The Treasury

Overseas Investment Act 2005 – Phase One Review Policy Advice (2017/18) Information Release

March 2019

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[2] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[3] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[4] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[5] 9(2)(h) - to maintain legal professional privilege

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Treasury Report: Overseas Investment Act Exemptions

Date:	Wednesday 18 April 2018	**Report No:**	T2018/30
		File Number:	IM-5-1-1

Action Sought

	Action Sought	**Deadline**
Minister of Finance (Hon Grant Robertson)	Note the contents of this report	N/A
Associate Minister of Finance (Hon David Parker)	Approve exemptions to be taken to Cabinet	19 April 2018

Contact for Telephone Discussion (if required)

Name	**Position**	**Telephone**		**1st Contact**
Carrie Cooke	Overseas Investment Team	[6]	N/A (mob)	✓
Thomas Parry	Team Leader, Overseas Investment	[6]	[6]	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Treasury Report: Overseas Investment Act exemptions required now

Executive Summary

This report seeks your agreement to progress a number of changes to the exemptions to the Overseas Investment Act, which are set out in regulations.

The regulations for the current Overseas Investment Act (the Act) include a range of exemptions from screening. The exemptions, in general, cover investments that are not the intended target of the screening regime and are of an incidental or technical nature.

We have considered how these existing exemptions will function in relation to the new screening of residential land. For the most part, these exemptions are as relevant to residential land as they are to other types of sensitive land. Examples include mortgage lending, changing trustees of a trust, the division of relationship property, and reorganisation of a corporate group.

We consider these exemptions are appropriate and, in general, do not present a significant risk of gaming or avoiding the new regime. However we do suggest some slight modifications around security arrangements, in particular to avoid risks that overseas persons buy distressed loans as a means to acquire sensitive land.

There are also two exemptions where modifications would directly improve the implementation of the residential housing changes:

1. Changes to the exemption regarding relationship property and company structures; and

2. A new exemption for registered charities with donee status buying residential housing.

There are three other amendments recommended to improve regime functioning more generally:

1. New exemptions for some types of shareholding changes;

2. Amendments to the administrative penalties for retrospective consents

3. Removal of TrustPower Limited from Schedule 4 of the Regulations.

Once you have confirmed the exemptions you wish to progress, we will draft a Cabinet paper. We propose this is taken to the Economic Development Committee (DEV Committee) on 16 May, and Cabinet on 21 May to enable Parliamentary Council Office (PCO) to draft the regulations in time for the commencement of the amended Overseas Investment Act.

Recommended Action

Security Arrangements

We recommend that you:

a) **agree** to introduce a separate definition of "permitted security arrangement", based on the wording in 33(1)(h), to be used in all relevant exemptions – 33(1)(h) to (ja) - and the definition of "permitted security interest" in regulation 36B.

Agree/disagree.

b) **agree** to change the security exemptions in regulations 33(1)(h) and 33(1)(ja) so that they extend to the acquisition of indirect interests in land.

Agree/disagree.

c) **agree** to add to the definition of "permitted security arrangement" that it does not extend to security arrangements where the security interest-holder is acquiring the interest as a means to acquire the underlying sensitive land without consent.

Agree/disagree.

d) **agree** to add to the exemption 33(1)(ja) that it does not extend to the acquisition of portfolios or bundles of security arrangements where:

i they are not acquired in good faith and the ordinary course of business (i.e. extend these existing 33(1)(h) requirements to (ja)); or

ii they are acquired as a means to acquire the underlying sensitive land without consent (i.e. also bring the clarification in the recommendation above across into (ja)).

Agree/disagree.

e) **agree** to change the (ja) exemption for transfers of multiple interests as a portfolio or bundle to provide that:

i. a portfolio or bundle of less than $100m would not require consent (as is currently the case); and

ii. a portfolio or bundle of $100m or more would require consent only under the significant business assets rules, if applicable (regardless of the whether the portfolio or bundle involved sensitive land or not).

Agree/disagree.

f) **note** [1,5]

Relationship Property

g) **note** that currently, if an overseas person and their New Zealand spouse wholly own and control a company, their company would require consent to purchase sensitive land. That same couple would be exempt from the need for consent to purchase sensitive land directly.

h) **agree** to allow companies wholly owned and controlled by a couple with an overseas person and a non-overseas person to purchase sensitive land without consent, provided the couple own the interests in the company as relationship property.

Agree/disagree.

New Zealand Registered Charities

i) **note** that some registered charities in New Zealand have a level of overseas control that makes them an overseas person under the Act, which will require them gain consent to acquire residential property under the Act.

Either:

j) **agree** to exempt registered charities operating in New Zealand who have 'donee status' under the Income Tax Act, and are not a schedule 32 charity, from the consent requirements for residential land. *(Treasury preferred)*

Agree/disagree.

OR

k) **agree** to exempt any registered charities operating in New Zealand (i.e. regardless of whether the funds are applied mainly within New Zealand or overseas).

Agree/disagree.

Amendments to the shareholding exemptions

l) **agree,** where an overseas person(s) already holds a consent to own securities, to exempt from screening all transactions within a group where the ultimate ownership and control of the group by overseas person(s) does not change.

