakeholders with regards to:**

4.1 **whether the new compliance and enforcement powers ensure proportionate and scalable responses are available for any contravention;**

4.2 **whether notification obligations under sections 98C, 98D and 98E are clear and reasonable;**

4.3 **whether existing reporting requirements, as specified in conditions, could be improved/streamlined; and**

4.4 **whether the introduction of infringement notices, monitoring and investigation powers and enforceable undertakings incentivise compliance.**

### 4.1 Whether the new compliance and enforcement powers ensure proportionate and scalable responses are available for any contravention

The enforcement powers are disproportionate in terms of scale and nature when compared to the potential breaches. The maximum penalties are the same whether the investor is a day late on a report or has deliberately breached a condition. This lack of proportionality, as well as the size of potential fines, disincentivises investment. Further, the potential fines could discourage people who inadvertently missed a deadline to come forward and seek to fix the issue, which runs counter to FIRB's objective of monitoring foreign investment into Australia.

The maximum penalties, which were increased significantly on 1 January 2021, are excessive and disproportionate to the relevant offences. For example, the maximum penalty for failing to notify a notifiable action or a notifiable national security action is:

- for criminal penalties – imprisonment for 10 years or 15,000 penalty units (or 150,000 penalty units if the person is a corporation), or both; and
- for civil penalties – the greater of 5,000 penalty units (or 50,000 penalty units if the person is a corporation) or 75% of the value of the investment to a maximum monetary value of 2.5 million penalty units.

The circumstances when these penalties apply include a passive increase where the investor may not even be aware that their interest has increased.

Inadvertent failures to notify often occur because of the complicated legislative provisions that are challenging even to experienced practitioners in this area, let alone investors' commercial teams tasked with executing transactions. Investors often do not realise a notification is even required, especially for offshore transactions where the Australian connection is remote or passive increases in interests where the investor has not taken any action actively. The Treasurer already has broad powers to call in investments for review, order divestment or prohibit an acquisition. The draconian maximum penalties are not necessary in respect of minor and inadvertent breaches.

It is true that we have not seen Treasury actually seeking to enforce the maximum penalties against inadvertent breaches in business acquisitions. This reasonable approach is much appreciated, but investors are not always aware of Treasury's approach in practice, especially if they do not have experience engaging with the foreign investment regime. Law-abiding investors could be unnecessarily alarmed by the large penalties and risk of imprisonment, especially after discovering that the legislation contains many known and unknown traps so that even with the best will in the world a breach of the law could be inevitable. The penalties, even if rarely used, may be a disincentive to investment in Australia.

Rather than focussing on strengthening the enforcement powers which are already extensive, the Committee considers that better compliance could be achieved by directing Government resources to simplify the law so that it is more easily understood and is actually able to be complied with in practice.

### 4.2 Whether notification obligations under sections 98C, 98D and 98E are clear and reasonable

Whilst the Committee considers it reasonable to require foreign persons to notify the Government of the occurrence of an action covered by a no objection notice or exemption certificate, there are a number of issues with sections 98C, 98D and 98E and the associated online 'notification of actions' form.

In respect of technical FATA and FATR matters:

- Sections 98C, 98D and 98E are, somewhat oddly, located in the civil penalties part of the FATA and are therefore difficult to locate. We submit that the provisions should sit in a stand-alone part of the FATA dedicated to reporting obligations.
- There is a mismatch between sections 98C(3), 98D(3) and 98E(4) of the FATA and the FATR (on the one hand) and the online notification of actions form (on the other hand) as to what information must be included in a notification. We submit that the FATA and/or FATR should set out in detail the information that must be included.
- There are some matters in sections 98C and 98D which are open to interpretation. For instance, section 98C(2)(a) refers to 'the day on which the person took the core Part 3 action'. This is straightforward if the action occurs as a single event, but unclear if it occurs via two or more transactions, eg. if a no objection notification approves the acquisition of up to a 100% interest in a target, and the acquirer acquires a 60% interest on a particular day and then the remaining 40% interest three months later, what is 'the day on which the person took the core Part 3 action'? The same issue arises with section 98D(2)(a).

