BUDDLEFINDLAY

Overseas Investment Act Phase 2 Reforms: Are the borders closed?

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2 April 2020

On 19 March 2020, the same day that New Zealand's borders were effectively closed to try to combat the spread of COVID-19, the Overseas Investment Amendment Bill (No 2) 2020 was quietly introduced in the House. This article summarises the key changes that the Bill proposes.

This latest round of proposed changes follows those made in October 2018 to bring residential land and forestry right acquisitions into the scope of the overseas investment regime.

The Bill has two key intended outcomes – to simplify the overseas investment regime to facilitate investment that is beneficial to New Zealand, and to strengthen aspects of the regime to ensure that it adequately manages the risks of overseas investment.

Has the government achieved its desired outcomes? There are definite 'pass marks' for some changes (for example, those aimed at better targeting the scope of the regime, therefore reducing some previously screened transactions or persons). For others, including replacing the 'substantial and identifiable benefit' requirement with a 'proportionality' principle, we think it's a matter of seeing the workings. Some areas will require further guidance. Whether that comes from the Overseas Investment Office (OIO), or by applicants or other parties testing the application of the new provisions through the courts, remains to be seen.

Finally, it remains to be seen whether the perceived risks-versus-benefit assessment of foreign investment remains the same, in light of a significantly different forward outlook for the New Zealand economy.

Overview

The national interest test and call-in power for strategically important businesses are a significant development in the scope of New Zealand's foreign investment regime. However, we do not expect that those changes will apply to the bulk of applications made to the OIO. Accordingly, this update focuses on the changes that we think are likely to be of the most interest to a broad range of investors:

- Various parts of the Bill will come into force at different times (most provisions come into force shortly after the date of Royal Assent, but others come into force six or 12 months later)
- The new provisions will apply to transactions entered into on or after commencement – but also to applications that are received by the Overseas Investment Office on or after commencement regardless of when the transaction is entered into (with some nuances, as described further below)
- The threshold for screening less-than-freehold interests in land (eg leases) will increase from three years to ten for sensitive land that is not residential, although the relevant provisions contain some complexities as to how relevant interests must be calculated
- Screening of certain entities that are fundamentally New Zealand entities will be limited through a carve-out from the definition of overseas person for New Zealand-listed entities, and an exemption for private entities that meet certain criteria
- The benefits test will no longer have a 'substantial and identifiable threshold' for acquisitions involving non-urban land over 5 hectares. Instead all sensitive land transactions will be assessed using a 'proportionality' principle
- The counterfactual test will change from an assessment against a hypothetical New Zealand purchaser to a before / after assessment
- The Bill contains new information-sharing powers that enable information to be shared amongst government agencies (including the Overseas Investment Office) for AML / CFT purposes, and enables Inland Revenue to require applicants to provide information for tax purposes.

When will the Bill take effect?

Most provisions in the Bill would come into force on the 42^{nd} day after the Bill receives Royal Assent. The Bill is intended to be enacted before the election (currently scheduled for 19 September) - but in the current climate the progress of the legislative programme seems unlikely to remain on track. How far off track the legislative programme has gone is yet to be determined.

There are some exceptions to the general commencement section. While most provisions will come into force on the 42nd day after Royal Assent, some provisions will come into force six months (eg the national interest test), or 12 months (eg changes to the benefit test) after Royal Assent.

How will these changes affect deals already on foot?

If the Bill is enacted in its current form, the changes will apply to:

- Transactions entered into on or after commencement
- Applications that are received by the OIO on or after commencement, regardless of when the transaction was entered into (or, in the case of farmland, when it was advertised)
- Transactions entered into before commencement in respect of applications that the Act requires be made on or after commencement (for example, for retrospective consent)
- Any other matters that relate to events or circumstances on or after commencement.

The effect of the second point above needs closer consideration. We think the intention is for parties to take advantage of any lessening of scope / requirements as a result of the changes, and some refinement of this provision appears to be necessary.

However, there are some areas of uncertainty based on our reading of the current drafting. For example, assume an overseas person enters into a transaction before commencement to acquire land that is sensitive under the current Act, but will not be sensitive as a result of the changes. The existing Act applies to the transaction. But if the application is not made until after the commencement of the new provisions, the OIO would be assessing an investment in land that would not require consent at the time it is completed. That would seem to be a waste of the OIO's resources (as well as applicants' resources).

Finally, in terms of existing consents, the transitional provisions provide for a person who ceases to be an overseas person as a result of the changes, who has received consent in the past, to apply to the Overseas Investment Office to vary their consent (presumably to reduce the extent of the obligations on that person).

Leases – increasing the screening threshold from three years to ten

The Act currently screens less-than-freehold interests in land (eg leases) if they are for a term of three years or more. The Bill proposes to increase that screening threshold for sensitive land (that is not residential) to ten years. The screening threshold for residential land will remain at three years.

The new ten-year threshold will require the calculation of the 'total term' of an interest, and includes previous interests held by the same overseas person, including periodic interests. We have set out two examples that illustrate when consent may / may not be required under the proposed changes:

Example 1: An overseas person had a five year lease with no rights of renewal, held over the lease for a year, and then entered into another five year lease. Consent would be required to enter into the second five year lease as the 'total term' would be 11 years (as it includes the holding over period).

Example 2: An overseas person had a 10% interest in a company that owned sensitive land. The company had a seven year lease. At the end of the seven year lease, the overseas person increased their interest to 30%, and the company entered into another seven year lease. Consent would **not** be required because only qualifying interests held by an overseas person count towards the ten year period – ie, any interest where an overseas person has a more than 25% interest in the sensitive land.

