REGULATION OF FOREIGN INVESTMENT

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GUIDE TO DOING BUSINESS IN AUSTRALIA

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Guide to Doing Business in Australia and New Zealand

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in Australia and New Zealand

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Guide to Doing Business in Australia and New Zealand

This publication has been prepared to provide an overview to foreign investors and business people who have an interest in doing business in Australia and New Zealand. The material in this publication is intended to provide general information only and not legal advice. This information should not be acted upon without prior consultation with legal advisors.

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The following currency notations are used in this book:

AUD Australian Dollar

NZD New Zealand Dollar

Please be aware that the information on legal, tax and other matters contained in this booklet is merely descriptive and therefore not exhaustive. As a result of changes in legislation and regulations as well as new interpretations of those currently existing, the situations as described in this publication are subject to change. Meritas cannot, and does not, guarantee the accuracy or the completeness of information given, nor the application and execution of laws as stated.

This book is intended to provide practical and useful insights into the 10 most common questions facing foreign investors and businesses:

1. What role does the government play in approving and regulating foreign direct investment?
2. Can foreign investors conduct business without a local partner? If so, what corporate structure is most commonly used?
3. How does the government regulate commercial joint ventures between foreign investors and local firms?
4. What laws influence the relationship between local agents or distributors and foreign companies?
5. What steps does the government take to control mergers and acquisitions with foreign investors of its national companies or over its natural resources and key sectors (e.g., energy and telecommunications)?
6. How do labor statutes regulate the treatment of local employees and expatriate workers?
7. How do local banks and government regulators deal with the treatment and conversion of local currency, repatriation of funds overseas, letters of credit, and other basic financial transactions?
8. What types of taxes, duties and levies should a foreign investor expect to encounter?
9. How comprehensive are the intellectual property laws? Do local courts and tribunals enforce them objectively, regardless of the nationality of the parties?
10. If a commercial dispute arises, will local courts or arbitration offer a more beneficial forum for dispute resolution to foreign investors?

Contributing to this book are the law firm members of the Meritas alliance in Australia and New Zealand. Each firm is comprised of local lawyers who possess extensive experience in advising international clients on conducting business in their respective countries. The firms were presented with these 10 questions and asked to provide specifics about their jurisdiction along with timely insights and advice. In a very concise manner, the book should provide readers with a solid overview of the similarities and differences, strengths and weaknesses of the states and territories of Australia and New Zealand.

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TOP 10 QUESTIONS

1. WHAT ROLE DOES THE GOVERNMENT PLAY IN APPROVING AND REGULATING FOREIGN DIRECT INVESTMENT?

The government regulates foreign investment through the Foreign Investment Review Board (FIRB), which is a Board within the Commonwealth Department of Treasury. One of its roles is to examine proposals by foreign interests to undertake direct investment in Australia and to make recommendations to the government whether the proposals are suitable for approval under the Australian government's policy. The ultimate decision whether a proposal is approved lies with the Treasurer.

FIRB is also responsible for monitoring and ensuring compliance with foreign investment policy.

Different rules apply depending on the nature of the proposed foreign investment, for example, an investment in residential real estate or commercial real estate versus in an Australian business. Whether FIRB approval is required for a proposed foreign investment may also depend on whether the proposed investment exceeds certain set monetary thresholds.

The application process for obtaining FIRB approval is fairly rigorous but is generally determined within 30 days of lodgement of the application, although this period may be extended.

2. CAN FOREIGN INVESTORS CONDUCT BUSINESS WITHOUT A LOCAL PARTNER? IF SO, WHAT CORPORATE STRUCTURE IS MOST COMMONLY USED?

Yes, there is no general legal requirement for a foreign investor to conduct a business with a local partner.

The most common corporate structure used in conducting business in Australia is a company, although other structures such as joint ventures, partnerships and trusts may also be used.

Even with a local partner, FIRB approval may be required.

3. HOW DOES THE GOVERNMENT REGULATE COMMERCIAL JOINT VENTURES BETWEEN FOREIGN INVESTORS AND LOCAL FIRMS?

Generally, the government does not regulate commercial joint ventures between foreign investors and local firms; however, the government may regulate the foreign investor through FIRB and other laws such as the *Corporations Act* (which regulates companies generally) and taxation laws.