- A 30 day notification period is too short. We submit that a longer period, of say 60 or 90 days, would be more reasonable.

In respect of the online notification of actions form:

- Unlike Treasury's application portal, there is no ability to establish an individual login which can save investor and agent details, nor to save a partially completed form, nor to generate PDFs of completed forms.

- The online form states that 'Notifications submitted using this form must only relate to a single No Objection Notification or Exemption Certificate.' This is problematic where a single No Objection Notification covers more than one FIRB file reference number.

- It would be preferable for the 'Consideration for action' field to allow for input of non-numerical data, not just numerical data.

- The 'Action' fields do not in all cases line up with the type of action. For instance, users are asked to complete 'Date Target acquired' when the action subtype is 'Starting an Australian business'.

- Where an exemption certificate covers a high volume of transactions, one-off notification of actions through the online form is unduly burdensome. We understand that Treasury has permitted alternative means of notifying actions in some cases. The potential availability of alternatives should be noted in guidance.

### 4.3 Whether existing reporting requirements, as specified in conditions, could be improved/streamlined

There are inconsistencies that arise from the current approach in which specific conditions are imposed in some but not all no objection notifications and exemption certificates where section 41B of the FATR applies. In cases where no condition applies and section 41B applies, investors have received notices stating reporting is required, which causes confusion.

### 4.4 Whether the introduction of infringement notices, monitoring and investigation powers and enforceable undertakings incentivise compliance

The Committee does not believe the infringement notices, monitoring and investigation powers and enforceable undertakings solves issues of non-compliance.

In our experience, the great majority of investors making business acquisitions have no intention to breach the law. However, the legislation is simply too complicated to comply with. Investors often do not understand what is actually regulated and why. Drafting issues and patchwork amendments of the legislation over the years have created many inexplicable anomalous provisions in the legislation. Coherent policymaking and guidance notes that explain the regulatory intention are needed. Difficulties in understanding the foreign investment legislation, combined with the complexity of conditions and numerous reporting deadlines, often results in unintentional non-compliance by investors.

As above, we believe that better compliance can be achieved if investors can actually understand what they are meant to comply with. Investors do not need to be shown a big stick to comply with the FATA. They just need conditions that can be easily understood, consistent reporting deadlines, and more coherent legislation.

**5. Overall operation of the foreign investment framework - Consultation questions**

5.1 **To help inform the Government's consideration of further foreign investment reform options, the Treasury is interested in hearing from stakeholders with regards to whether there are any other ways to improve the overall design and operation of Australia's foreign investment framework.**

## Sales processes

The higher application fees applying from 1 January 2021 have resulted in bidders in larger sales processes being reluctant to submit FIRB applications at an early juncture due to the loss of the meaningful application fees if they are unsuccessful. While there is the potential to apply for a credit for use in future applications, bidders tend not to value that potential (especially as it is discretionary and there is no assurance that they will be able to use any credit on future transactions).

This has the effect that FIRB applications are being submitted at a later juncture in large sales process and frequently after the sale agreement has been signed or exclusivity has been granted. We think that this trend is undesirable as it reduces deal certainty and increases the period between signing and completion where there is FIRB conditionality.

The Committee believes that there is a way to accelerate this for larger sales processes (say where the application fee is more than $50,800) with the vendor initiating the process and then allowing bidders to leverage off that work.

In short we would see the process could operate broadly along the following lines:

- **Phase 1:** The vendor initiates the FIRB application process and pays a portion of the overall anticipated application fee (say 20%). The lodgement of a formal submission would enable FIRB to commence the consultation process with its consult partners at a much earlier juncture. Many vendors are seeking to have an informal meeting with FIRB at this early juncture in any event but the quality of any feedback is by necessity limited as FIRB will not typically have consulted with its consult partners in the absence of an application.

  We see three principal advantages with this first stage approach:

  - The information regarding the target is received directly from the target which at a practical level will have much deeper knowledge of the sale assets (and avoids receiving inconsistent information from multiple bidders).
  - The process and consultation starts earlier reducing some of the time pressure on the consult partners.
  - If there are specific national interest or national security matters they can be fed into the process at a much earlier juncture and appropriate feedback provided.

