THE TAX INSTITUTE

THE MARK OF EXPERTISE

22 April 2016

Mr James Benson
Foreign Investment Tax Conditions Consultation
Foreign Investment and Trade Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: firbstakeholders@treasury.gov.au

Dear Mr Benson,

Draft guidance note on foreign investment Tax Conditions

The Tax Institute welcomes the opportunity to make a submission to the Foreign Investment Review Board (**FIRB**) in relation to the draft guidance note on foreign investment tax conditions (**Guidance Note**). The Guidance Note relates to the standard conditions for foreign investment applications announced by the Treasurer in a Media Release[1] dated 22 February 2016 (**Tax Conditions**).

We have several concerns in relation to the Tax Conditions and the Guidance Note which are outlined below.

Lack of public consultation before application

We regret the lack of public consultation in relation to the Tax Conditions and the Guidance Note. Over the past few months, our members have seen the Tax Conditions attached to FIRB approvals prior to any public guidance being issued. It is our view that imposing the Tax Conditions in these circumstances puts an onerous compliance burden on purchasers and may result in inadvertent breaches of the conditions due to lack of awareness.

Our members have reported that offshore investors have generally been surprised by the potential breadth of the Tax Conditions, having regard to the penalties that could be imposed. In this context, a lack of uncertainty about how the rules would be imposed from a practical perspective poses a foreign investment risk for Australia.

[1] http://sjm.ministers.treasury.gov.au/media-release/010-2016/

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Unclear scope of application

It is the view of the Tax Institute that the Tax Conditions are not worded with sufficient precision or specificity given the serious consequences that will attend non-compliance. As discussed further below, practical compliance with the Tax Conditions will require ongoing dialogue with the Australian Taxation Office (**ATO**) to ensure that there is a mutual understanding of the scope and intent of the Tax Conditions. This is inappropriate given the sanctions that are imposed on purchasers who fail to comply with conditions imposed by FIRB.

Added to this uncertainty regarding the interpretation of the Tax Conditions, is a lack of clarity regarding how broadly they will be imposed. The Treasurer's Media Release stated that the standard conditions to be imposed on foreign investment applications were as set out in Attachment A which sets out 8 standard conditions and 2 potential additional conditions. This has been interpreted by some practitioners to mean that the Tax Conditions will operate as a default. The Guidance Note on the other hand states that the imposition of Tax Conditions will be considered on a case by case basis, and other practitioners have interpreted this to mean that they will only be imposed in a few cases.

Further, the Guidance Note states that the Treasurer may impose one or more of the Tax Conditions at Item A of Attachment A rather than all 8 standard conditions where the Treasurer considers there is a risk to Australian taxation revenues, however, no guidance is provided in the Guidance Note in relation to the following:

- The nature of the circumstances that might lead to an increased number of Tax Conditions being imposed; and

- whether the Tax Conditions at Item A of Attachment A follow a particular order in which they are likely to be imposed (e.g. increasingly onerous conditions being imposed as perceived level of risk to the Australian taxation revenues rise).

In addition, the Guidance Note states that the Treasurer may impose one or more Tax Conditions at Item A of Attachment A where the proposal may involve "a risk of any kind to taxation revenues" and the additional Tax Conditions at Item B of Attachment A where the proposal is considered to have "a particular taxation risk". In our view, the Tax Conditions at Item A of Attachment A should only be imposed where there is a perceived material risk to Australian taxation revenues not simply where there is "a risk of any kind to taxation revenues". In relation to the Tax Conditions at Item B of Attachment A, the Guidance Note should provide a clearer indication of the particular types of taxation risks envisaged. Further, the Tax Conditions at Item B of Attachment A should also only be imposed where the particular taxation risk represents a material risk to Australian taxation revenues.

It is also not clear whether Condition 1 extends to taxes other than income tax such as fringe benefits tax or state based taxes (e.g. stamp duty or payroll tax).

We ask that these matters be clarified in the Guidance Note.

Guidance from ATO needed

The Tax Conditions and the Guidance Note require purchasers to engage early with the ATO in relation to their tax affairs, however little guidance is provided as to how the ATO should be approached. The Guidance Note also does not specify whether taxpayers should approach FIRB, the ATO or both in order to confirm their compliance with the Tax Conditions.