Agree/disagree.

m) **agree**, where an overseas person holds one or more classes of securities, to exempt from screening all acquisitions by that overseas person of further identical securities:

- for a period of five years from the initial consent (the existing limit);
- up to a limit of 10% of all securities in each relevant class; and
- without the overseas person's overall ownership or control interest in the relevant entity hitting thresholds of 25%, 50%, 75% or 90%.

Agree/disagree.

n) **agree** to make it clear in regulations that multiple exemptions may apply to a single transaction and render that transaction exempt from the relevant requirements for consent.

Agree/disagree.

Administrative penalty for retrospective consents

o) **agree** to replace the variable penalty with a series of fixed penalties set depending on **the type and value of the consideration paid for the assets:**

a. For residential land being acquired under the 'commitment to reside' pathway:

Consideration paid for the asset	Penalty
<$2m	$5,000
>$2m	$10,000

b. For all other pathways:

Consideration paid for the asset	Penalty
<$2m	$20,000
$2m-$10m	$30,000
$10m+	$40,000

Agree/disagree.

p) Officials also recommend that the Overseas Investment Office retain the discretion not to impose a penalty, when imposing a penalty would be unduly harsh or oppressive having regard for the nature or, and the reasons for, the retrospective consent.

Agree/disagree

Removal of TrustPower Limited from Schedule 4

q) **agree to** revoke the item 'TrustPower Limited' from Schedule 4 of the regulations

Agree/disagree.

Thomas Parry
Team Leader, Overseas Investment

Hon Grant Robertson
Minister of Finance

Hon David Parker
Associate Minister of Finance

Treasury Report: Overseas Investment Exemptions

Purpose of Report

1. This report seeks your agreement to progress a number of changes to the exemptions to the Overseas Investment Act, which are set out in regulations.

2. If you agree to the proposed modifications to these exemptions, we will prepare a Cabinet paper for the policy decisions which we suggest is taken to DEV Committee on 16 May and Cabinet of 21 May, to enable PCO to draft regulations in time for the commencement of the amended Overseas Investment Act.

Background

3. The current regulations for the Overseas Investment Act include a range of exemptions from screening. The exemptions, in general, cover investments that are not the intended target of the screening regime and are of an incidental or technical nature.

4. We have considered how these existing exemptions will function in relation to the new screening of residential land. For the most part, these exemptions are as relevant to residential land as they are to other types of land and other screened investment. Examples include mortgage lending, changing trustees of a trust, the division of relationship property, and reorganisation of a corporate group.

5. We consider these exemptions are appropriate and, in general, do not present a significant risk of gaming or avoiding the new screening requirements.

6. However there are several changes we suggest to the current exemptions to improve implementation of the regime with regard to residential land, and to improve regime functioning more generally.

Criteria for assessing proposed exemptions

7. The following amendments have been considered against the three criteria used to assess the effectiveness of options in the 31 October 2017 "100 Day Commitment: Banning Overseas Buyers from Buying Existing Homes" Cabinet Paper [CAB-17-MIN-0489 refers]:

    a. *Policy effectiveness:* That the policy is effective, and any updates proposed will improve the operation of the regime, and are consistent with Government's objectives for the restriction of overseas buyers of residential housing. Where the proposals are less directly related to residential housing, they are consistent with the Government's wider objectives relating to overseas investment. .

    b. *Compliance with New Zealand's international obligations:* Obligations in a number of existing trade and investment agreements include the obligation not to discriminate on the basis of nationality.

    c. *Minimising compliance and administration costs:* Supported by clear and simple rules that fit in with existing regulatory frameworks and land sale processes.

Changes to exemptions regarding security arrangements

8. Regulation 33(1) sets out various exemptions to the requirement for consent, and includes exceptions for certain security arrangements (e.g. mortgages) and their effects that are otherwise caught by the regime, due to being interests in land. These exemptions will be particularly important once the Act is extended to cover residential land.

9. During our review of the regulations to check for consistency with the Overseas Investment Amendment Bill, we identified several issues with these regulations, some of which are directly related to the inclusion of residential land in the regime.

10. Addressing each issue in turn:

Ambiguity to be fixed

11. The regulations are ambiguous on the meaning and application of the term "security arrangement", due to it being referred to differently in different exemptions.

12. We consider it would be beneficial to provide clarity on this to support the operation of the Act. It is also likely to reduce Overseas Investment Office's (OIO) workload as investors have greater certainty of this matter.

Recommendation:

13. Introduce a separate definition of "permitted security arrangement", based on the wording in 33(1)(h), to be used in all relevant exemptions – 33(1)(h) to (ja) - and the definition of "permitted security interest" in regulation 36B.

Extension of exemption to indirect acquisition of securities

14. The exemptions that relate to the operation of securities apply to direct security arrangements, but as currently worded may not apply to indirect securities caught by the regime (e.g. the acquisition of shares in a company that owns securities). The rest of the regime typically treats direct and indirect interests as the same.

15. We consider it useful to clarify that this exemption applies to indirect and direct securities to be consistent with the rest of the regime, and remove any uncertainty in how this applies.

16. Extending the security exemptions to the acquisition of indirect interests in land (i.e. shares in companies and similar that own interests in land, as well as direct interests in land) will achieve this.

