

The Treasury

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

March 2019

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Treasury Report: Overseas Investment in Forestry – 5 hectare screening rule and accumulation test for non-forestry profits à prendre

Date:	8 June 2018	Report No:	T2018/1567
		File Number:	IM-5-8

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	Note the contents of this report.	None.
Associate Minister of Finance (Hon David Parker)	Agree to the proposed recommendations on the two issues discussed in this report. Refer a copy of this report to the group of Ministers with Power to Act.	Monday 11 June 2018.

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Steve Cantwell	Principal Advisor	[6]	N/A (mob) ✓
Robbie Taylor	Acting Team Leader, Overseas Investment	[6]	N/A (mob)

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

Return the signed report to Treasury.

Refer a copy of this report to the Deputy Prime Minister, the Minister for Crown/Māori Relations, the Minister for Māori Development, the Minister of Forestry, the Minister for Climate Change and the Minister for Land Information.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Overseas Investment in Forestry – 5 hectare screening rule and accumulation test for non-forestry profits à prendre

Executive Summary

This Treasury Report seeks decisions from you on two issues that officials have identified in relation to Supplementary Order Paper No.19 to the Overseas Investment Amendment Bill (the SOP). These issues have been identified in the process of officials providing PCO with drafting instructions on the revision tracked copy of the Bill, which now incorporates the SOP.

The two issues we are seeking decisions on are:

- *The 5 hectare screening rule for non-forestry profits à prendre* – whether you want to retain the 5 hectare screening threshold for non-forestry profits à prendre (as currently drafted in the SOP), in the context that, in certain circumstances, leases and freeholds have a lower than 5 hectare screening threshold.
- *The accumulation test for non-forestry profits à prendre* – whether you want to retain the accumulation test for non-forestry profits à prendre (as currently drafted in the SOP), in the context that no accumulation test exists for leases.

The Ministry of Foreign Affairs and Trade and the Overseas Investment Office have been consulted on this report, however due to time constraints we have not had the time and capacity to do a full economic analysis. The report therefore contains our best advice given the constraints under which it is written.

Recommended Action

We recommend that you:

- a **agree** the following recommendations based on technical issues raised in this report:

The 5 hectare screening rule for non-forestry profits à prendre

either

- b **confirm** the uniform 5 hectare screening rule for non-forestry profits à prendre as agreed to by Cabinet and currently drafted in the SOP (Issue A – option 1) (Treasury recommended).

Agree / Disagree.

or

- c **amend** the uniform 5 hectare screening rule for non-forestry profits à prendre and re-instate the previous decision by Cabinet to directly align screening with the threshold screening for leasehold land (Issue A – option 2) (OIO recommended).

Agree / Disagree.

The accumulation test for non-forestry profits à prendre

either

- d **confirm** the accumulation test for non-forestry profits à prendre as currently drafted in the SOP (Issue B – option 1).

Agree / Disagree.

or

- e **remove** the accumulation test for non-forestry profits à prendre and rely on the general anti-avoidance provision (Issue B – option 2) (Treasury, MFAT and OIO recommended).

Agree / Disagree.

or

- f **extend** the accumulation test for non-forestry profits à prendre to also apply to leases (Issue B – option 3) (Not recommended by Treasury, MFAT and OIO).

Agree / Disagree.

Process if you select option (c) (Issue A – option 2) and / or option (f) (Issue B – option 3)

g **Note** that if you select option (c) (Issue A – option 2) and / or option (f) (Issue B – option 3) you will need to introduce a Government Supplementary Order Paper at the Committee of the Whole Stage.

h **If** you need an Government Supplementary Order Paper at the Committee of the Whole Stage you will need to:

either

i **agree** to take an oral item to Cabinet.

Agree / Disagree.

or

j **direct** officials to draft a Cabinet paper for lodgement, on either (circle one):

- a. Monday 18 June, OR
- b. Monday 25 June.

or

k **direct** officials to draft a paper to the group of Ministers with the delegated power to act on these two issues.

Agree / Disagree.