We submit that the ATO should publicly release guidance on its interpretation of the Tax Conditions and their administrative processes in relation to them, covering issues such as who should be contacted and what information should be provided. The ATO guidance should be issued at the same time as the Guidance Note. For example, it is not clear what is meant by a "notification" of a tax matter to the ATO in Condition 5. It would be helpful for the ATO to state what would qualify as a complying notification. This is particularly relevant given that the Guidance Note issued by FIRB is not administratively binding based on the "Important notice" disclaimer on page 5.

Significant departure from tax penalties

The Guidance Note states that "consideration of taxation issues is a longstanding feature of the consideration of the national interest" and we understand that FIRB has existing procedures for liaising with the ATO on these issues. However we would emphasise that, from a public perspective, these Tax Conditions signify a significant departure and escalation of existing penalties imposed for equivalent breaches under tax law. For example, under the Tax Conditions, purchasers could face severe penalties such as imprisonment for up to 3 years[2] for actions which would not be breaches of the tax law, and which would otherwise only attract minor consequences. For example, a breach of Condition 4 would usually only result in an evidentiary consequence[3] under the tax law. Additionally, relatively minor breaches of the tax law which would give rise to a relatively minor administrative penalty (e.g. for late lodgement of a return by 5 days) would expose purchasers to disproportionate consequences.

Should not impact on taxpayer's objection or appeal rights

The Guidance Note states under "Conditions One and Two – Comply with Australian Taxation Laws" that "*compliance with Australia's tax laws would be determined by applying the usual legal principles and processes, including reliance on objection or appeal rights by affected entities*." This wording is ambiguous and it should be clarified that parties will not be treated as not complying with Australian tax laws merely because they exercise rights available to them such as objection or appeal rights.

[2] Section 87 of the *Foreign Acquisitions and Takeovers Act 1975*
[3] Section 264A of the *Income Tax Assessment Act 1936*

Overlaps with tax disclosure requirements

The reporting requirements in Conditions 5 and 6 (and potentially also Condition 2 in Item B of Attachment A) would appear to impose an unnecessary additional compliance burden on foreign investors given the overlap with existing disclosure requirements ,such as the International Dealings Schedule lodged with the annual income tax return, and additional disclosure requirements that will apply in the near future under Subdivision 815-E of the *Income Tax Assessment Act 1997*, such as country-by-country reporting and local file requirements.

For example, Conditions 5 and 6 require notification “where such transactions or dealings have not been previously notified to the Commissioner”. Related party international dealings are disclosed in the International Dealings Schedule but some transactions may fall outside of those disclosures due to a relatively small charge or no charge. It is would be inconsistent for those transactions to then be reported under the Tax Conditions on the basis that they were not previously notified.

This issue is exacerbated by the potential for the Tax Conditions to be imposed indefinitely into the future which results in ongoing reporting requirements. Condition 8 requires the company to provide an annual report to FIRB on compliance with the Tax Conditions. This reporting obligation should not apply in perpetuity and one option would be to amend the conditions if the circumstances change such that a continuing reporting obligation is not appropriate.

Furthermore, the description of Conditions 3 and 4 in the Guidance Note, particularly the references to section 353-10 of Schedule 1 of the *Taxation Administration Act 1953* (**TAA**) and section 264A of the *Income Tax Assessment Act 1936*, appear to change what would otherwise be informal requests for information from the ATO into an exercise of the Commissioner’s compulsive powers. Failure to comply with a formal notice constitutes an offence under sections 8C and 8D of the TAA. We would ask that the Guidance Note be clarified to avoid this result as it may hamper the early engagement with the ATO envisaged in the Tax Conditions.

The Guidance Note has confirmed that privileged documents do not need to be provided. However, there are other concessions available in Australia (e.g. board papers and accountant’s concession) which do seem to fall within the scope of what can be requested. The status of these documents should be confirmed at least in the Guidance Note, but preferably in the Tax Conditions. It is submitted that this issue is too important to be left to non-binding guidelines, and that the Tax Conditions should be amended to make it clear that investors are not required to agree to waive privilege or other rights.

There is no concept of reasonableness in requests that can be made by the ATO under Conditions 3 or 4. Most taxpayers usually find it difficult to comply with the standard timeframe that the ATO imposes for providing documents, and the timing for providing documents is frequently negotiated with the ATO. The Guidance Note should say that the ATO will act reasonably in making any request under Conditions 3 or 4, and in accordance with its usual procedures for setting time frames for providing documents. The Guidance

Note should discuss what happens if the requested documents are not within the custody or control of the purchaser and whether penalties could be imposed by FIRB in these circumstances.