17. Transactions may still need consent for other reasons.

Recommendation:

18. Change the security (e.g. mortgage) exemptions in regulations 33(1)(h) and 33(1)(ja) so that they extend to the acquisition of indirect interests in land.

Possible loopholes

19. The existing regulations may have two loopholes in that they may allow overseas persons to agree or buy mortgages as a means to acquire the underlying sensitive assets without consent. In particular:

    a. Regulation 33(1)(h) allows the acquisition by an overseas person of securities (e.g. mortgages) so long as they are entered into by the parties in "good faith" and in the ordinary course of business. OIO believes "good faith" is sufficient to prevent initial lenders agreeing mortgages with the intention of using them to acquire the underlying sensitive assets without consent, but ideally more clarity would be given that lend-to-acquire arrangements of this nature are not exempted.

    b. Regulation 33(1)(ja) allows the acquisition of bundles of security arrangements (e.g. the transfer of loan books) so long as the initial security arrangements were *entered into* on the grounds in (h) (in good faith and in the ordinary course of business). There is no explicit requirement in (ja) that the acquirer buys them with that same intention, so in theory an overseas person could buy bundles of distressed loans intending to enforce mortgages and take possession.

20. The number of these forms of avoidance are likely to be low. OIO is only aware of a two cases historically where security interests may have been used to acquire land. In both of those cases the acquirer of land needed consent anyway, due to the operation of other elements of the regime.

21. In the case of the first possible loophole (regulation 33(1)(h)), OIO considers that it can use the existing good faith requirement to enforce against overseas persons who take mortgages intending to use them to acquire sensitive land without consent – this would be its current practice if the situation arose. Adding the specific requirement that there can be no intention to use a mortgage to acquire sensitive land without consent is not entirely necessary but will add clarity and make the OIO's interpretation of "good faith" clearer to potential investors. OIO has therefore expressed a preference to clarify this exemption.

22. The second loophole could be resolved by extending the good faith and ordinary course of business requirements to also apply to acquirers of pre-agreed securities (the exemption in regulation 33(1)(ja)). Similarly, if that option was taken, the regulations could also be updated as with the first possible loophole above to clarify that buying security arrangements with the intention to acquire land is not exempted under (ja). OIO has expressed a preference to close this loophole.

23. For clarity these changes would not preclude the actual outcome of a security interest-holder taking possession or ownership, should the borrower default on the loan and the lender choose possession as an option in response. However that outcome cannot have been the lender's intention in agreeing the loan (33(1)(h)), or the buyer of a loan book's intention in buying the loan book (33(1)(ja)).

24. (Legally privileged) [1,5]

[1,5]

25. In terms of current practice, OIO and the Treasury advise that:

    a. [1,5]

       This is because the policy intention has always been that investors do not purchase securities as a means to acquiring the underlying land. As noted above this policy intention is currently captured by the "good faith" requirement and OIO's current intended practice. The changes being considered are consistent with this intention. The change to (h) is only intended to clarify and make this policy intent explicit, and extending the requirements to apply to the (ja) exemption brings that exemption in line with the policy intention of the regime.

    b. As identified above, OIO expects the number of these forms of avoidance to be low already. OIO practice would already deny use of the possible loophole in 33(1)(h), and in reality the more obvious loophole in 33(1)(ja) is not practically used at the moment by investors seeking to acquire land through security arrangements, avoiding the need for consent. So no existing practices are likely to be affected.

26. (Legally privileged) [1,5]

27. An unrelated and technical point: the clarifications above, if made, will need to ensure that people and companies (or similar) who later rely on the existence of a security arrangement aren't harmed by a lack of good faith/an intention to use it to acquire land on the part of the original lender. E.g. 33(1)(j) exempts a borrower reacquiring rights once a mortgage debt is paid, and 33(1)(ja) exempts the transfer of portfolios of loans. Those acquisitions should remain exempt even where the original lender agreed the loan in bad faith.

<u>Recommendations:</u>

28. Add to the definition of "permitted security arrangement" that it does not extend to security arrangements where the security interest-holder is acquiring the interest as a means to acquire the underlying sensitive land without consent.

29. Add to the exemption 33(1)(ja) that it does not extend to the acquisition of portfolios or bundles of security arrangements where:

    a. they are not acquired in good faith and the ordinary course of business (i.e. extend these existing 33(1)(h) requirements to (ja)); or

    b. they are acquired as a means to acquire the underlying sensitive land without consent (i.e. also bring the clarification in the recommendation above across into (ja)).

Limit on, and application of, security portfolio transfer exemption

30. Regulation 33(1)(ja) (the acquisition of bundles of loans):

    a. exempts acquirers from the need for any consents; but

    b. is only available to the acquisition of bundles for $100 million or less.

31. This exemption is necessary because it permits the transfer of *multiple* security arrangements in a *single* transaction, for example when banks and other lenders use their loan portfolios as security for their own borrowing, and when banks and other lenders transfer loans and security arrangements between each other.

32. At present, a transaction only involving security arrangements over residential land is unlikely to require consent. However, with the changes to the Act to bring residential land within the definition of sensitive land, virtually all such transfers of security arrangements will require consent unless specifically exempted. These transfers may well involve more than $100m in loans.

33. We consider that *sensitive land consents* in these circumstances are unnecessary and not within the policy intention of the regime (consents for the acquisition of significant business assets would still be required where the transactions involve more than $100m in assets).

