C.E.R. - THE BUSINESS AND LAW ESSENTIALS
Part III

Paper Presented at Seminar
by C. Bruce Rampton
Commentaries on papers in Parts I and II
by
Hon. J.K. McLay
Geoffrey Palmer
Peter Brannigan
Kerrin Vautier

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FOREWORD

by The Hon. Mr Justice R.I. Barker,
Chairman of the Legal Research Foundation Inc.

In 1967 the Legal Research Foundation Inc. invited the Rt. Hon. Paul Hasluck, then Australian Minister for External Affairs and later to become Governor General of Australia, to give an address on Australia - New Zealand Relations.

For an organisation then only two years old the participation in its activities of a person of such eminence was a tremendous boost. Since 1967 the Foundation has organised many seminars on topics of legal and community interest with the aim of fostering participation of all interested parties. In addition, it continues to encourage research on a wide variety of legal and related topics.

The recent signing of the "Closer Economic Relations Agreement" between the governments of New Zealand and Australia highlights the need for informed discussion on the legal and other problems arising out of such an agreement. All manner of questions present themselves: Should there be a Trans Tasman court to resolve litigation between Trans Tasman traders? What are the taxation implications? What of anti dumping? What of investment controls?

To stimulate discussion amongst members of the business community and the legal profession the Foundation held a seminar on July 22/23 1983. The high calibre of the speakers and their papers makes publication of the papers for a wider audience a matter of duty for the Foundation.

Along with the other members of the Council of the Foundation I hope that these excellent papers will promote discussion on a whole range of topics and assist the decision makers on both sides of the Tasman.

Judges Chambers, High Court, AUCKLAND

R.I. Barker 22 July, 1983
COMPARISON BETWEEN NEW ZEALAND AND AUSTRALIAN LAWS AND POLICIES RELATING TO OVERSEAS INVESTMENT

Mr C. Bruce Rampton LL.B., B.A.(Econ), Secretary, Overseas Investment Commission (N.Z.); formerly with the Securities Commission (Australia)
From the early days of European settlement direct foreign investment has played an important part in the development of both countries, with the bulk of the foreign investment originating from Britain and the United States of America. In the case of New Zealand direct investment from Australia was also important although there was little flowing in the opposite direction. The reason for this concentration in the origin of investment is historic since controls have generally made no distinction between investors on the grounds of nationality. Things are changing, and the records of both the Foreign Investment Review Board (FIRB) and New Zealand's Overseas Investment Commission (OIC) show that proposals involving investment from what may loosely be called "non traditional sources" are now more common.

Deane, in his 1970 study on foreign investment in New Zealand manufacturing (1) found that Australian firms were among the very first to arrive in New Zealand. He found that geographical proximity seemed to generate a greater awareness by Australians of the New Zealand market, leading to what a number of companies referred to as a "logical market expansion" by coming across the Tasman. One of the major motives given by Australian firms, but not by firms of any other country, was the desire to increase or maintain a share in the New Zealand market.

New Zealand continues to be the recipient of a substantial amount of direct foreign investment from Australia and of all countries has the greatest number of firms which are affiliated with Australian companies. From data prepared by the Australian Bureau of Statistics relating to 1980 it was found that 81 Australian based companies held investments in 369 enterprises in New Zealand, which represented 26% of the total number of Australian's overseas affiliates. By comparison countries in the ASEAN region had 240 enterprises with Australian investment, Papua New Guinea 143 and the United Kingdom 134 (2). Records kept by the New Zealand Department of Trade and Industry show that the number of firm enquiries from Australia to establish a business in New Zealand is rising in numbers and in addition represent a growing proportion of total enquiries.
Firm Investment Enquiries from Overseas

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Source: Department of Trade and Industry

New Zealand involvement in Australia has been small and usually warrants no mention in official records as a major source of direct investment. However, there is evidence of a growing interest on the part of New Zealand companies to invest across the Tasman. Figures made available by the Australian Treasury indicate that during the period April 1976 to March 1983 there were 380 New Zealand investment proposals, of which 289 (76%) were approved unconditionally, 76 (20%) gained conditional approval, 3 were rejected and 12 withdrawn.

The Broad Policy

The policy of both Governments is to welcome foreign investment because of the contribution it has made to the development of the respective economies and the demands for new investment in the future which may be difficult to meet or to finance from each country's own resources.

In 1982, the Australian Treasurer made the following statement which summarised his country's overall policy:
"The Australian Government welcomes the contribution foreign investment can make to the development of Australia's industries and resources. Capital from other countries supplements Australia's domestic savings and so adds to the funds available for investment. Foreign investment can also provide access to new technology, management skills and international markets. It is valuable in enhancing Australia's productive capital by increasing the resources available to the economy. The Government's policy is therefore to encourage foreign investment, provided such investment is consistent with Australia's national interests and meets the needs of the Australian community." (3.).

There has been speculation in the media that since the Labour Government came to power the rejection or delay of a number of foreign takeover proposals (including two from New Zealand) indicates a hardening in attitude towards foreign investment. While denying this to be the case the following statement which now accompanies the publication - "Australia's Foreign Investment Policy" - shows that the new Government is unwilling to accept the Liberal Government's policy in toto:-

"The Australian Labour Government recognises that foreign capital has a significant role to play in the development of the Australian economy and is in general agreement with broad thrust of the policy outlined herein. There are inevitable differences of emphasis on some points of policy and when these have been developed in detail, a new guide to foreign investors will be issued."

We will have to wait until the next guide is published to learn the extent of these "differences of emphasis."