4. WHAT LAWS INFLUENCE THE RELATIONSHIP BETWEEN LOCAL AGENTS OR DISTRIBUTORS AND FOREIGN COMPANIES?

Broadly speaking the relationship between an Australian agent or distributor and an overseas supplier would be a contractual one governed by the same principles of contract law as the UK and other English speaking jurisdictions.

Under Australian tax law, the pricing of goods and services supplied under contract between an Australian agent or distributor and an overseas supplier is expected to be set on an "arms-length" basis. There are comprehensive and complex tax laws dealing with transfer pricing of goods and services imported to or exported from Australia for the purposes of protecting the revenue.

Where the Commissioner of Taxation forms the opinion that cross-border transactions have not been priced on an arms-length basis, the Commissioner has power to make compensating adjustments and impose penalties.

5. WHAT STEPS DOES THE GOVERNMENT TAKE TO CONTROL MERGERS AND ACQUISITIONS WITH FOREIGN INVESTORS OF ITS NATIONAL COMPANIES OR OVER ITS NATURAL RESOURCES AND KEY SECTORS (E.G., ENERGY AND TELECOMMUNICATIONS)?

FIRB controls whether a foreign investor may invest in certain sectors. There are certain sectors where foreign investment will be prohibited or restricted or otherwise restricted as being against the national interest or as being against Australia's national security. These include residential real estate, media, telecommunications and military (albeit FIRB approval may be granted in these areas in certain circumstances).

Even if a proposed foreign investment does not fall within a sensitive sector, FIRB has an overriding policy where approval may be declined where the proposed investment is against the national interest or is against Australia's national security.

6. HOW DO LABOR STATUTES REGULATE THE TREATMENT OF LOCAL EMPLOYEES AND EXPATRIATE WORKERS?

LOCAL EMPLOYEES

Australia's system is strongly regulated by state and federal legislation. Companies that are trading corporations fall within the federal system of industrial relations presently administered pursuant to the Fair Work Act 2009. A review of the Act is currently underway with the Review Panel scheduled to report to the federal government by 31 May 2012

Most blue-collar and clerical workers have their employment terms and conditions determined by reference to the National Employment Standards, and various awards and collective agreements approved by Fair Work Australia, a third party tribunal.

Senior executives and management more commonly have their terms and conditions of employment determined by reference to common law agreements negotiated directly between the employer and the employee. The terms of such agreements must still exceed the statutory minimum standards.

Workplace health and safety, discrimination, and workers' compensation for workplace injury are regulated by state or territory legislation.

EXPATRIATE WORKERS

The terms and conditions for expatriate workers will greatly depend upon the type of visa arrangements approved by the Australian immigration authorities. Business people visiting from overseas can continue to enjoy the benefits of their home-based employment arrangements while undertaking short-term business activities in Australia. However, where visas are required, the employees will most commonly be required to be engaged as if they were employees fully covered by the Australian industrial relations regime and legislation referred to above. In any event, key legislation covering such issues as workplace health and safety and worker's compensation will apply to any person working in Australia.

7. HOW DO LOCAL BANKS AND GOVERNMENT REGULATORS DEAL WITH THE TREATMENT AND CONVERSION OF LOCAL CURRENCY, REPATRIATION OF FUNDS OVERSEAS, LETTERS OF CREDIT AND OTHER BASIC FINANCIAL TRANSACTIONS?

Generally, Australia does not have any exchange controls. The Australian Dollar (AUD) is a floating currency widely and transparently traded, although the Reserve Bank may, from time to time, buy or sell AUD to smooth out unusual market events.

There are no restrictions on repatriation of profits back to overseas parents by way of dividends or loan repayments other than:

- The usual requirement that the Australian entity meet the solvency test of being able to meet its debts as and when they fall due, or
- In some cases, making sure the company does not fail the thin capitalisation test to ensure that its interest expense is fully deductible for tax purposes.

Local banks are generally well capitalised and sophisticated financial institutions. As such, they are accustomed to trading in foreign exchange and dealing with letters of credit and other trade-based securities.

There are, however, some reporting requirements in relation to the movement of large sums of money and there may also be financial sanctions imposed in relation to transactions involving certain countries, entities or individuals.