34. Mortgages are key instruments used to facilitate the acquisition of land by people who are entitled under the Act to own it. In many cases capital is provided in mortgage arrangements by overseas persons – usually banks or other lenders. Mortgage lenders do not typically agree mortgages intending to use them to acquire land, and the previous recommendations seek to close off any ability for lenders to use the security exemptions for that purpose.

35. We therefore recommend removing the $100m threshold, and clarifying that the exemption only exempts from the need for consents related to sensitive land (i.e. those consents required by section 10(1)(a)). [1]

36. (Legally privileged) [5]

<u>Recommendations</u>

37. Change the (ja) exemption for transfers of multiple interests as a portfolio or bundle to provide that:

    a. a portfolio or bundle of less than $100m would not require consent (as is currently the case); and

    b. a portfolio or bundle of $100m or more would require consent only under the significant business assets rules, if applicable (regardless of the whether the portfolio or bundle involved sensitive land or not).

Exemptions for overseas persons not intended to be captured by the regime

38. We recommend creating two new exemptions to exclude people from the requirement for screening who we consider were not intended to be screened under the regime. These are:

    a. Expand the exemption regarding relationship property and company structures;

    b. New exemption for charities benefiting New Zealand.

39. Making these changes to the regulations will help to ensure investors are not faced with unnecessary barriers that are not in line with policy intent.

Expanding the relationship property exemption

40. The current relationship property exemption relates to interests in land acquired by a couple where one member is and one is not an overseas person. To the extent that the ownership interest is relationship property, couples in this scenario do not require consent:

    a. to acquire an interest in sensitive land itself; or

    b. to acquire securities (e.g. shares) in a company that owns sensitive land. It is reasonably common for people to form companies to own residential land.

41. In the second case, the acquisition of securities is exempt but the company may then become an overseas person with screening requirements before it may buy sensitive land.

42. In summary, for couples (with one overseas person and one non-overseas person) seeking to buy sensitive land:

    a. The couple can rely on the current exemption to buy sensitive land directly.

    b. If the couple wishes to buy sensitive land through a company, the situation is more complex:

        i. If the land is already owned by a company, the couple can buy shares (potentially all of them) in that company and rely on the exemption.

        ii. If the land is not owned by a company, companies the couple start, own or buy are likely to be overseas persons, meaning the couple cannot rely on the exemption to buy the land through that company.

43. The key point is that couples can use the current exemption to buy land directly but generally not through a company. We recommend expanding the existing exemption to allow companies wholly owned and controlled by a couple including a non-overseas person to purchase sensitive land without consent, provided the couple own the shares as relationship property.

44. Our reasoning for this recommendation is:

    a. From a policy perspective, the exemption already applies to relationship property in sensitive land held by relevant couples (one overseas person, one non-overseas person). The same grounds for that exemption ought to apply where those two people simply chose to own the property through a company. There is no reason for differentiating between the direct ownership and wholly owned company ownership scenarios.

b. Requiring these couples' companies to go through screening means New Zealand citizens and other non-overseas persons are treated differently to others because of their relationship. Were they single, they could buy property through a company, but if they're in a relationship and their property is relationship property then (without the extended exemption) they would need consent to do so.

c. Providing an exemption would remove those barriers, and increase the consistency of the regime.

d. Expanding the exemption will also reduce the administrative burden on the OIO at the margin as there will be fewer applications for them to consider.

45. There is one area where our recommendation (regarding ownership through companies) is not consistent with the existing exemption (regarding direct ownership):

a. The existing exemption exempts direct ownership of an interest in land, which may be a *part-share of a house* (e.g. where the couple own as relationship property half a share in a house).

b. We only propose that companies *wholly owned* by the couple be exempt from buying sensitive property. So the exemption won't extend to couples owning a *part-share of a company*. However the couple could use a company they wholly own to buy a part-share in a house.

46. We have limited the extension to wholly owned companies to limit the application of the exemption more widely. Our recommendation is sufficient to allow the relevant couples to buy sensitive land, including part shares in that land, through companies.

47. (Legally privileged) [5]

48. (Legally privileged) [5]

We believe this may be the case. [5]

See the risks section for more detail.

Recommendation

49. Allow companies wholly owned and controlled by a couple with an overseas person and a non-overseas person to purchase sensitive land without consent, provided the couple own the interests in the company as relationship property.

New exemption for Registered Charities operating in New Zealand

50. Some charities that are registered in New Zealand have a level of overseas control that makes them an overseas person under the Act. This means they need to gain consent to acquire residential property under the Act, and they currently need to gain consent to acquire land already classified as sensitive. An example of this is the Salvation Army New Zealand Trust. The General of The Salvation Army in London appoints trustees. The trustees may also be overseas persons. The Salvation Army New Zealand Trust owns residential properties for its officers to live in.

51. Requiring registered charities whose core purpose is to benefit New Zealand, but who are deemed overseas persons under the Act, to apply for consent to acquire an interest in residential land, may not be consistent with the policy intent of the Bill and may have unintended consequences:

    a. Charities operating in New Zealand usually receive donations from people living in New Zealand. This means, if charities are not exempted, money from non-overseas persons may be used to meet OIO fees.

    b. Charities tend to have limited funds and the OIO fees may be a barrier to their work.