The policy of the New Zealand Government is also to welcome foreign investment as this extract from a Ministerial press statement indicates:

"There is no doubt that New Zealand will benefit from more foreign investment and the inflow of technology and innovation that it can bring. The new criteria and guidelines make it quite clear that New Zealand welcomes foreign investment that can contribute to this country's development." (4.)
The Administration of Foreign Investment Policy

In Australia the Treasurer is responsible for the administration of foreign investment policy which covers the legal requirements of the Foreign Takeovers Act 1975 and other requirements which are established by way of statements of policy. The administration of Policy is based on the powers contained in that Act, the Banking (Foreign Exchange) Regulations and controls over exports. The Treasurer has delegated certain powers to the head of the Foreign Investment Division of the Treasury.

In New Zealand the Minister of Finance is responsible under the Overseas Investment Act 1973 for foreign investment matters, but he has delegated wide powers to the OIC which makes most of the decisions (in conformity with settled policy) and attends to the day to day administration.

In practice, the Australian Treasurer is more directly involved in decision making than is his New Zealand counterpart.

The Foreign Investment Review Board (FIRB) and the Overseas Investment Commission (OIC)

The FIRB advises the Treasurer as to the administration of foreign investment policy. It is an administrative body that has no statutory existence, thus the Foreign Takeovers Act 1975 makes no reference to the FIRB. The foreign investment Guidelines which relate to the establishment of new businesses indicate that the Treasurer is ultimately responsible for foreign investment policy but that the FIRB is the main source of advice to the Minister.

The FIRB has three members - two of whom, including the Chairman, are men from the world of business, while the third is the head of the Foreign Investment Division of the Treasury.

The main functions of the FIRB are:

(i) to examine proposals by foreign interests for investment in Australia and make recommendations to the Government on these proposals;
(ii) to advise the Government on foreign investment matters generally;
(iii) to foster an awareness and understanding, both in Australia and abroad, of the Government's policy;
(iv) to work towards a high level of Australian equity participation in new investment projects;
(v) to give guidance, where necessary, to foreign investors so that their proposals may be in conformity with Government policy;
(vi) to keep in touch with the activities of foreign-controlled businesses operating in Australia; and
(vii) to maintain liaison with State Government authorities.

It can be seen from the above that the FIRB is clearly at the centre of regulating foreign investment, notwithstanding that it has no authority to make final decisions.

The New Zealand Overseas Investment Act 1973 established a five member OIC, comprising two members from the private sector, one of whom is the Chairman. The representatives from the private sector make available to the Government the thinking and experience of people familiar with commerce and business. The other members represent the Treasury, The Reserve Bank of New Zealand and the Department of Trade and Industry.

The functions of the Overseas Investment Commission are of two kinds. First, it has the power to make decisions under delegated authority from the Minister of Finance and in practice very few of the investment proposals are referred to him. Secondly, the Commission has a duty to advise on foreign investment matters generally.

The specific functions of the OIC which are set out in section 9 Overseas Investment Act 1973 are:

(i) to consider proposals concerning overseas investment that are to be submitted for approval, consent, permission or exemption in accordance with regulations made under the Act;
(ii) to advise the Minister, or, as regulations made under this Act may so require, to determine, whether the proposals so submitted are in the national interest and whether any approval, consent, permission or exemption to them should be granted or refused;

(iii) to advise the Minister, or as regulations made under the Act so require, to decide, on the compatibility of any proposal for overseas investment with the policy of the Government relating to any other matter;

(iv) to advise the Government on such means as will ensure that the fullest possible benefit from overseas investment will accrue to New Zealand in promoting economic growth and development by the efficient utilisation of resources, and the highest degree of production, trade and employment;

(v) to keep under continuous supervision, and, if regulations made under this Act so require, to control the level and extent to which overseas persons may own or control property in New Zealand, and to report from time to time on this matter to the Minister.

(vi) to advise the Government on all matters relating to overseas investment in New Zealand;

(vii) to exercise and perform such functions, powers and duties in relation to overseas investment as are confirmed or imposed on it under this Act or regulations made under this Act.

The idea of a Commission to deal with overseas matters was mooted publicly in the 1972 Labour Party Manifesto, where the Party indicated that it would supervise overseas investment, whether in new enterprises or existing concerns.

The Hansard report of the Parliamentary debate indicates the responsibilities which the Labour Government had in mind for the OIC. The Hon. W.E. Rowling (then Minister of Finance) when moving in March 1973 that the Bill be introduced, said this:
"The final powers of decision and control of overseas investment in New Zealand will remain with the Government, as this is an area of such importance to the future of New Zealand."

This extract suggests that the Minister of this early stage probably envisaged a vetting procedure that would involve him (or the Government) in more of the decision making than in fact emerged once the Overseas Investment Regulations 1974 became operative.

During the second reading of the Bill he said:

"The Commission's major duty will be to advise the Government, and when in doubt, the matter must be and will be referred to the Government." (Emphasis added).

An interesting point to emerge from the Parliamentary debate was the enunciation by the Government of a general principle that the onus of proof was on the applicant to show that the economy would benefit from any overseas takeover or other significant overseas capital injection. Since these earlier days, the emphasis has changed and the policy is now that applications will generally be approved unless there are good reasons why a proposal should not be allowed.

**Decision Making**

The FIRB member who is also the Treasury official has power delegated to him and he makes many of the routine decisions. About 70% of proposals are dealt with this way. The remainder are considered by the FIRB which merely makes recommendations to the Treasurer, for his final decision.