- **Phase 2**: Potential bidders could then submit their application referencing the vendor initiated process and using a single vendor prepared template. We envisage that this might occur at phase 2 of the bid process when typically the buyer universe has been refined. At this stage, each bidder applying could pay say 20% of the application fee. FIRB having received a detailed understanding of the sale assets in Phase 1 would now be focussing on the bidder specific national interests and/or security issues alone eg. the identity of the investor, tax and competition and could develop the matter description and settle and negotiate any conditions. Reducing the fee to say 20% may encourage the bidders to file much earlier than is currently the case.

- **Phase 3 –** The successful bidder pays decision fee (say 60%) so at a minimum FIRB would receive 100% of the estimated application fee.

We think that this fee outcome could be achieved using the remission power rather than having to make changes to the FATA or FATR. Specifically, we think that the remission letters and any no-objection notification could be conditional on the entire fee being paid (whether by one or multiple instalments).

The advantage of this process is that it follows the phases of the sales process and would hopefully shorten the post-signing time frame. We would see that this process would be optional rather than mandatory.

**<u>Carrying on business in Australia</u>**

The term "carrying on business in Australia" is defined in section 21 of the *Corporations Act 2001* (Cth) (**Corporations Act**). "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[1] (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; and
- 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."

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;

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

- 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;
- supplying information to entities within the same control group e.g. reporting to head office on the feasibility of proposed business initiatives or identifying potential business opportunities;
- 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 or a tender response) 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 FIRB approval at a stage well before a business is actually started.

We are particularly concerned that, in a national security business context, premature classification of business activities as constituting the starting of a national security business may discourage new market entrants from responding to public and private sector requests for tender thereby reducing potential competition in business sectors that may already suffer from limited competition.

As an example, some goods and services with potential ‘dual-use’ application may be regarded as ‘critical’ from the perspective of the Australian Defence Force but represent a relatively modest business opportunity for an existing supplier into the civilian market. Putting in place early barriers to potential expansion from a civilian market into a relatively small defence market is not in the national interest.

A solution would be to draw from the Corporations Act and Tax Legislation and identify 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 a foreign government investor (**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.

**Land subdivisions and amalgamations**

We have previously advised of the concern among foreign investors regarding FIRB's position in Guidance Note 2 that land subdivisions and amalgamations will generally result in an acquisition of a new interest in Australian land that can constitute a significant and notifiable action under the FATA.

From a legal perspective, it is difficult to understand how a subdivision or amalgamation constitutes the acquisition of a new interest in land unless there is an increase in land owned, and we reaffirm our view that section 12(3) of the FATA is directed at acquiring different types of interests in land (for example, moving from leasehold to freehold) rather than a subdivision or amalgamation.

There are significant issues for foreign investors arising from the view expressed in Guidance Note 2. While it may be possible to address a known subdivision or amalgamation at the time of making an application, it is not possible to address through that process a subdivision or amalgamation which:

- occurs several years after the initial approval/acquisition;

- is not planned for at the time of acquisition;
- is undertaken without the knowledge or control of the foreign investor by the master developer who has sold part of the development to the foreign investor; or
- is driven by a request from a government department (whether as part of planning approvals or as a result of the department's own projects (e.g. road widening).

The consequences of the above include:

- a risk of projects not being able to achieve funding milestones if potential financiers do not have certainty that a FIRB approval for a subdivision or amalgamation will be forthcoming in the future;
- unnecessary cost and delay to obtain a FIRB approval for what is essentially the same or smaller piece of land; and
- foreign investors being inappropriately penalised when subsequently notifying FIRB of third party action outside of their control (e.g. being asked to implement and report on improved compliance controls as a condition to receiving a retrospective FIRB approval, despite the need for the approval being due to a matter outside of an applicant's control such as an upstream investor providing incorrect information to the applicant or an error in information provided by the target to the applicant).

All of these events have the potential to disrupt the expansion of Australia's residential and commercial land stocks, as well reduce competition in those areas as foreign developers are placed at a competitive disadvantage.