52. We do not have data to determine the scale of this concern, however we consider it worthwhile to explore options to address it, should you wish to. There are three main options:

Option One – status quo

53. This option is to make no change to Act or the Bill as it currently stands. This would mean any registered charities that are overseas persons (e.g. because more than 25% of the governing body members are overseas persons) would need to apply for consent to acquire an interest in residential (but not other sensitive) land.

54. As noted above, it is not clear how many charities would fall into this category. OIO reports that applications from such charities to acquire sensitive land under the current regime are very uncommon.

Option Two – do minimum (recommended option)

55. Exempt registered charities operating in New Zealand who have ‘donee status’ under the Income Tax Act, and are not a schedule 32 charity, from the consent requirements for residential land.

56. To register as a charity in New Zealand, an organisation must meet the requirements within the legal definition of ‘charitable purposes’. This is a complex legal concept that continues to evolve, but broadly speaking a ‘charitable purpose’ must fall under one or more categories:

    a. The relief of poverty.

    b. The advancement of education.

    c. The advancement of religion.

    d. Other purposes beneficial to the community.

57. A subsection of registered charities also have ‘donee status’ under the Income Tax Act, which means donations are tax deductible. To get this status the charity has to either:

    a. meet the definition in section LD3 of the Income Tax Act 2007, which generally means the funds are applied in New Zealand, and directly benefits people in New Zealand; or

    b. be explicitly granted this status by Parliament, despite their funds being applied overseas. These charities are listed as Schedule 32 in the Income Tax Act 2007. Examples of these charities include Habitat for Humanity New Zealand Limited, Amnesty International, The Sir Edmund Hilary Trust.

58. This option would mean exemptions apply only to those charities where the funds are applied directly to New Zealand, for the benefit of those living here. Compared to

option three, it also minimises any potential loophole for overseas persons to acquire an interest in residential land. This is our recommended option.

Option Three – all registered charities

59. Exempt any registered charities operating in New Zealand (i.e. regardless of whether the funds are applied mainly within New Zealand or overseas).

60. This would be a broader exemption as it will enable charities where the funds are principally applied overseas to be exempt from the Act. However, you may want to do this if you consider that charities operating through New Zealand donations should not need to apply for consent to acquire an interest in residential land irrespective of the use of those donations.

61. One risk with this option is that the legal definition of 'charitable purpose' is fairly broad. For example a group of overseas persons could establish a charity for educational purposes for the benefit of overseas persons only, and then purchase residential land. While there can be no private profit from a charity, the overseas persons would still enjoy all the benefits of owning property.

Risks associated with Options Two and Three

62. (Legally privileged) [5]

Recommendation

63. We recommend progressing option two: exempting registered charities operating in New Zealand who have 'donee status' under the Income Tax Act, and are not a schedule 32 charity, from the consent requirements for residential land.

Changes that will improve the functioning of the regime

64. We recommend making a number of small changes to the regulations which will help to improve the functioning of the regime at the time residential housing is included. The changes are:

    a. Amendments to the exemptions regarding shareholding changes;

    b. Amendments to the administrative penalties to improve enforcement of the Act;

    c. Amendments to the exemptions added in 2016 that are not working well; and

    d. Removal of TrustPower from the list of NZ Controlled Companies.

65. Making these changes now would be beneficial for investors as it would reduce compliance costs where their investments are only captured by the regime for technical reasons. It would also reduce the administrative burden on the OIO at a time when the burden is significantly increasing overall.

Amendments to the shareholding exemptions – part one

66. The Act screens certain acquisitions of interests in companies that own sensitive land. Currently, transactions may require consent even where the ultimate shareholders don't change, for example, consider the following "intra-group" transfer:

    a. overseas persons A, B, and C own HoldCo, which in turn owns sensitive land;

    b. A, B, and C wish to add a new company between themselves and HoldCo (called TopCo).

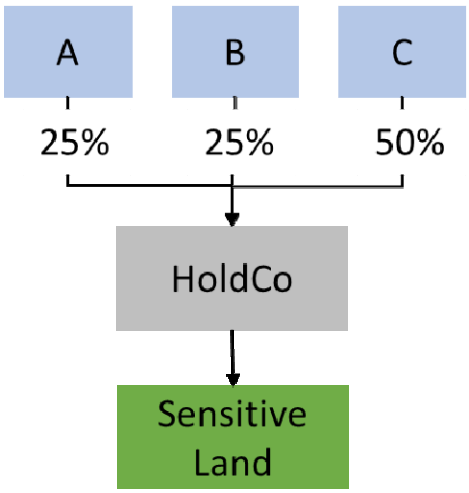

Figure 1: Before transaction

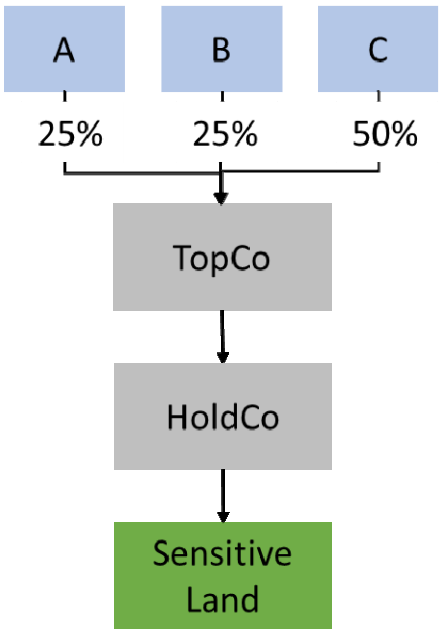

Figure 2: After transaction

67. TopCo will be an overseas person and will require consent to acquire HoldCo, despite the ultimate ownership of both HoldCo and the land not changing, i.e. A, B and C remain the ultimate shareholders in both cases.

