
Taxation conditions – clarifying requirements for foreign investment

4 May 2016

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In brief

As discussed in our February LegalTalk Alert, on 22 February 2016 the Australian Government announced that tax conditions will formally be applied to the clearance of foreign investment proposals which present a possible risk to Australia's revenue base, aimed at ensuring foreign investors are compliant with Australian tax laws.

The conditions are intended to formalise and extend the consideration of tax issues in the assessment of Australia's national interest, the key criterion in the foreign investment clearance process, and show a convergence of debate relating to foreign investment regulation and the base erosion and profit shifting (BEPS) agenda.

Drafts of the proposed tax conditions and guidance note providing additional information on the application of the conditions themselves were released by the Australian Government in early March and there have since been consultations between Treasury, the Australian Taxation Office (ATO) and industry to discuss the practical application of these conditions. PwC were invited to be involved in this consultation process and provided a submission to the Treasury.

As part of the Federal Budget handed down on 3 May 2016, the Treasurer released a revised set of conditions, incorporating the feedback it received during the consultation process. It has also been indicated that the guidance note relating to the conditions will be finalised and released shortly to provide additional information on the conditions.

In this LegalTalk Alert we look at some of the changes made by the Treasury in producing the revised set of conditions.

In detail

Conditions to apply until a termination event

The revised set of conditions clarifies that if any tax conditions are imposed on an applicant, such conditions will continue to apply only until a 'termination event' occurs. A termination event is defined as

an event where the applicant ceases to: (i) hold the interest; (ii) control the entity or business; or (iii) carry on the business that was the subject of the notification imposing the tax conditions.

Although this provides a clear term for the application of the conditions, prospective applicants may be disappointed that the conditions will continue to apply for as long as they continue to be interested in the relevant action, potentially years after it took place.

New conditions to advise of actions and termination events

Two new conditions have been included in the revised set of conditions. These conditions oblige applicants to advise the Foreign Investment Review Board (FIRB) within 60 days of:

- a) taking an action; and/or
- b) a termination event (please refer to the discussion of this term, above),

notifying FIRB that such action/termination event (as applicable) has occurred.

The requirement to notify that an action has been taken will likely be uncontroversial. However, the additional requirement to notify FIRB of a termination event places an obligation on applicants to continually be mindful of any changes to the structure of an investment, which may be a more onerous requirement to comply with, requiring applicants to have proper reporting systems in place and regularly monitoring those systems.

'Associates' replaced with 'entities in its control group'

The original draft of the tax conditions included conditions requiring applicants to ensure that their 'associates' complied with certain conditions. 'Associate' had the meaning given in section 318 of the *Income Tax Assessment Act 1936*. The practical implication of this was that the reach of certain conditions was extended to a significant degree, capturing, for instance, any entity that may benefit under a trust, as well as partnerships, joint ventures and other arrangements between unrelated third parties. This raised concerns that the scope of the tax conditions may have shifted away from the national interest in respect of a particular investment proposal, to extraneous matters arising from the relationship between third parties which is unrelated to the proposed action.

The revised set of conditions attempts to lessen the impact of the requirement imposed on applicants to ensure compliance by their 'associates' by removing the reference to 'associates' and replacing it with 'entities in its control group'. The definition of this term is limited to entities that: (i) control the applicant; (ii) are also controlled by an entity that controls the applicant; or (iii) is controlled by the applicant, with 'control' having the meaning given to that term in the *Corporations Act 2001 (Cth)*.

Provision of information to the Australian Taxation Office

The revised set of conditions clarify the scope of any documents or information to be provided to the ATO and confirm the position that an applicant is only required to provide such documents or information *that is required* to be provided to the ATO in accordance with taxation laws, rather than any documents or information that ATO *may request*. In other words, the revised conditions attempt to clarify that the ATO does not intend to go on a 'fishing expedition' and only information required to be provided to the ATO pursuant to Australia's taxation laws in relation to the action in question is required to be provided.

Removal of express conditions relating to transfer pricing and anti-avoidance rules

The original draft of the tax conditions included conditions requiring applicants (and/or their 'associates') to notify the ATO if they (or their 'associates') entered into any material arrangement in connection with an action to which the transfer pricing rules in Division 815-B of the *Income Tax Assessment Act 1997* or the anti-avoidance rules in Part IVA of the *Income Tax Assessment Act 1936* may potentially apply.

These conditions have been removed in the revised set of tax conditions which may apply to investment proposals that pose a possible tax risk to Australia's revenue base. However, they will continue to apply to those investment proposals where a particular tax risk has been identified and FIRB has determined to impose the condition requiring the applicant to engage in good faith with the ATO to resolve any tax issues in relation to an action. This condition now includes in its footnote that this may include reporting requested information on transactions relating to the transfer pricing or anti avoidance rules. Therefore although the notification requirement has been removed, information with regard to transactions relating to the transfer pricing or anti avoidance rules can still be requested by FIRB.

Conditions clarified

The revised set of conditions amends several of the original conditions to provide further clarity with regard to their application and how to achieve compliance. For example, the previous condition that applicants must generally comply with Australia's taxation laws now includes the clarification that an applicant does not breach this condition if it has taken reasonable care to comply with the relevant taxation laws and has a reasonably arguable position.

These points of clarification will be a welcome addition to prospective applicants and advisers alike.

Guidance note

As stated above, the Treasury has indicated that a guidance note will be released to provide additional information on the conditions shortly. Please look out for further LegalTalk Alerts for more information.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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