We query the national interest concern with subdivisions and amalgamations given that there is no change in landowner at the time of the event. 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 potentially requiring approval.

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 FIRB.

Where there is a concern that data relating to the approvals will become distorted if subdivisions and amalgamations proceed without FIRB intervention, we recommend that the Government resolve this issue by imposing reporting conditions upon applicants if any approved land interests are subsequently subdivided (or amalgamated) and an obligation to provide any updated title details. The upcoming registers of foreign ownership could facilitate this.

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.

**<u>Owners corporations</u>**

A related issue arises where foreign investors are deemed to take significant and notifiable actions upon obtaining an interest in an owners' corporation (**OC**) as part of their ownership of land interests.

We are aware of examples where FIRB has determined an OC created under state legislation to be an "Australian entity" under section 4 of the FATA. The result of this is a foreign investor may trigger a significant and notifiable action if it acquires certain interests in the voting power in that OC (which may also be an 'Australian land entity' under section 13 of the FATR).

While in most cases the land interests held by an OC will be of nominal value, the issue can be problematic if a $0 threshold is triggered, for example when:

- the foreign investor is a foreign government investor;
- the OC is being established in relation to residential land prior to disposal by the developer or during the development phase of commercial land (ie the land cannot satisfy section 52(3) of the FATR); or
- the OC is deemed to be an FGI due to upstream FGI ownership and it makes secondary acquisitions of land (e.g. arising from an increase in common property due to design changes or due to further subdivision or amalgamations).

Again, the issue can be exacerbated for similar reasons to those noted above, such as the event:

- occurs several years after the initial approval/acquisition;
- is not planned for at the time of acquisition; and
- is undertaken without the knowledge or control of the foreign investor by the master developer who has sold part of the development to the foreign investor.

We note that there is a perception in some circles that section 30 of the FATR solves these issues, but dealings with FIRB have not clarified this issue and the lack of guidance on the point is creating confusion and a belief that the matter is being treated inconsistently. Applications to FIRB have been unnecessarily delayed due to a lack of familiarity with these highly technical considerations. As a result, there is likely to be an inadvertent and unmeasurable level of non-compliance occurring.

In a similar vein to subdivisions and amalgamations, it is difficult to understand how the separate and distinct regulation of interests in OCs advances or protects Australia's national interest. The OC is a legal construct to assist with management of common areas, not to provide control over meaningful interests in Australian land. Furthermore, the monetary value and use of such interest is irrelevant without the related freehold land. The acquisition of such land by a foreign investor will itself be subject to the FIRB approval process if the relevant thresholds are met.

We recommend that the Government consider urgently an exemption for the acquisitions of interests in or by an OC for all foreign persons who have interests in the related land provided that the foreign investor has obtained approval for the acquisition of that related land.

The urgency stems from the need to limit the inadvertent non-compliance as well as the potential this issue has to significantly disrupt and slow the recovery of the commercial construction economy which is already experiencing significant strain following the impacts of the COVID-19 pandemic.

**Build-to-rent**

The Committee considers that the Government's long-standing policy that foreign persons are generally prohibited from purchasing established dwellings (**the Established Dwellings Policy**) ought not to apply to:

- the acquisition by foreign persons of interests in a fund or other entity in circumstances where the fund or entity owns build-to-rent residential properties (**BTR Properties**) that are developed and constitute residential land; and
- the acquisition by such a fund or entity (should it become a foreign person) of residential land or of BTR Properties which are already developed and constitute residential land,

given that the purpose of such acquisitions are not for the acquirers to occupy residential properties and remove them from the supply of housing stock, but rather to increase accommodation opportunities by facilitating the construction and operation, or the continuing operation of, BTR Properties (ie. renting out of residential properties). This is consistent with FIRB's policy position (in Guidance Note 6) that *"Foreign investment applications are therefore generally considered in light of the overarching principle that the proposed investment should increase Australia's housing stock."*

The Committee understands that the FIRB Policy Team agrees with that view. Assuming that to be the case, we submit that this be reflected in an update to FIRB's residential land guidance note. Ideally, the guidance note should state as a general position that BTR Properties are not treated as residential land for the purposes of the Established Dwellings Policy.