68. There is currently an exemption from screening some transactions where the ultimate ownership doesn't change, but it is limited. There is an argument that it covers the situation above, but it is not clear or explicit.

69. Under the existing exemption, the outcome above would be different if HoldCo and TopCo were owned by overseas person A alone. In that case, the existing exemption would apply and consent would not be required.

70. Accordingly, we recommend that the exemption be extended to exempt any intra-group transfer where the ultimate owner(s), however large their interest and however large in number, do not change. If this amendment is made, the example scenario described above would therefore become exempt.

71. We recommend the extended exemption above because:

    a. The *current* exemption applies only to intra-group restructuring where one overseas person owns a large portion (95% or more) of the group. We consider there to be no difference in principle between intra-group transfers where the group is owned by one overseas person with a large investment as opposed to several overseas persons (in fact the overseas ownership being split across several overseas persons may lessen the actual degree of overseas control able to be successfully exercised in a company);

    b. The overseas persons have already acquired consent (or did not require consent) to take a certain level of interest in sensitive land. How those interests are structured has no impact on the ultimate control over sensitive land and assets, and therefore requiring further consent is unnecessary and adds a compliance burden on investors.

    c. The expanded exemption will ensure screening is only required where an overseas persons' degree of control changes.

    d. This will reduce the administrative burden on the OIO at a time when the burden is significantly increasing overall.

Recommendation:

72. Exempt from screening all transactions within a group where the ultimate ownership and control of the group by overseas persons does not change.

Amendments to the shareholding exemptions – part two

73. The current exemptions also allow "shareholder creep" of up to 5% where overseas persons already have consents to own shares. Specifically, if an overseas person has consent to own securities then, within five years of that consent, the overseas person can acquire more securities, up to 5% of the overseas person's initial amount (e.g. 2.5% more shares for a 50% shareholding). This shareholder creep may occur over several transactions. Rights, privileges, limitations and conditions attaching to the further securities must be the same as those attaching to the initial securities.

74. This exemption is considered impractical by stakeholders. We consider it to be unnecessarily narrow as:

    a. there is unlikely to be a change in control from a small increase in shareholding unless the increase moves them beyond key thresholds (25%, 50%, 75% and 90%), being the key statutory minimum shareholding thresholds for certain changes in control; and

    b. where a small increase in shareholding does not change control, it can be difficult for the shareholding investor to demonstrate that the specific increase in shareholding brings benefit to New Zealand (i.e. to be granted consent under the benefit to New Zealand pathway).

75. For example, under the current Act, the transaction below would require A and B to seek consent because their shareholding has increased by 9% each (where person A and B are overseas persons, and person C may or may not be an overseas person):