Should not require entry into advance pricing arrangements

The Guidance Note and Condition 1 in Item B of Attachment A state that a foreign investor (and/or its associates) may be required to enter into an advance pricing arrangement (**APA**). Compelling foreign investors to enter into an APA is contrary to the OECD's Transfer Pricing Guidelines: see paragraph 4.147.

Condition 1 also refers to "the obtaining of a private ruling with the ATO within a certain timeframe". The investor will not have control over the timeframe in which the ATO will issue a ruling, so a condition that such a ruling be "obtained" within a time is unreasonable.

Uncertain definition of "associate"

Attachment A to the Guidance Note and the Tax Conditions state that the term "associates" has the meaning in section 318 of the *Income Tax Assessment Act 1936*. Section 318 is a provision that is regularly criticised by tax practitioners due to its complexity and breadth.

One consequence of using such a broad term is that it is often difficult to determine whether entities are associates or not as the term depends on certain factual matters (e.g. sufficient influence). It seems inappropriate to impose a best endeavours obligation in relation to a potentially unknown class of entities.

We also observe that it seems to be assumed in the Guidance Note that an entity will be in a position to influence another entity merely because the entities have common directors. This conflicts with the general position that a director must act in the best interests of the company of which they are a director, which may be inconsistent with taking steps at the behest of, or for the benefit of, another entity.

Further, the definition is particularly problematic where trusts are involved, as any person who benefits under a trust is an associate. The potential scope for widely held investment vehicles structured as a trust therefore creates an onerous burden on an investor.

We also note that the meaning of "associate" in section 6 of the *Foreign Acquisitions and Takeovers Act 1975*, to which the Guidance Note relates, is not the same as the meaning of "associate" in section 318.

The Guidance Note further states that the applicant has to ensure the associate complies with the relevant conditions where the applicant has the power to do so. This should be modified by reference to some "reasonableness" criteria where exercise of a "power" might be costly or otherwise onerous.

Where the applicant does not have the power to do so, it must use "best endeavours", which is an imprecise term. The Guidance Note should provide some practical examples of when the "best endeavours" requirement would be satisfied.

Insufficient reference to materiality

Conditions 5 and 6 and the Guidance Note in relation to these conditions do not clearly exclude immaterial transactions, even though these Tax Conditions appear to be the most difficult to apply in practice. For example, any international transaction could be subject to the transfer pricing rules, including a transaction with a third party. Further, it is up to the Commissioner when to choose to apply Part IVA of the *Income Tax Assessment Act 1936* (subject to general administrative law constraints). Therefore, there is an incredibly broad range of transactions that could be caught by this condition, and that range may include numerous transactions that are otherwise seen by the market as being relatively standard and not warranting any communication with the ATO.

In any event, guidance on materiality should be issued in the form of ATO guidance as Conditions 5 and 6 state that the term “material” is to be defined by the ATO. The ATO guidance and Guidance Note should be issued simultaneously and factor in the size of dealing relative to the size of the company involved.

Further specific issues with Conditions 5 and 6

In addition to the above matters, the following should also be clarified in relation to Conditions 5 and 6:

- The conditions refer to the fact that transfer pricing and general anti-avoidance provisions “may potentially apply”. It is unclear whether this means that a taxpayer does not need to notify matters where an opinion obtained by the taxpayer that “Part IVA should not apply”.
- The conditions refer to entering into transactions “directly or indirectly”. Clarification is required as to when an “indirect” transaction or dealing is required to be notified to the ATO.
- The conditions and the Guidance Note refer to paragraph 82 of TR 1999/1. An alternative reference should be provided as this ruling does not apply to income years commencing on or after 29 June 2013: see TR 1999/1A1.

Should factor in payment arrangements

Condition 7 suggests that a purchaser would be in breach even if the purchaser has a payment arrangement in place with the ATO in relation to a tax debt. This is because such an arrangement does not alter the time that such a debt is due and payable, which remains at the time an assessment is issued by the Commissioner. This condition should exclude agreed payment arrangements. This could be achieved by including the second paragraph of the Guidance Note under ‘Condition Seven – Payment of Outstanding Debt’ in Condition 7 itself.

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If you would like to discuss any of the above, please contact either me or Tax Counsel, Thilini Wickramasuriya, on 02 8223 0044.

Yours sincerely,

Arthur Athanasiou
President

cc Mr Andrew Mills, Second Commissioner - Law Design and Practice, Australian Taxation Office