Robbie Taylor
Acting Team Leader, Overseas Investment

Hon Grant Robertson
Minister of Finance

Hon David Parker
Associate Minister of Finance

Treasury Report: Overseas Investment in Forestry – 5 hectare screening rule and accumulation test for non-forestry profits à prendre

Purpose of Report

1. This Treasury Report seeks decisions from you on two issues that officials have identified in relation to Supplementary Order Paper No.19 to the Overseas Investment Amendment Bill (the SOP). The SOP brings overseas investment in sensitive land that involves forestry rights or certain other profits à prendre within the scope of the Overseas Investment Act (the Act or the OIA).
2. The two issues we are seeking decisions on are:
 - The 5 hectare screening rule for non-forestry profits à prendre, and
 - The accumulation test for non-forestry profits à prendre.
3. The issues do not affect forestry rights (which have a 1000 hectare per calendar year screening threshold).

Background on the Issues

4. These issues have been identified as part of the process of officials providing PCO with drafting instructions on the revision tracked copy of the Bill, which now incorporates the SOP, and both largely relate to minor inconsistencies between the treatment of non-forestry profits à prendre and leases in certain circumstances (described in full below).
5. Whilst the issues are relatively minor and technical in nature, given we understand that the Government's objectives for introducing the SOP include:
 - [1]

- Achieving greater consistency across the treatment of forestry rights, non-forestry profits à prendre, freehold and leasehold land within the Act.

we want to re-confirm whether you are comfortable with the current policy settings contained in the SOP.

6. The Ministry of Foreign Affairs and Trade and the Overseas Investment Office have been consulted on this report, however due to time constraints we have not had the time and capacity to do a full economic analysis. The report therefore contains our best advice given the constraints under which it is written.

Issue A: 5 Hectare Screening Rule for Non-Forestry Profits à Prendre

7. This section seeks a decision from you regarding whether you want to retain the 5 hectare screening threshold for non-forestry profits à prendre (as currently drafted in the SOP). This is in the context that, in certain circumstances, lease and freehold interests have a lower than 5 hectare screening threshold. For example, the screening threshold for land adjacent to a lake is if it exceeds 0.4 hectares

The current drafting of the SOP

8. The SOP includes a uniform 5 hectare threshold that requires overseas persons to be screened by the Overseas Investment Office (OIO) if the overseas person purchases 5 hectares or more of non-forestry profits à prendre over sensitive land (and the profits are for 3 years or more in duration). A uniform 5 hectares was selected for the following reasons:
- It aligns with an existing land sensitivity in the Act (i.e. the land is over 5 hectares in size and non-urban), and corresponds to a change in the benefit threshold (benefits from overseas investments in non-urban land over 5 hectares must be 'substantial and identifiable').
 - An original concern was that profits-à-prendre on other primary products may be used to construct transactions that sidestep the OIA screening regime. The 5 hectare threshold was anticipated to capture significant transactions.
 - It was anticipated to be easier for an overseas person to understand and comply with the regime (than a range of different thresholds).
9. Initially, instead of this uniform 5 hectare threshold, Cabinet agreed to directly align the thresholds for non-forestry profits à prendre with the existing thresholds for acquisitions of leasehold land in the Act. This decision was later changed by Cabinet to the uniform 5 hectare threshold (DEV-18-MIN-0017 and CAB-18-MIN-0094 refers).

Possible issue with current drafting of the SOP and options

10. Given the objectives of achieving greater consistency in the Act ^[1,5]
we have identified that you may prefer to directly align the threshold of non-forestry profits à prendre with the existing thresholds for acquisitions of leasehold and freehold land in the Act (as was originally agreed by Cabinet). We are raising this with you now as we have identified that ^[1,5]
11. Therefore the options for you to consider are:
- Retain the threshold proposed in the current SOP for screening non-forestry profits à prendre at 5 hectares (Issue A – option 1 – the status quo SOP), OR
 - Change the threshold for screening non-forestry profits à prendre to be directly aligned to the screening of leases within the existing Act (Issue A – option 2).
12. Trade-offs associated with making this decision are discussed in the table below. These trade-offs are not comprehensive due to the limited timeframe available in undertaking analysis and providing this advice.