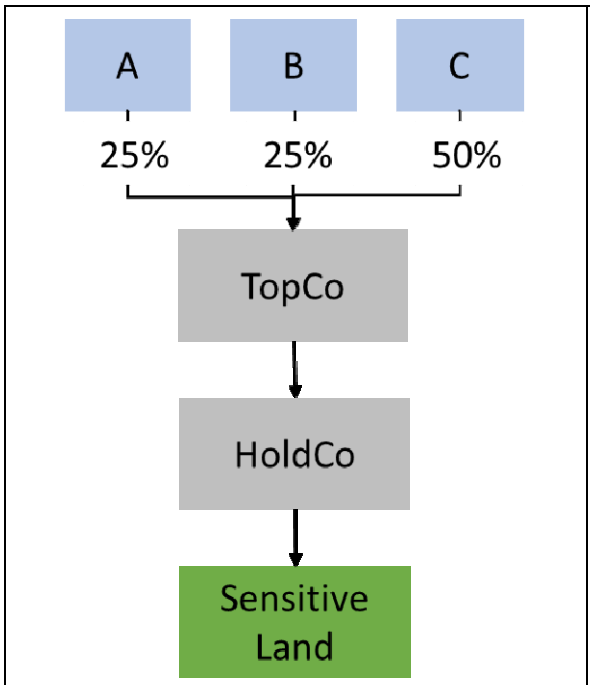

Figure 3: Before transaction

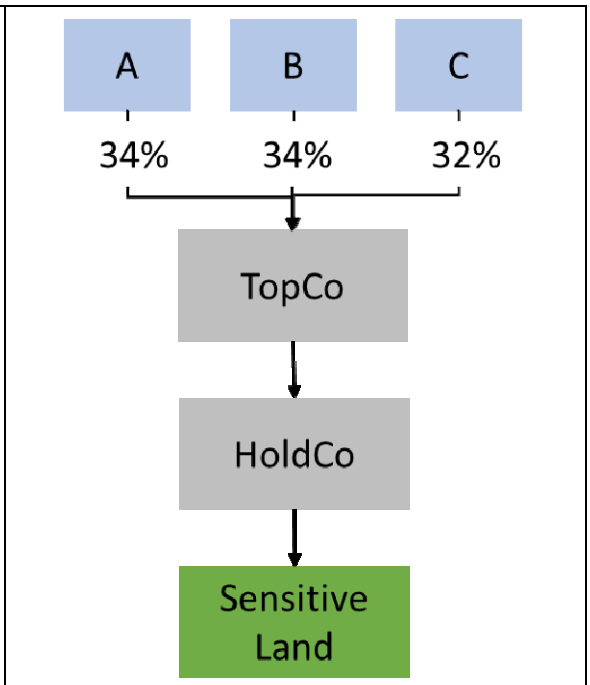

Figure 4: After transaction

76. Requiring small changes such as these to obtain consent places a high burden on both investors and the OIO. In many of these cases, the business transaction that caused the change is not the intended focus of the regime. For example, if a business undergoes a capital raising exercise or a dividend re-investment plan, and not all shareholders choose to take part, those that do will see a small increase to their relative shareholding.

77. Companies may issue several different "classes" of securities, each with different rights attached. We recommend increasing the "creep" allowance so that overseas persons who own one or more classes of securities do not need further consent:

    a. to increase their ownership or control interests in each of the relevant classes of securities by up to 10% of the total securities in that class (i.e. 10% of all securities in the class, compared to the existing exemption of 5% of only the investor's existing securities),

    b. so long as their overall ownership or control interest in the relevant company (or similar entity) does not take the overseas person to or past a specific control threshold, being 25%, 50%, 75% or 90% of any class of security.

78. Other existing specifications would apply, i.e. the further securities could be acquired in multiple transactions and must be acquired within five years of the initial consent, and the further securities must have identical rights, privileges, limitations and conditions to the initial securities.

79. Some existing shareholders may not have consent for their original purchases (as it was not needed at the time they made the purchase). Should you progress this

exemption, we will work with OIO as we develop the regulations to ensure they apply appropriately to all types of shareholders, and we will report back to you on this matter.

Recommendation:

80. Where an overseas person owns one or more classes of securities, exempt from screening all acquisitions by that overseas person of further identical securities:

    a. for a period of five years from the initial consent;

    b. up to a limit of 10% of all securities in each relevant class; and

    c. without the overseas person's overall ownership or control interest in the relevant entity hitting thresholds of 25%, 50%, 75% or 90%.

Amendments to the shareholding exemptions – part three

81. At present, multiple transactions could be given effect in sequence, each relying on an exemption. It is unclear however whether a person could undertake a single transaction to the same effect in reliance on more than one exemption.

82. For example: in the transaction below, the parties must rely on both of the exemptions described above. They could achieve this outcome by first undertaking the transactions in figures 1 and 2 (in reliance on an exemption) in order to insert another company in the group structure, before undertaking the transactions in figures 3 and 4 (again, in reliance on an exemption) in order to effect minor changes to shareholdings as amongst the ultimate owners. We see no reason why they should not be able to achieve the same result in a single transaction, as shown in figures 5 and 6.

Recommendation:

83. Accordingly, we recommend making it clear in the Regulations that multiple exemptions may apply to a single transaction and render that transaction exempt from the relevant requirements for consent.

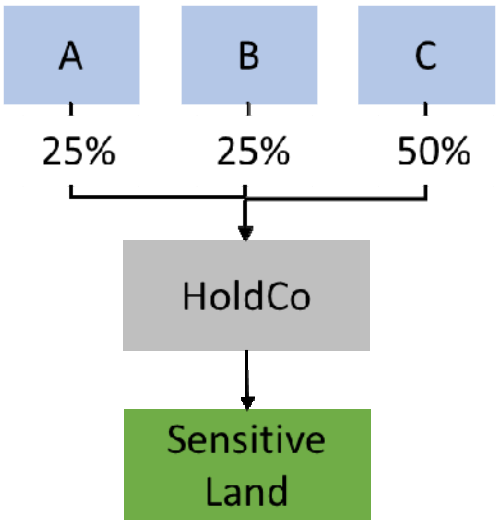

Figure 5: Before transaction

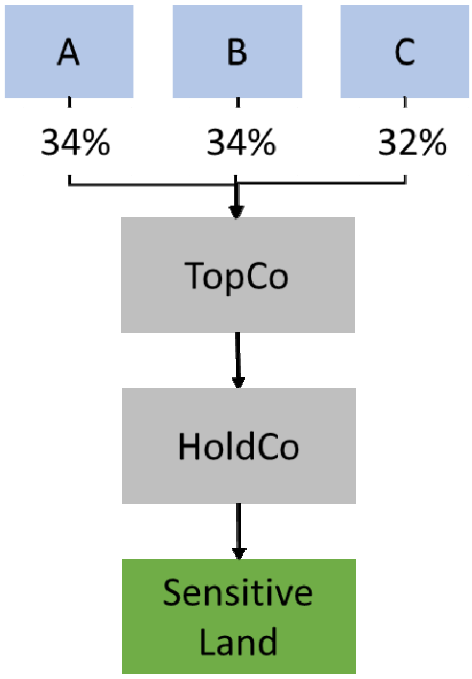

Figure 6: After transaction

Amendment to administrative penalty for retrospective consents

Background

84. The Act requires an overseas person to obtain consent before giving effect to a transaction. However, sometimes an investor fails to obtain consent and acquires assets in breach of the Act. The main reason for failing to obtain consent is not realising that consent was required, often due to not obtaining legal advice, or obtaining incorrect legal advice.