The position in New Zealand is different. The Minister of Finance has delegated decision making powers to the OIC which in turn has delegated certain powers to the Secretariat which deals with proposals that fall clearly within policy. Applications involving takeovers or commencing business are generally decided by the OIC while those outside settled policy, but containing elements which could warrant special consideration, are referred to the Minister. There are about twenty such cases a year and the Minister's decision may be taken as setting a new policy against which subsequent proposals are measured.
A comparison between the functions of the FIRB and the OIC draws out an important difference which largely accounts for the current difficulties between the Australian and New Zealand Government over harmonising foreign investment policy. The FIRB has an obligation to promote a high level of Australian participation in investment proposals. Indeed as we see later, this objective is central to Australia's foreign investment policy. By comparison the OIC has no explicit duty to foster local participation and in practice is more comfortable with higher levels of foreign ownership than is the case in Australia. In other words, although the degree of local share participation is taken into account in New Zealand in assessing proposals, it would appear to be interpreted more flexibly than in Australia.

The Australian Foreign Takeovers Act 1975

It should be understood that the Act only applies to acquisitions, therefore the policy has rather limited control over a foreigner establishing a new business. Unless a new business or project is in a sector of the economy which is subject to special restrictions (i.e. finance, insurance, the media, civil aviation and uranium), proposals to establish a new business are only examinable under the Policy where the total amount of the investment (including the value of any leased assets) is $5 million or more. An acquisition of real estate valued at less than $350,000 does not require approval unless the acquisition is part of a property investment programme or an acquisition of a business. A proposal to establish a new business will, however, almost certainly involve a transaction requiring exchange control approval, even if it only involves the incorporation of a company with a nominal share capital.

The Act contains detailed provisions designed to catch any means by which an Australian business or company may fall under the control of a foreigner. The following provisions in the Act are of particular significance:

- Sections 18 and 19 empower the Treasurer to prohibit or reverse an acquisition of shares or assets by a "foreign person" that results in "foreign control" of a business or corporation that would be contrary to the "national interest;"
Section 25 provides that such power is not available to the Treasurer once he has been notified of the proposed transaction but does not issue a prohibiting or interim order within 30 days;

Section 26 requires that any proposal by a foreigner to acquire shares in an Australian corporation, that would result in, increase or alter the ownership of a "substantial interest" in the corporation must be notified to the Treasurer.

The meaning of "foreign person" and "foreign control" depend upon the term "substantial foreign interest" defined as an interest of 15% in ownership or voting power of a corporation or business by a single foreign interest (either alone or together with associates) or an interest of 40% in the aggregate in the ownership of voting power of a corporation or business by two or more foreign interests (either alone or together with associates);

The Act applies to "foreign-to-foreign takeovers" where a foreign-owned business or company is to be take over by another foreigner;

The Act similarly applies to "off-shore takeovers" where an overseas company that conducts a business in Australia is acquired by another overseas company and the value of the assets of that Australian business within the target overseas company exceeds $3 million (Section 13);

The Policy states that the Government will not usually intervene in proposals falling within the scope of the Act where the total assets of the business or corporation are less than $2 million unless the acquisition is in the specially restricted sectors referred to above or involves the acquisition of real estate. Note that no account is taken of liabilities since "total assets" are measured as the higher of:
(i) the last balance sheet gross value of all assets employed in the target business (including any tangible assets); or

(ii) the total consideration to be paid for the business.

A foreign investor will seek to come within Section 25 by notifying the Treasurer of the proposal and submitting that the Treasurer should not make a prohibiting or an interim order within the 30 day period. If the Treasurer does not make such an order and instead responds by stating that he has no objections to the proposal in terms of the Policy, the investor will have received what is termed a FIRE Approval.

There are limits imposed on the Treasurer's consideration and the options available to him. These are as follows:

. if he fails to make an order within 30 days and does not publish it within 10 days of its making then the proposal cannot be prohibited;

. the order can be a final prohibiting order under Sections 18, 19, 20 or 21 or an interim order under Section 22 prohibiting the proposal for 90 days after the publication of the order (therefore giving the Treasurer a maximum of 130 days from notification to consider the proposal);

. if after making the interim order the Treasurer does not make a final prohibiting order within the 90 day period, then again the proposal can proceed;

. under Section 23 the Treasurer can revoke any order when he is satisfied that, prior to the expiry of that 90 day period, the proposal should proceed.

The two criteria to which the FIRB apparently gives greatest weight in arriving at a recommendation are the "Net Economic Benefits Test" and the "Australian Participation Opportunity Test".
The "Net Economic Benefit Test" examines against the circumstances in the relevant industry whether or not the proposal would produce net economic benefits to Australia in relation to the following matters:

. competition, price levels and efficiency;

. introduction of technology or managerial or work-force skills new to Australia;

. improvement in the industrial or commercial structure of the economy or in the quality and variety of goods and services available in Australia; and

. development of or access to new export markets.

The "Australian Participation Opportunity Test" examines the extent to which Australians are to take part in the proposal through equity participation and the degree of local management and control following the implementation of the proposal.

The new Labour Government appears to be enforcing the "Australian Participation Opportunity Test" quite vigorously and is asking applicants to demonstrate that no Australian interests are willing to participate in the proposed takeover on reasonable terms. It is now important that there be a public announcement of the proposal as early as possible to convince the authorities that the public is aware of the proposed transaction. The Government's attitude is brought out clearly in the Treasurers' press statement dealing with the proposed takeover by New Zealand's Healing Industries Limited of the English owned firm - Lawrence Smith and Canning Pty Limited.