Further, we submit that the FATA and FATR should be amended so that BTR Properties are not considered 'residential land' for all purposes, including screening thresholds and filing fees. Currently, a BTR Property will not be considered residential land and will instead be considered 'commercial land' if the BTR Property comes within the GST legislation's definition of 'commercial residential premises'. However, not all BTR Properties fall within the definition of 'commercial residential premises'. Many BTR Properties provide tenants with rights of exclusive possession, long-term rights of occupation and unfurnished premises and, as such, do not fall within the definition, notwithstanding the BTR Properties are practically operated as commercial residential premises.

**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 last update to FIRB Guidance Note 7, the conservative view was 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 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 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 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 (FATR 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.

**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.

**Legal arrangements (FATR s 16)**

The definition of 'direct interest' in section of the FATR includes, in paragraph (b), 'an interest of at least 5% in the entity or business if the person who acquires the interest has entered a legal arrangement relating to the businesses of the person and the entity or business'. There is little understanding as to what precisely constitutes a 'legal arrangement', apart from a strategic alliance agreement (as per the example given in FIRB Guidance 7). We submit that paragraph (b) be removed or the concept of a legal arrangement defined, or alternatively the Government provide clear and comprehensive guidance on what constitutes a legal arrangement.

**Discretionary trusts (FATA s 18(3))**

The deeming provision in s18(3) of the FATA which extend the rules relating to determining percentages of interests in entities to any potential beneficiary of a discretionary trust is extremely broad. It is very common for Australian discretionary trusts (in particular Australian family trusts) to have an extensive and indeterminate category of potential beneficiaries.

Where even one of these potential beneficiaries is technically a foreign person (for example, because they live overseas even if they have never received a distribution from the trust), the trustee of the trust is deemed to be a foreign person, and actions taken by the trustee may be screened.

It is difficult to see the policy justification for this position which, for example, results in many truly Australian family office vehicles being technically deemed to be foreign, even where no foreign person has any influence or control over the activities of the trust and in many cases, where a foreign beneficiary has not received any distributions, or received only a small amount of distributions.

This deeming provision should be deleted. If there are any concerns about discretionary trust vehicles being used to avoid the application of the foreign investment regime the strong anti-avoidance provisions already protect against that.

**Acquisitions of interests from government (FATR s 31)**

The Committee submits that the exemption in section 31 of the FATR should not be limited to acquisitions in relation to an Australian business and acquisitions of interests in Australian land, and should extend to acquisitions of interests in Australian entities. Whilst in many cases the acquisition of an interest in an Australian entity is in relation to an Australian business, that is not always the case, eg. where the Australian entity is a unit trust which is merely a property holding vehicle it does not necessarily carry on an Australian business.

Separately, 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).

**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 5 per cent or more. 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:**

(i) 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.

(ii) A consequence of the FATA s 19 tracing rules no longer applying to aggregate substantial interests is the potential for entities owned by a foreign person to not come within the 'foreign person' definition. For example, Company X is an Australian-incorporated company whose shareholders include 3 foreign corporations from different countries each having a 15% interest. Company X is a foreign person pursuant to paragraph (c) of the 'foreign person' definition because 3 foreign corporations have an aggregate substantial interest in Company X. But the same could not be said for any wholly-owned subsidiary of Company X (nor, for that matter, any entity in which Company X has a substantial interest). This is because no individual foreign corporation has a substantial interest in Company X and therefore does not have a traced interest in any downstream entity, and the aggregate substantial interest of the 3 foreign corporations in Company X does not trace through to any downstream entity. We assume that this is an unintended consequence of the changes to the FATA tracing rules, and submit that the foreign person definition be amended to clarify the position.

(b) **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 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.

(c) **Renaming of significant actions and notifiable actions:** We submit that significant actions should be renamed as reviewable national interest actions and notifiable actions renamed as notifiable national interest actions, that there be removal of the overlap between these concepts so that the first is voluntary only and the second remains compulsory. This will assist with reducing the confusion that currently arises when explaining the significant action and notifiable action concepts to foreign investors.