While this is a slightly different approach to the current Act, overall, we expect that the number of transactions that involve leasehold interests that require screening under the Act will decrease.

Limiting the screening of fundamentally New Zealand entities

Currently, the Act's definition of 'overseas person' captures a range of domestically incorporated bodies corporate that are majority owned and controlled by New Zealanders. This includes many of the largest 40 entities listed on New Zealand's Exchange.

The Bill will amend the definition of 'overseas person' for New Zealand listed issuers. The proposed definition means that, a New Zealand listed issuer will be an overseas person if it meets the 'ownership test' **or** the 'control test':

- The **ownership test** is met when an overseas person has, or more than 1 overseas persons cumulatively have, a beneficial entitlement to, or a beneficial interest in, more than 50% of the issuer's securities
- The **control test** is met when overseas persons who each own 10% or more of the issuer's securities control the composition of 50% or more of the issuer's governing body, or control the exercise of more than 25% of the voting power at a meeting of the issuer.

This means that many listed companies that have diverse shareholdings would no longer be caught by the Act.

Although the regulations that will accompany the changes to the Act have not yet been drafted, it is contemplated that they will include a specific exemption for bodies corporate that do not meet the ownership or control test described above (ie, an exemption for private entities that would have the same effect as if they were a New Zealand listed issuer who is not an overseas person).

We think these changes are positive, and more accurately target screening at entities with substantive levels of overseas ownership and control.

Changes to the benefits test: a simpler counterfactual, proportionality, and farm land

Currently, transactions that involve sensitive land, and for which the residential land consent pathways do not apply, must meet the benefit to New Zealand test. The test requires an assessment of 21 different factors (and subfactors) that are set out in the Act and the Overseas Investment Regulations. The benefit that an investor offers is assessed against what an adequately funded, alternative New Zealand purchaser could offer (known as the counterfactual). The benefit to New Zealand test and the counterfactual have been criticised as being too complex and highly theoretical, and result in high costs for both investors and the OIO.

Where an investment involves non-urban land that is larger than 5 hectares, a higher benefit threshold must be met. For overseas investments of this type, the relevant Ministers must determine that the benefit to New Zealand is substantial and identifiable.

The Bill is intended to simplify the benefit to New Zealand test by implementing the following measures:

- Replacing the 21 factors with 7 broader factors, including economic benefits, benefits to the natural environment, and continued or enhanced access over sensitive land
- Introducing a new factor allowing consideration of any negative impacts on water quality or sustainability for water-bottling investments
- Replacing the current requirement that the benefits of overseas investments in non-urban land greater than 5 hectares must be substantial and identifiable with a 'proportionate approach'. This approach requires that the benefits of the overseas investment must be proportional to the interest being acquired and to the sensitivity of the land
- Changing the counterfactual from a hypothetical assessment to a before and after test, by requiring benefits to be measured against the current state of the sensitive land.

These changes give more discretion to the decision-maker. Our experience with the decision-makers in this area indicate a tendency towards conservative decision-making. While these changes may appear to liberalise the nature of the benefits test, we are not certain that there will be many tangible benefits for investors.

This is particularly the case with the introduction of the proportionate approach. In our view, this is a highly uncertain test, and think that how 'proportionality' is properly applied will likely have to be settled by the courts.

Finally, another key change to the benefits test is that the current Ministerial Directive letter for rural land will now be enshrined in legislation for farm land. This emphasises the current Government's view that an overseas investment in farm land must show a significant margin of benefit compared to what would occur if the overseas investment did not take place. Even in combination with the new counterfactual, we think that investors should assume that there will be a high hurdle to be able to invest in farm land.

Information-sharing

As outlined above, the Bill also includes two changes to the way that information can be shared amongst agencies.

The first change is that the OIO will be added to the list of government agencies that can disclose information they receive under the Act to other relevant agencies, where the agency believes that the disclosure of the information is necessary or desirable for ensuring compliance with the Anti-Money Laundering and Countering Financing of Terrorism Act 2009.

The second change is that the Bill proposes new specific information-sharing provisions for tax purposes. The Commissioner of Inland Revenue will be able to require people who apply for consent under the Act to provide information for the purposes of the administration of an Inland Revenue Act. Regulations are expected to set out further information about this power – including the types of investments that it would apply to and the procedural requirements.

Other points of interest

The Bill also contains a number of other changes, including:

- Introducing a national interest test for transactions that are already screened under the Act that will be a backstop tool for the government to manage significant risks associated with overseas investments that warrant greater scrutiny
- Introducing a 'call-in' power for the government to review transactions that are not currently subject to screening, but which may affect national security and public order (ie, transactions involving strategically important industries and high-risk critical national infrastructure)
- Amending the investor test to significantly narrow the scope of considerations that can be taken into account when assessing an investor's suitability to invest, but at the same time allowing decision-makers to consider the character of corporate entities that have substantive control over the investment, and excluding New Zealanders from the scope of assessment
- Overseas persons will not be able to enter into an agreement to buy farm land until after the farm land has been advertised for sale on the open market
- Introducing statutory timeframes for decision-makers to review overseas investment applications, although the likelihood of significant impacts will be mitigated by the fact that there will be a power to extend those statutory timeframes
- Increasing the OIO's enforcement powers by increasing the maximum penalty for a breach of the Act from $300,000 to $10m for corporates. This change will bring the Act's enforcement regime more closely in line with other regulatory regimes such as the Commerce Act.

The first reading of the Bill will not be able to be completed until Parliament reconvenes (which is not expected to be before the end of April at this stage).

If you would like any further information about the proposed changes, or how they may affect your business, then please feel free to contact a member of our team.

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