"In view of its concern about the extent of foreign control of Australian industry, the Government considers that the Australian interests should have an opportunity to submit offers to buy businesses, be they currently Australian or foreign owned, which are the subject of foreign investment proposals."
Other criteria contained in the Policy which are taken into account by the FIRB are:

(i) whether the business could be expected to be conducted in a manner consistent with Australia's best interests in such matters as:

. local processing of materials and the utilisation of Australian components and services;

. involvement of Australians on policy-making boards of the businesses;

. research and development;

. royalty, licensing and patent arrangements; and

. industrial relations and employment opportunities;

(ii) the interests of Australian shareholders, employees, creditors and policyholders affected by the proposal;

(iii) whether the proposal would be in conformity with other government economic and industrial policies and with the broad objectives of national policies concerned with such matters as Australia's defence security, aboriginal interests, decentralisation in the environment, as well as with Australia's obligations under international treaties; and

(iv) taxation considerations, including the manner in which the proposal is to be financed.

New Zealand Overseas Investment Regulations 1974

This legislation provides a mechanism whereby new foreign investment can be screened and covers borrowing in New Zealand by overseas companies and borrowing overseas by companies incorporated in New Zealand.
In respect of new investment consent is required for:

(i) "an overseas person" to acquire 25% or more or any class of share in a company;

(ii) a company incorporated in New Zealand to issue or allot shares to an "overseas person" if the effect of the transaction is to give the "overseas person" 25% or more of any class of share;

(iii) an "overseas person" to commence business in New Zealand.

An "overseas person" can be an individual or a company not resident in New Zealand, or a resident company in which 25% or more of any class of share is owned by an overseas person.

The takeover of a company, whether by the acquisition of shares or the assets used in carrying on the business is normally approved automatically where the consideration is under $500,000. (In practice a detailed application is still needed to ensure that an investments accords with policy.)

On receipt of a notice of a proposed takeover that complies with the requirement of Regulation 7, Overseas Investment Regulations 1974 the Secretary of the Commission must "forthwith", record the notice in a register and a decision as to whether or not to grant consent must be made within 6 weeks of the date of registration.

On receipt of a notice that does not comply with regulation 7 the Secretary may, at his discretion, record the notice in the register. The six weeks in which a decision must be made runs from the time of registration.

Consent is required for an overseas company to raise funds in New Zealand where the total amount of borrowings undertaken by that company exceeds $300,000. The definition of borrowing is wide, covering loans, overdrafts, mortgages and the acceptance of any bill of exchange or the issue or any promissory note except where the acceptance or issue a directly associated with a trade transaction.
Consent is also required for companies incorporated in New Zealand to borrow overseas.

In 1979 the Minister of Finance revised the criteria to be used by the OIC in its assessments of investment proposals. In so far as the criteria conveyed by the Minister to the OIC constitute "...general or special directions given by the Minister to the Commission....", the Commission is obliged under Section 9 (2) Overseas Investment Act 1973 to make decisions with close regard to the criteria. They are:

(i) added competition to local industry, lower prices and greater efficiency;

(ii) the introduction of new technology, managerial or technical skills;

(iii) the development of new export markets or increased market access;

(iv) the extent to which the proposal is likely to make a net positive contribution to the balance of payments;

(v) the creation of new job opportunities;

(vi) the promotion of New Zealand's economic growth.

As additional considerations the OIC is also expected to take account of:

(i) the degree of equity participation by local shareholders in relation to proposals which involve the ownership and control of New Zealand's natural resources;

(ii) the potential impact of the proposal on the environment and on regional development;

(iii) the implications of the proposal for the Government's other economic and industrial policies and any other national policies which might be affected by the proposal;
(iv) the relative opportunities of shareholders in small private companies to dispose of their shares to the best advantage.

Australian Participation and the "Naturalisation" of Companies

The Australian Government holds strongly to the view that its citizens should have the opportunity to participate fully in the development of Australia's industries and natural resources. For this reason one of the criteria against which foreign investment proposals are assessed is the extent of Australian participation which is sought and the level of Australian ownership, management and control which will exist once the proposal is implemented. In view of the importance attached in foreign investment policy to provide opportunities for Australians to participate in the control of Australia's industries and natural resources it is normally expected that the existence of a proposal for the acquisition of a significant Australian business be a matter of public record. A public announcement is not usually required in respect of small takeover proposals (that is proposals where the assets of the target company are less than $2 million).

In line with its policy of giving Australian citizens an opportunity to participate in companies operating in Australia the Government welcomes proposals by foreign companies already operating in Australia to increase the level of local participation in their operations. There is a framework and an incentive under the naturalisation provision of the foreign investment Policy for companies that are predominantly foreign owned to increase the level of Australian operations. The benefits arising from a naturalisation proposal include the right to undertake new projects in Australia. (Other than projects in the uranium, finance, insurance, media and civil aviation sectors).
It is rare for the OIC to insist on a public announcement as to the intentions of an overseas person to acquire a company operating in New Zealand. Similarly the Commission has no policy which explicitly encourages New Zealand participation in existing businesses which are overseas owned. However, policy relating to local borrowings provides an indirect incentive for companies to become at least majority New Zealand owned in order to gain unrestricted access to the local capital market. Under the present policy companies which are 50% or more overseas owned have local borrowing limits based on turnover. Once a company is majority owned and controlled by New Zealand interests, it is allowed free access to the New Zealand capital market, notwithstanding that there may still be a significant minority overseas shareholding.

Is Australia's Policy More Restrictive than New Zealand's?

There is a good deal of similarity between the two countries' foreign investment policies, which by international standards are liberal. Each country has special features which reflect its resource endowments; for example Australia has tight control over the utilisation of mineral resources, while New Zealand virtually excludes overseas ownership of rural land. The main differences are:

- Australia has a lower threshold of overseas share ownership than is the case in New Zealand before the vetting procedures come into play. (15% compared with 25%);

- Both foreign investment policies require a demonstration of net national benefit. This appears to be generally administered less restrictively in New Zealand than in Australia;

- Australia places a high priority on promoting Australian shareholding and control in ventures. By contrast although New Zealand also favours local share participation, it usually adopts a more relaxed attitude to the level of overseas ownership and control;

- Notice of an overseas takeover is generally given to allow Australians the opportunity to make a counter bid. As a general policy this is not the case in New Zealand.
All told it is probably fair to conclude that the Australian foreign investment regime is somewhat more restrictive than that of New Zealand.