(d) **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.

(e) **Devolution exemption** (FATR s 29): Arrangements under Part 5.1 or 5.3A of the Corporations Act 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.

(f) **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'.

(g) **Internal reorganisations** (Fees Regulation s 41(2): Currently, a form of corporate reorganisation known as "top-hatting" is not included within the definition of an 'internal reorganisation'. In a top-hatting, a holding entity that is not itself a subsidiary of any other entity becomes the subsidiary of a new holding entity. We submit that the definition of internal reorganisation should be modified to include a top-hatting where the new holding entity has the same investors holding the same percentage interests as they held in the original holding entity.

(h) **Interests in corporations without share capital**: As a general proposition, we submit that the form a body takes should not lead to differences in how it is regulated for foreign investment purposes. A current example of where there is a difference is in the treatment of limited liability companies (**LLCs**) and other bodies corporate that do not have share capital. A company limited by guarantee for example has membership interests that are not represented by shares or stock. Under the FATA, the membership interests of an LLC cannot be used to determine whether the LLC is a foreign person or a foreign government investor, or whether a foreign person acquires a direct interest or substantial interest in it. Instead, the only bases for measuring the interests in an LLC are by reference to voting power and potential voting power.

Contrast this with unincorporated limited partnerships and trusts where sections 11 and 11A of the FATA consider the equivalent of membership interests in determining whether a person holds an interest in these types of bodies. LLCs and other bodies corporate without share capital should have their membership interests considered as an interest in them.

(i) **Offshore transactions – de minimis exception for land entities**: The tracing rule exceptions in section 19(3) do not apply to notifiable actions triggered by the acquisition of interests in land entities. In circumstances where a land entity is not covered by section 52(3) of the FATA, or where the land entity is an agricultural land corporation or an agricultural land trust, an offshore transaction may trigger compulsory notification in circumstances notwithstanding that the value of the land entity is immaterial in the context of the offshore transaction.

We recommend that this be addressed by introducing a new exception that operates in a similar way to the de minimis exception for foreign government investors in section 56(4) of the FATR such that the tracing rules would not apply to render an action a notifiable action involving the acquisition of securities in land entities where:

- the foreign person acquires an interest in a land entity (and, therefore, an interest in land) only pursuant to the tracing rules in section 19 of the FATA);
- the total value of the interests in land entities acquired is less than 5% of the value of the total assets of the foreign entity;

- the total value of the interests in land entities acquired is less than $63 million (indexed); and

- no land in which the land entities hold an interest are assets of a sensitive business.

We do not propose that the de minimis exception apply in the case of a notifiable national security action or a reviewable national security action. The Government may also wish to exclude:

- agricultural land corporations and agricultural land trusts; and/or

- Australian land corporations and Australian land trusts that are not covered by section 52(3) of the FATR.

(j) **Leases without freehold characteristics** (FATA s 12(1)(c)) – FIRB Guidance Note 3 – *Agriculture* refers to the concept of a 'leasehold interest with freehold characteristics' in the context of the open and transparent sale process requirement. The concept is explained in footnote 8 of the note as follows:

> Leasehold interests with freehold characteristics could include where: there are no significant/market-based periodic payments (the consideration is primarily upfront with a nominal annual lease payment); the term of the lease is indefinite or the lease would be renewed automatically or at the election of the tenant at no extra charge; there is an option to acquire a freehold interest at the end of the lease; and where the lessor is a state/territory government (e.g. perpetual or pastoral leases).

We recommend using this concept to relax the length of a lease or licence term permitted before the relevant interest as lessee or licensee is treated as an interest in Australian land. Relying on this concept – and leaving aside national security land – we submit that the permitted length of the term of a lease or licence (including any extension or renewal) could be increased from five years to ten years where the lease or licence did not have any freehold characteristics.

While we submit that – absent freehold characteristics - national interest concerns are unlikely to arise from any acquisition of a lease or licence for a term that is no longer than ten years, the Government could limit this relaxation to (a) commercial land that is not vacant or (b) commercial land that is not vacant and does not meet any of the categories listed in section 52(6)(c) of the FATR.