8. WHAT TYPES OF TAXES, DUTIES AND LEVIES SHOULD A FOREIGN INVESTOR EXPECT TO ENCOUNTER?

For most operating companies the following taxes would be encountered by an Australian operation:

- Company tax at 30% on taxable income
- Withholding tax on any dividends to the extent that these are unfranked (i.e., franked dividends to overseas shareholders are free of withholding tax)
- Withholding tax at 10% on interest payable to an overseas party
- Withholding tax on royalties payable to an overseas party
- State duties on the acquisition of land and other assets including shares in a company

- In some cases, payroll tax on wages and salaries (a state-based impost)
- Resource Rent Tax (oil and gas only)
- Pay-as-you-Go withholding tax (on the salaries and wages of employees which is remitted directly to the Commissioner of Taxation and a credit allowed to respective employees on filing their income tax return)
- In some cases, Fringe Benefits Tax on non-cash compensation paid to employees

9. HOW COMPREHENSIVE ARE THE INTELLECTUAL PROPERTY LAWS? DO LOCAL COURTS AND TRIBUNALS ENFORCE THEM OBJECTIVELY, REGARDLESS OF THE NATIONALITY OF THE PARTIES?

Australia is a member of World Trade Organisation and TRIPS, as well as the Berne, Paris and Rome Conventions, the Patent Co-Operation Treaty, the Madrid Protocol (for trade marks) and a member of other international IP treaties administered by the World Intellectual Property Organisation. As a result, Australia has a comprehensive intellectual property regime. It includes legislative regimes (e.g., *Copyright Act, Trade Marks Act, Patents Act, Designs Act, Plant Breeders Rights Act* and *Circuit Layouts Act*) and common law regimes (e.g., the protection of confidential information and common law trade marks). Australia's intellectual property statutes create both civil and criminal liability for infringements, but criminal prosecutions are rare. Where applicable, Australian intellectual property laws are enforced objectively (principally in the federal jurisdiction) and are enforced regardless of the nationality of the parties, subject to a principal of reciprocity in respect of copyright infringement such that Australia counts will only recognise copyrights of foreign nationals to the extent that courts of that national's country recognise an Australian copyright.

10. IF A COMMERCIAL DISPUTE ARISES, WILL LOCAL COURTS OR ARBITRATION OFFER A MORE BENEFICIAL FORUM FOR DISPUTE RESOLUTION TO FOREIGN INVESTORS?

All Australian courts including federal, state and territory courts offer well-regulated dispute resolution processes. The *Federal Civil Dispute Resolution Act 2011* requires parties to litigation to certify that they have taken genuine steps to resolve a dispute prior to commencing proceedings in the Federal Court. Increasingly these courts, generally with the support of litigants and their lawyers, are requiring that pro-active case management, mediation and other alternate dispute resolution processes be implemented as early as possible to resolve disputes without the costs and delays involved in full-blown trials.

Further, in September 2010, the Federal Attorney General's Department established a Mediation Standards Board for the accreditation and regulation of Australian mediators. Accredited commercial mediators may be sourced through accrediting organisations such as LEADR and Institute of Arbitrators and Mediators Australia.

Mediation is cross-jurisdictional and therefore increasingly attractive for the resolution of international disputes.

While arbitration is also available, with well-regulated commercial arbitration procedures in most jurisdictions, the growth in alternative dispute resolution processes has meant that in general terms litigants are less attracted to arbitration than they may have been in the past. The fact that arbitration is no longer seen as a significantly less expensive alternative than traditional court-based litigation is a likely contributing factor to this.

REGULATION OF FOREIGN INVESTMENT

One of the first matters a foreign investor must consider when planning to invest in Australia is the impact of Australia's foreign investment policy.

REGULATION

Foreign investment in Australia is principally governed by the *Foreign Acquisitions and Takeovers Act* and is administered by the Foreign Investment Review Board (FIRB).

The FIRB is a division of the Federal Treasury. Its function is to review foreign investment proposals and to make recommendations to the Federal Treasurer. The Treasurer will then make a decision, based on these recommendations, which will either permit or prevent the proposed foreign investment in Australia. This decision is commonly referred to as FIRB approval.