The Future

Foreign investment has been relegated to a "second generation" issue for consideration under CER. However, the subject deserves a higher priority and recent developments indicate that reconciling the two investment regimes is an urgent task, which will exercise the wit and ingenuity of the respective Governments and their advisers.

The reductions of trade barriers under CER is very likely to lead to greater flows of investment between the countries and the new arrangements will alter the relative attractiveness of Australia and New Zealand as recipients of investment from other countries. Income gains from freer trade should encourage investment in each country from the other as decision makers perceive improved opportunities for growth. On the other hand direct investment which owed its origin to the presence of trade barriers may ease as protective levels are reduced. Thus, changes to the foreign investment guidelines are likely to affect flows of investment between the countries but a measure of these cannot be determined in advance, with certainty.

The New Zealand Government has made it known that its policy is to have the investment regimes in the two countries harmonised once CER comes into operation. (5).

Even if this aim is not achieved in the short term, New Zealand should still benefit from the investment from Australia and from investment arising from third countries attracted by the prospect of an extended Australasian market.


Sources.


Commentaries on:

C.E.R. — A TRANS TASMAN COURT?
Paper presented by Hon. Mr Justice M.D. Kirby — Page 16, Part I.

Hon. J.K. McLay  LL.B., Minister of Justice, Attorney-General (N.Z.)


AUSTRALIA — NEW ZEALAND RELATIONS: THE CLOSER ECONOMIC RELATIONS AGREEMENT IN CONTEXT
Paper presented by Alan Burnett — Page 59, Part I.

Kerrin Vautier  B.A. (V.U.W.), Research Economist, Auckland, Member of N.Z. Planning Council

TRANS TASMAN TAXATION
Paper presented by Dr R.L. Congreve — Page 3, Part II.

Commentary on:

C.E.R. — A TRANS TASMAN COURT?
Paper presented by Hon. Mr Justice M.D. Kirby — Page 16, Part I.

by

Hon. J.K. McLay LL.B., Minister of Justice, Attorney-General (N.Z.)
I want to congratulate Mr Justice Kirby for the contribution that he has made in this paper to a number of ongoing debates: the legal issues, of appeals to the Privy Council and matters of state sovereignty; the trade and economic issues, as to who will benefit most, and how, under CER; the commercial issues, about the need for specialist courts and judges to handle complex cases involving essentially trade issues; and the jurisprudential issues, touching on such things as whether the problems we are facing in achieving closer links with Australia are really nothing more than expanded versions of the same relations that are at present under some strain (and scrutiny) between the Federal and State Governments in Australia over such things as the Tasmanian Dam.

He has skilfully drawn together many of the issues to develop a thesis of perhaps deceptive simplicity and seemingly impeccable logic. He has left few stones unturned. And yet from his remarks, I cannot help but be left with the impression that under each stone there is a viper of one kind or another lurking in wait for the intrepid reformer to step within its reach.
Each stone obviously has to be approached not just with caution and restraint, but also with trepidation. Indeed some must be avoided altogether. For instance I want immediately to lay to rest any suggestion of some sort of Australasian political union. Mine is not a jingoistic reaction from a politician in a small state. I simply do not believe that any balance of advantage has been demonstrated. Indeed the only benefit would be that they'd get a good cricket team; we'd get a good rugby team; and an Australian horse would win the Melbourne Cup!

Mr Justice Kirby suggests that the original foundations for CER were first laid almost a hundred years ago. In fact it may have been even earlier. It was in 1783 that James Matra, a midshipman on Captain Cook's "Endeavour", pressed for the colonisation of New South Wales and drew attention to the advantages that it would gain from trade with New Zealand, particularly the flax trade which did develop and prosper after the colony was established. Indeed those acquainted with the thesis developed in Geoffrey Blamey's "The Tyranny of Distance" will know that access to such products and resources may have been one of the underlying reasons for the foundation of the penal colony at Sydney.

Moreover the spirit of CER was clearly evident in 1901 when William Pember Reeves wrote to the then New Zealand Premier Richard Seddon saying "for my own part, as you will know, I do not think we ought to enter the [Australian] Federation, though I do think we ought to make a working agreement with Australia on-such matters as defence, customs tariff etc ..."
Because of the geographical isolation of New Zealand and Australia, European colonisation and the common cultural origins of their white settlers; and because we have always faced similar problems both in dealing with other countries and breaking into foreign markets; it has always seemed inevitable that we should move closer together at least economically.

But, as I say, I do not believe that such movement will ever reach the stage of complete union.

Nonetheless closer links in many areas are obviously both likely and highly desirable; and CER clearly paves the way for the development of such links.

A TRANS-NATIONAL COURT?

As to the principal options for a new trans-national court structure for New Zealand and Australia that Mr Justice Kirby discusses in his paper I must say that, although all seem possible, none at the moment seem very probable.

I have previously said that in my view the continuation of a right of appeal to the Privy Council from New Zealand is an anachronism; and that in due time it should come to an end. There has been sufficient support for that view (although also I concede considerable opposition) to lead me to believe that, in time, it will become a reality. Indeed, in my recent discussions
in Australia, lawyer-politicians of both major parties expressed surprise that the question of abolition is still an issue in New Zealand. However I have also accepted the need for the retention of a two-tier appellate structure. But whether that should be an entirely internal domestic structure or should include machinery for appeals to some external or regional judicial body is by no means an easy question to answer.