85. The Act provides that consent may be granted retrospectively, subject to the applicant paying an administrative penalty.

86. The reason for allowing retrospective consent is to enable an overseas person who inadvertently fails to get consent to obtain consent and retain the assets. The purpose of the administrative penalty is to make it clear that consent should be obtained before a transaction is entered into and to deter investors from misusing the process. Deliberate or knowing breaches of the Act generally won't be eligible for retrospective consent.

87. At present, the OIO determines the amount of the administrative penalty up to a limit of $20,000 (as stipulated in current regulations). The Regulations require the OIO to consider whether requiring the applicant to pay the amount would be unduly harsh or oppressive given—

    a. the value of the consideration for the asset that was acquired under the relevant overseas investment transaction; or

    b. the nature of, and the reasons for, the retrospective consent.

88. Between 2013 and 2017, the OIO granted retrospective consent an average of 8 times a year. The assets ranged in value from $420,000 to $215m. It is not unusual for the OIO to process applications involving transactions where the consideration is hundreds of millions of dollars.

89. There are two key issues with the current regime:

    a. the penalty is a variable one, with the OIO having the discretion to set the penalty amount, a position which has been criticised by the Law Commission; and

    b. the quantum of the penalty is insufficient to act as an effective deterrent when dealing with assets of large value, and has not increased in-line with fee increases since 2005.

Issue one: the variable nature of the penalty

90. The OIO's ability to set the amount of the penalty came in for criticism in the Law Commission's 2014 report "Pecuniary Penalties: Guidance for legislative design."[1] The Law Commission considered that the OIO was empowered to act as both complainant and judge, and that the issue was compounded by the OIO's ability to exercise discretion about the quantum of the penalty in any given case.

91. The Law Commission noted that while it anticipated that there was a desire to increase enforcement bodies' ability to impose penalties, this should be done by way of infringement notices. It suggested that the imposition of variable monetary penalties imposed by non-judicial bodies should be discouraged.

[1] NZLC R133

92. Officials recommend that the Law Commission's concern that the current regulation power to set a variable penalty could be addressed by providing set penalty bands based on the consideration paid for the sensitive asset. This would align with the current provision which requires the consideration to be taken into account but removes the discretion as to what level to set the penalty at.

93. Officials also recommend that the OIO retain the discretion not to impose a penalty, when imposing a penalty would be unduly harsh or oppressive having regard for the nature or, and the reasons for, the retrospective consent.

Issue two: quantum of the penalty

94. Currently the maximum penalty that the OIO may impose is $20,000. For a small transaction, such as the purchase of a residential property, officials consider that the penalty is more than sufficient to act as a deterrent. However, in larger transactions (which can involve assets worth tens of millions of dollars or more), officials consider a $20,000 penalty to have little deterrent effect.

95. Furthermore, the $20,000 penalty cap was set in 2005 and was intended to align with the cost of an application fee. Application fees have subsequently been increased, most recently in July 2016. However the penalty fee for not applying has remained static.

Recommendation

96. Replace the variable penalty with a series of fixed penalties set depending on the type and value of the consideration paid for the assets:

    a. For residential land being acquired under the 'commitment to reside' pathway:

Consideration paid for the asset	**Penalty**
<$2m	$5,000
>$2m	$10,000

    b. For all other pathways:

Consideration paid for the asset	**Penalty**
<$2m	$20,000
$2m-$10m	$30,000
$10m+	$40,000

97. Officials also recommend that the OIO retain the discretion not to impose a penalty, when imposing a penalty would be unduly harsh or oppressive having regard for the nature or, and the reasons for, the retrospective consent.

Removal of TrustPower Limited from Schedule 4

98. As a result of structural changes in its business, TrustPower wishes to be removed from the list of NZ controlled companies.

99. Being on this list means that, in some circumstances, TrustPower could acquire an interest in sensitive land without OIO consent. Removing it from this list takes away this privilege but has no other material impact, and therefore we support this request.

Recommendation

100. Revoke the item ‘TrustPower Limited’ from schedule 4 of the regulations.

Risks [legally privileged]

101. Crown Law has reviewed the proposed new exemptions and the proposed amendments to the existing exemption regime, as against the empowering provision in the existing Act.

102. [5]

103. [5]

104. [5]

105. [5]

106. [5]

107. [5]

108. [5]

109. [5]

Next Steps

110. Once you have confirmed which exemptions you wish to progress, we will draft a Cabinet paper for your consideration.

111. We propose the paper be lodged with the DEV Committee on 16 May 2018 and Cabinet 21 May 2018 to enable PCO to draft the regulations in time for the commencement of the amended Overseas Investment Act.

Consultation

112. The following agencies have been consulted on this draft: Housing New Zealand, Ministry of Justice, Land Information New Zealand, Ministry of Business, Innovation and Employment, Ministry of Foreign Affairs and Trade, Parliamentary Council Office, Te Puni Kōkiri.