Retaining the proposed uniform 5 hectare rule (Issue A – option 1 – the status quo SOP)	Change the threshold to be directly aligned with the screening of leases (Issue A – option 2)
<ul style="list-style-type: none"> • A 5 hectare threshold rule is likely to be sufficient to capture significant transactions by those who are trying to use profits à prendre on other primary products to avoid screening. That is, profits on transactions under 5 hectares are unlikely to be considered significant enough to warrant concern even if the transaction is related to another primary product for the sole purpose of attempting to avoid the Act. • It is likely to be more straight forward and simple for the overseas persons to understand. 	<ul style="list-style-type: none"> • This would achieve direct consistency between the screening threshold of leases and non-forestry profits à prendre. • [1,5] • [1]

13. On balance, Treasury prefer retaining the status quo SOP (Issue A – option 1), but don't have a strong view. Officials' preference for retaining the proposed uniform 5 hectare rule is based on the fact that 5 hectares is likely to capture significant transactions (and therefore the loss of option value is minor as there is no strong reason to want to further reduce the screening threshold). Based on this, the primary rationale for change would be to achieve direct consistency.
14. The OIO's view is that if the intention is to address avoidance issues associated with the use of profits à prendre instead of leases then the thresholds should be the same. The OIO considers that the use of different thresholds for similar interests adds complexity and undermines the coherency of the Act. The OIO supports Issue A - option 2 (aligning non-forestry profits à prendre with the leases).

Issue B: Accumulation Test for Non-Forestry Profits à Prendre

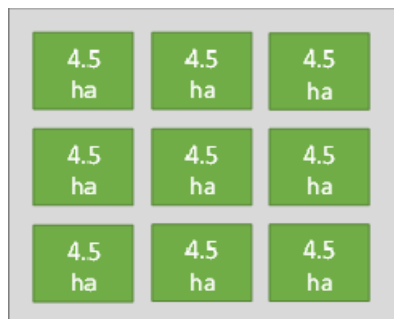
15. This section seeks a decision from you regarding whether you want to make changes to how smaller (e.g. less than 5 hectares) leases or non-forestry profits à prendre held by the same overseas person or its associates are grouped together, to determine if the 5 hectare, or other area threshold is met.
16. This is in the context that the SOP introduces an accumulation test for non-forestry profits à prendre, where one does not currently exist for leasehold land.

The current drafting of the SOP

The accumulation test for non-forestry profits à prendre

17. The SOP introduces an accumulation test for non-forestry profits à prendre. This accumulation test requires that if an overseas person or its associates holds a combined area of 5 hectares of profits over the same parcel of land (i.e. the same parcel of fee simple estate in land), or over adjoining parcels of land, then it requires screening under the OIA – even if the profits are not themselves adjoining.

18. This accumulation test is an attempt to avoid a “tiles” approach of having multiple smaller profit areas, with corridors of non-profit land between them to prevent the profits from being adjoining. This “tiles” approach was identified as a possible way overseas persons may try to avoid screening, and this is why the accumulation test was introduced, although we note that in certain cases there may be legitimate reasons for having several non-adjoining profits. The OIO note that it has not seen cases where a “tiles” approach has been used in the past. The approach is depicted in the picture below.



Multiple 4.5 hectare (ha) profits are taken over a piece of land ("tiles"). These require screening regardless of whether they are genuine or an attempt to avoid screening.

Key:
Profit
Freehold

19. If an overseas person did use this “tiles” approach to avoid screening, under the current Act, the OIO would need to rely on the general anti-avoidance provision section 43. This creates an offence of knowingly or recklessly entering into a transaction for the purpose of, or having the effect of, in any way, directly or indirectly, defeating, evading, or circumventing the operation of the Act.
20. The introduction of the uniform accumulation test will provide the OIO with an alternative provision for such instances. It will only be available for profits, so they will be treated differently to leases in this circumstance.
- Why the accumulation test was introduced*
21. The SOP introduced the accumulation rule for non-forestry profits à prendre because, at that time, officials considered that:
- It was more likely that overseas persons would attempt to avoid screening by “tiling” using profits rather than leases.
 - It would be easier for the OIO to enforce a uniform threshold than the general anti-avoidance provision.
22. Through the drafting process however officials have updated this view and now consider that:
- The risk that overseas persons would attempt to avoid screening using “tiling” is similar for leases and profits (although we understand that to register a lease over part of a parcel of land requires formal surveying, but to register a profit over a part-parcel does not).
 - The general anti-avoidance provision under section 43 of the Act should be sufficient to deal with overseas persons who attempt avoidance using “tiling”, whether using leases or profits.
 - The introduction of the new accumulation test creates an inconsistency in the Act through creating a special rule for profits.