Personally I have considerable reservations about the suggestion of an external or regional court. Whether it be a regional Privy Council or a South Pacific appellate court I think that many of the objections that at present are raised to the Privy Council would continue to be equally valid. The three concerns of nationalism, social responsiveness of local judges and economic factors, as discussed on pages 15-17 of this paper are, in my view, almost overwhelming considerations.

I accept that a combination of the legal talents of judges in New Zealand and Australia could produce a "stronger" appellate bench than either country could provide on its own. And if, as Mr Justice Kirby suggests, Britain's further moves towards Europe might leave Australia and New Zealand as the "ultimate guardians of the Common Law grail", the idea becomes even more appealing.

But it must be recognised that the Common Law that once truly was a "common" law throughout most of the English speaking world has since developed in many different ways and with different emphases from one country to another; thus making it difficult
for judges, trained in one country and familiar with its laws and conventions, to have a proper understanding of both the background to different laws in other countries and the social conditions in which they are to be applied. Moreover, so much of the law that now comes before our courts is statutory, reflecting national perceptions of national economic and social policies.

The problem is perhaps analogous to that found in countries having a basically uniform language, but a variety of different dialects. Communication is always possible. The fundamentals are in common. But total understanding without much additional effort is often very difficult indeed.

Furthermore, both the differences in our legal systems and recent legislative developments would add quite considerably to the difficulties. New Zealand lawyers and judges, unfamiliar with the Australian Federal system and the provisions of the constitution, find it difficult to appreciate the constraints under which the Australian system operates. Similarly Australian lawyers and judges might well have difficulty in appreciating the effect of not having those constraints in New Zealand; from a distance, many find it hard to grasp the concept of a unicameral, unitary state with no formal written constitution.

I do not suggest that these difficulties would be insurmountable; but merely observe that they do exist. Things that are taken for granted in one country may not exist at all in, or may be anathema to, the other.
In many areas I doubt whether New Zealand's laws will ever be uniform with those of Australia. In some I doubt that we would want them to be; and vice versa.

One field that comes readily to mind is the law on personal injury by accident. Some work on this topic has been recently undertaken by the New South Wales Law Reform Commission. By our standards at least the recommendations are very timid. But they were undoubtedly pitched at what the Australian "market" would bear; obviously expectations in each country are rather different.

The same is undoubtedly true in other areas - such as large parts of the law of contract and commercial law.

Clearly the history, the social climate and even the balance of economic and political expectations will be reflected in legal and judicial approaches in each country.

So, what we would each be doing if we abandoned appeals to the Privy Council - or in Australia, more correctly, abolished the last vestiges of appeal - and then replaced them with appeals to some other sort of reconstituted (but closer to home) judicial authority; would be to replace one group with a number of known and accepted disadvantages with another with very similar disadvantages. The result in real terms would be little overall improvement.
Without the overriding link of formal union with Australia (and as I have made it clear that I do not favour nor do I believe that it will eventuate) I doubt that such an arrangement would ever operate satisfactorily for either Australian or New Zealand litigants.

In Australia of course, appeals to the Privy Council have already been abandoned in Federal cases, and are soon to be abolished in all State cases; so that shortly the final appellate court for all cases will be the High Court of Australia. The question of Privy Council appeals is undoubtedly a political issue, in that the final decision on retention or abolition must be made by politicians; although happily in neither country has it become a party political issue. Nonetheless political reality makes it highly unlikely that in the absence of political union politicians, having taken the significant step to abolish appeals to the Judicial Committee, would then put in its place another court of international character. It is simply not realistic to suppose that Australians would to resile from their recently achieved judicial autonomy and submit to the authority of a newly created composite court for Australasia or the South Pacific.

Certainly political reality in New Zealand is such that there would be a general unwillingness, if and when we do abolish appeals to the Privy Council, then to subject the decisions of our own courts to a further appeal to the High Court of Australia or a Pacific court.

There we have the essence of the dilemma.
The High Court is, of course a highly respected appellate body, and I admire Mr Justice Kirby's ingenuity in pointing out how simple it would be to arrange for New Zealand appeals to be taken to that court; either through federation under the terms of the Australian Constitution (which make specific provision for New Zealand's admission) or through an Act similar to that already in place for the Republic of Nauru.

However, I think I can safely say that however high the standing of the High Court, and however simple it might be for us to arrange for it to hear our appeals, there is nonetheless very little likelihood of that ever happening.

On the other hand, however, the notion of a commercial court or some other specialist court being set up to deal specifically with problems of CER trade and to provide uniform interpretation of CER inspired laws does have some greater attraction.

Nonetheless, in his paper, Mr Justice Kirby points to the constitutional difficulties in Australia facing the establishment of such a court. I suspect that the difficulties could be just as great in New Zealand - at least in a political sense - even though we are not confronted by the rigidly constricting effects of a formal written constitution.

Moreover the problems of who should sit on such a court, what they should decide, and what effect their decisions would have in each country (and what appeals should lie - and to where) would be potentially never-ending.
Nonetheless I want to make it clear I personally have no philosophical or conceptual objection to the basic idea of a trans-Tasman commercial court or a specialised CER tribunal. I can see many practical advantages that would flow to those people - the traders - on whom the ultimate success of CER will depend. I see in such a proposal no greater denial of national identity than is inherent in CER itself.

But I do see many practical difficulties that will not be easily overcome.

And so; in the short term we may have to accept the need to concentrate attention on harmonising our commercial and trade practice laws. To that end active New Zealand participation in Australian law reform work, meetings of Attorneys-General and other activities aimed at promoting uniform legislation throughout Australia seem to me to provide a more realistic short term objective.