FOREIGN INTEREST

Foreign investment regulation applies to investment proposals in Australia by a foreign interest. This term is defined to include:

- A person who is not ordinarily resident in Australia
- An Australian company, business or trust where 15% or more of the voting shares are held by a foreign corporation or nonresident person (even if that foreign interest does not exercise control), or where several nonresidents hold a total of 40% or more

If you fall within one of these categories, and are proposing to make any of the types of investment described below, it is likely that you will need to apply for FIRB approval.

CATEGORIES OF FOREIGN INVESTMENT

The main categories of foreign investment which are regulated by FIRB are:

- **Acquisition of Shares**
  Subject to certain minimum limits, any foreign interest proposing to acquire, increase or alter a "substantial interest" in an Australian company, the value of whose assets exceeds AUD248 million or, where the proposal values the business at over AUD100 million, must first obtain FIRB approval.

  For U.S. investors, a notification threshold of AUD1078 million applies except for investments in certain sectors (e.g., media, telecommunications, transport, human resources or training, manufacture or supply of military goods or equipment,

development, manufacturing and supply of securities technology goods, extraction or rights to uranium, plutonium or operation of nuclear facilities). U.S. entities controlled by a U.S. government (state and/or federal) are subject to an AUD248 million threshold.

A "substantial interest" in an Australian company is an interest acquired (either directly or indirectly) by a foreign entity that amounts to 15% or more of the issued shares or voting power of the Australian company. It also arises where associated foreign interests hold 40% or more in aggregate of the issued shares or voting power of the Australian company.

- **New Businesses Proposals**
  Proposals by private investors to establish new businesses do not require notification or approval under the Act or the policy. Direct investments by foreign governments and their agencies, including proposals to establish new businesses, require approval.

- **Offshore Takeovers**
  Takeovers by a non-U.S. foreign interest in an offshore company that holds Australian assets or conducts business in Australia are subject to FIRB approval where the proposal exceeds AUD248 million.

- **Acquisition of Real Estate**
  Prior FIRB approval is required for foreign acquisitions of interests in urban land (including interests that arise via leases, financing and profit sharing arrangements and acquisition of interests in urban land corporations and trusts) that involve:
  - Developed nonresidential commercial real estate, where the property is subject to heritage listing valued at AUD5 million or more and the acquirer is not a U.S. investor
  - Developed nonresidential commercial real estate, where the property is not subject to heritage listing but is valued at AUD54 million or more, or AUD1078 million for U.S. investors
  - Accommodation facilities, vacant, and residential real estate irrespective of value

  Proposals for acquiring developed residential real estate by foreign interests are normally rejected except in limited circumstances.

- **Foreign Government Investments**
  All types of direct investments by foreign governments and their agencies require prior FIRB approval and notification to the Australian government.

- **Special Cases**
  Separate rules apply to foreign interests participating in certain sensitive industry sectors in Australia without express approval. These sectors include: media, civil aviation, telecommunications, banking, airports, shipping, holding rights to extract plutonium or uranium, and operating a nuclear facility.

REVIEW OF INVESTMENT PROPOSALS BY FIRB

The FIRB's review process of investment proposals is generally prompt. Forwarding an investment proposal to the FIRB activates a "time clock" so that if action is not taken within 30 days (or an extended time period as notified by the FIRB), the FIRB cannot withhold its approval.

In most cases a decision is made within the 30 day period and FIRB approval is normally granted unless the proposal is judged to be contrary to the national interest. This judgment may be made in consultation with other government departments, such as the Australian Taxation Office. Generally the FIRB is required to satisfy itself that the investment is for a legitimate purpose benefiting Australia. If an investment proposal is on a large scale, political considerations may become important.

In some cases, the FIRB's approval may be subject to the foreign interest meeting certain conditions. If the FIRB's approval is conditional, the foreign interest must comply with the conditions. For example, in real estate investments such conditions may include obtaining feasibility studies and environmental impact reports and providing evidence that the foreign interest has planned for the long-term management of the development.

PENALTIES

There are heavy penalties for failure to comply with the *Foreign Acquisitions and Takeovers Act* or with conditions imposed by the FIRB, including fines or an order requiring the foreign entity to sell its interest. Accordingly, we strongly recommend that you always seek legal advice before structuring or submitting a proposal to the FIRB to make an investment in Australia.

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