- It creates an inconsistency with the treatment of freehold land which only requires screening when the separate areas are adjoining.
- The OIO's view is that anti avoidance rules should apply consistently to all relevant interests and should be carefully designed to ensure they achieve their objectives and minimise the risk of unintended consequences.
- The accumulation rule could lead to perverse outcomes unless an additional proximity element were included. Currently, for example, a 4 ha profit on the far-west boundary of a large legal parcel (freehold estate) could require consent because of another 4 ha profit on the far-east boundary of the neighbouring large legal parcel (to the east), even if the two profits were kilometres apart, or separated by mountains or rivers.

Possible issue with current drafting of the SOP and options

23. Given that the concerns that prompted the introduction of the accumulation test for profits have largely been mitigated, and your objectives for consistency in the regime, we wanted to confirm if you were comfortable with retaining the accumulation test.
24. The options for consideration are:
- Retain the accumulation test for non-forestry profits à prendre as currently drafted in the SOP (Issue B - option 1 - the status quo SOP), OR
 - Remove the accumulation rule proposed for non-forestry profits à prendre so that attempted avoidance by overseas persons is dealt with in the same way as leasehold land using the general anti-avoidance provision (Issue B - option 2), OR
 - Extend the special accumulation rule for non-forestry profits à prendre to also apply to the treatment of leasehold land (Issue B - option 3).
25. Trade-offs associated with making this decision are discussed in the table below. These trade-offs are not comprehensive due to the limited timeframe available in undertaking analysis and providing this advice.

Retain the accumulation test for non-forestry profits à prendre (Issue B – option 1 - the status quo SOP)	Remove the accumulation rule for non-forestry profits à prendre (and rely on the general anti-avoidance provision) (Issue B - option 2)	Extend the accumulation rule to also cover leases (Issue B - option 3)
This creates an inconsistency in the Act and is difficult for the OIO to operationalise.	[1,5]	Leases that are non-adjoining (but are on adjoining freehold parcels) for legitimate reasons would require screening which will place an additional burden on this group of overseas investors. [1,5]

		<p>[1,5]</p> <p>This change is likely to increase the number of applications to the OIO (compared to the current Act which does not require screening unless the overseas person is trying to avoid screening).</p> <p>This would create an inconsistency with the treatment of freehold land within the Act which only requires screening when its adjoining and would likely need a proximity rule be introduced.</p>
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26. On balance, Treasury therefore consider that the non-forestry profit à prendre accumulation test is not required and that those who use the “tiling” for profits can be addressed using the general anti-avoidance provision in section 43 of the Act.
27. The OIO supports this option as well as. Further the OIO considers that extending the existing (complex) accumulation test to leases without a full analysis of the likely impact and effectiveness risks unintended consequences.
28. The accumulation test was introduced through the SOP as a way of improving the integrity of the 5 hectare threshold rules. However no Cabinet decision was made on this. Officials are therefore of the view that the accumulation test could be removed (Issue B – option 2) without the need for decisions by Cabinet or the group of Ministers with the delegated power to act on these two issues.

Next steps

29. Should you wish to make changes to:

- The 5 hectare screening rule for non-forestry profits à prendre to directly align it with leases (Issue A – option 2), and / or
- Extend the accumulation test for non-forestry profits à prendre to cover leases (Issue B – Option 3).

You will need to introduce a Government Supplementary Order Paper at the Committee of the Whole Stage. This is currently expected to be the week commencing 2 July 2018.

30. You will need to obtain policy approval for the changes ahead of PCO drafting the SOP, either by:

- Taking an oral item to Cabinet, or
- Taking a paper directly to Cabinet, or
- Seeking agreement through the group of Ministers with the delegated power to act on these two issues (i.e. 5 hectare screening rule and accumulation test). This group includes: the Deputy Prime Minister, the Minister for Crown/Māori Relations, the Minister of Finance, the Minister for Māori Development, the Minister of Forestry, the Minister for Climate Change, and the Minister for Land Information.

31. If you want to take an oral item or paper directly to Cabinet, you have two options for timing:

- Monday 18 June – this will not provide any timeframe for coalition consultation, or
- Monday 25 June – this will allow you one week of coalition consultation.