New Zealand participation in Australian law reform activities already occurs to a limited extent. As Attorney-General for New Zealand I regularly attend meetings of the Australian Standing Committee of Attorneys-General; and there is a continuing flow of information between officials regarding the reforms and uniform law proposals that are considered at such meetings. A continuation and expansion of these de facto links is obviously both useful and important.
In addition, I see an urgent need to liberalise requirements for the admission of lawyers from one jurisdiction who seek to practice before the courts of another. With the expansion of trade through CER the demand for reciprocal admission rules will doubtless increase.

Obviously some nice legal points could arise because of the divided nature of the profession in some Australian states; the admission of lawyers as both barristers and solicitors in New Zealand; and even the different admission requirements of the various Australian States. However, with appropriate co-operation and goodwill on both sides, I am certain that these need not be a source of long term difficulty.

Beyond that, however, at a practical level lawyers acting for clients engaged in trans-Tasman trade will need to be far more aware of differences in our respective laws and legal systems.

So far as it is possible harmonisation of laws would obviously help in this regard. But even that can only go so far.

It will never mean that New Zealand or Australia will blindly follow what has been done by the other. Just as the Australian States cannot at present agree amongst themselves to uniform laws on matters such as credit contracts, trade practices, corporation and securities matters, and a host of other topics; so would the inclusion of New Zealand in such negotiations add a further complication and make differences even more likely.
Indeed we may not be far from the point where the work of the Australian Ministerial Council for Companies and Securities should be expanded to include New Zealand participation. That may well be a sound first step towards achieving harmony in our commercial and trade practice laws.

In fact it may well be that the commercial community itself will call for harmony. Fortunately experience has shown that in such circumstances commercial laws are among the most easily aligned, and usually are those in respect of which international agreement can be most easily achieved.

In short: everyone has something practical to gain from such harmonisation. Indeed there are already many existing trade conventions that form the basis of domestic laws in many countries.

However, numerous difficulties can arise from efforts to achieve harmony particularly when in one country there is no single law applicable.

Australian trade practice laws provide a good example. These are regulated on the basis of Federal laws if the trader is a company or if it trades inter-state, but on the basis of State law if he isn't incorporated and trades solely within one State. There are extensive differences between the Federal law, and the various State laws.
With which should we try to align?

At this stage I don't know the answer. The obvious and simple solution is to align with the Federal (or Commonwealth) law; but that may not be much use to the New Zealander who wants to trade solely in, say, New South Wales. Thus it is clear that harmony between some New Zealand laws and those of Australia may be as difficult to achieve as is uniformity between the laws of the individual Australian states. In fact uniformity of State laws may well be a prerequisite for any significant degree of harmonisation between Australia and New Zealand.

As to the difficulties with such matters as service and execution of process between New Zealand and Australia, I am certain these can and should be quickly corrected. We already do have a certain degree of reciprocal recognition of courts and court orders. For example in the family law field we have special reciprocal provisions for recognising and enforcing maintenance and custody orders. However there is obviously room for further reciprocity; and I certainly will not be averse to any new proposals.

If the Australian Law Reform Commission does decide to expand its reference on this subject to include service and execution of Australian processes in New Zealand, and vice versa, its recommendations could possibly be a suitable basis for reciprocal action in both countries.
The point is well made throughout the paper that New Zealand and Australia have always had a special relationship. Close economic and political links between our two countries have always made very good sense; and movements to strengthen and develop those links to the advantage of both countries have always seemed highly desirable.

The New Zealand and Australia Free Trade Agreement (NAFTA) of the mid 1960's and now the Closer Economic Relationship (CER) provide both the impetus and a formal structure around which this process can occur.

It is now up to the traders - and their lawyers - to take the next steps and deal with the practical and legal problems that remain.
Commentary on:

C.E.R. — A TRANS TASMAN COURT?

Paper presented by Hon. Mr Justice M.D. Kirby — Page 16, Part I.

by

Taken from remarks commenting on paper "CER - A Trans-Tasman Court?" delivered by Hon Mr Justice Kirby to the Legal Research Foundation's Seminar "CER - The Business & Law Essentials" held at the University of Auckland, 22-23 July 1983

To be a sovereign state, even a small one, is a very different matter from being a state in a federation.

Federation is not congenial to the New Zealand political experience. I do not think we would take kindly to it. I am doubtful that we would benefit from it.

There are suggestions in the paper that New Zealand could possibly be admitted to the Australian Federation as two states. As a South Island MP in New Zealand it may be thought that I should pause to consider the implications of that. I do. I predict it will not happen - despite the generous and charitable instincts of the Australians. It will not happen because New Zealanders will continue to cherish their independence.

The only chance of New Zealand merging with Australia would be if we faced a further 20 years of sustained economic adversity. We could be driven to it by the poverty of our economic performance. The sort of scenario which would bring us to it would be painful economically, socially and psychologically.

I do not expect it to take place. The future should look kindly on our part of the world.

Australia, we must remember, is bound to become a more important place in the world with each decade that passes. We must become even more closely involved with them or risk becoming an isolated and somewhat primitive backwater, as I said in a 1982 paper which Mr Justice Kirby was kind enough to quote.
In that paper I also pointed out the contribution will not be all one way. New Zealand social welfare schemes have often been models for Australian development.

I am actually one of two New Zealanders who were once involved in an exercise in 1973-75, the basic purpose of which was to give the Australians the benefit of New Zealand thinking about accident compensation.

It was an unforgettable experience. It was a bold piece of Trans-Tasman vision on the part of Gough Whitlam to try and translate a New Zealand social experiment to Australia. It has not yet taken root there.

It was an experience which convinced me that social experiments are easier to legislate in New Zealand. A federal state is so profoundly different from a unitary state in this respect that it still comes to my mind often as I sit in the New Zealand Parliament.

One of the challenges we faced was the Australian Constitution Act. I have, therefore, a special regard for what Mr Justice Kirby terms in his paper "the specially sophisticated intellectualism and legalism of a federal polity". As a person who spent even more time in the United States than Australia in the law I would interpolate the remark that the Australian federal polity seemed to some of us to be dominated by what the Americans would call a climate of the most strict construction.

It remains my opinion, as it was in 1982, that shared institutions must develop as a result of CER. The possible shape of these shared institutions is in one respect made clearer in my mind by the paper.

Judicial institutions will not be the place where shared institutional commitment will begin. Shared trade or political institutions will have to come first. Judicial institutions arise from a polity. Building an Australian-New Zealand polity is a political task, not a legal one.
The process of building the polity should begin now. Practical legal problems of a commercial nature will certainly arise out of CER. They are likely to be of a kind which will be of a substantial irritant to the relationship. There is a legal need for authoritative means of settling such disputes. But the political commitment to supra-national institutions must come first. And when such institutions come they must not confine themselves to legal questions.

Mr Justice Kirby's excellent and comprehensive analysis persuades me a lot of things are not possible.

He demonstrated a number of conclusions with which I find it hard to disagree:

1. It is beyond the time when a regional Judicial Committee of the Privy Council could be established.
2. Use of the High Court of Australia is practicable only if there is federation which will not occur.
3. A Court of Appeal for the South Pacific does not address itself to the legal problems arising from CER.
4. A special Trans-Tasman Commercial Court appears to be an attractive possibility - there are real problems in making it work, especially on the Australian side.

We are left with a number of more prosaic but also more practical suggestions: dual commissions, arbitration, service and execution of process, and professional contact.

I see no harm in those suggestions. Solid practical advances may flow from them. I confess, however, they leave me unsatisfied.

I share with Mr Justice Kirby the desire to infuse the Australian-New Zealand relationship with excitement and vision.

I can see why the Judge arrives at the conclusion anything short of New Zealand joining the federation will not do (he does not say exactly that but it is implied). My difficulty is that I cannot see that federation is politically either saleable or desirable.
The risk which flows from this conclusion is that CER will drift into the same sort of doldrums that NAFTA became - boring trade negotiations of limited significance.

I know that is not enough. But I cannot see the way out of the tunnel.

We owe Mr Justice Kirby a debt for exhibiting so clearly the sterility of our present plight.

The answer lies in developing an Australian-New Zealand polity. I hope it will happen.
Commentary on:

AUSTRALIA — NEW ZEALAND RELATIONS: THE CLOSER ECONOMIC RELATIONS AGREEMENT IN CONTEXT

Paper presented by Alan Burnett — Page 59, Part I.

by

Kerrin Vautier B.A.(V.U.W.), Research Economist, Auckland, Member of N.Z. Planning Council
AUSTRALIA-NEW ZEALAND RELATIONS: THE CER IN CONTEXT

Commentary by Kerrin M. Vautier Consulting Research Economist

"CER In Context" is one of those deliciously broad topics that allows considerable freedom to authors and commentators in the way it is interpreted. Which context? Alan Burnett chooses three.

First, the CER Agreement is viewed as part of the wider ANZ community relationship that has developed historically. Secondly, CER is viewed amidst speculation ("perhaps an expectation") that, as NAFTA was a stepping stone to CER, so might CER be a stepping stone to a customs union, with all that that implies. What is lacking in this area, however, is a time context, although the gradual evolution which Mr Burnett refers to implies a longer term perspective.

Thirdly, the paper brings the political context to the fore - that is the context which, in Mr Burnett's view, will have a marked influence on whether CER falters or flourishes; and, if the latter, a marked influence on what form the new growth takes.

Three aspects of the political context are identified. First, political structures - the institutional and constitutional arrangements that distinguish Australia and New Zealand; secondly, political style - although I am reluctant to assume that stylistic aberrations will be typical of the future style of New Zealand politics; and, thirdly, political "realities" - the various pressures that can be applied to politicians, particularly when there is poor economic performance and unemployment on the home front. First and foremost, politicians have to be seen to be accountable to their electorates. This point lies behind Mr Burnett's statement that even the present labour mobility across the Tasman should not be taken for granted;
although, if there were a dramatic change in this respect, the whole ANZ community concept - and not just CER - would presumably be weakened. The political realities serve as a timely reminder of the fragility of international arrangements.

Now let me focus on the second context to which I referred: the possible path of the stepping stones. There are those who adhere to the view that New Zealand and Australia have a free trade agreement that is planned, certain and open-ended, but that is the end of the path as far as a formal development of the trans-Tasman relationship is concerned. There are those who recognize that while a customs union has been foreshadowed in the Agreement, it has not been made an explicit objective; theirs is a cautious approach to what could be a very slippery stone. Then there are those who see as inevitable much broader economic harmonisation and, ultimately, political union.

The boundaries are not as clear-cut as this catalogue of views implies. There is a certain logic in the progression from one step to the other. For example, a common external tariff may be the best response to the problem of "intermediate goods"; but then there are exchange rate and political implications, as the paper points out.

By asking whether it is sensible for Australia and New Zealand either to hasten the progress of CER into a customs union, or to allow it gradually to come about, Mr Burnett appears to be eliminating the option of no customs union. But, even to be suggesting possible out-growths from CER is indicative of the marked change in attitudes that has taken place since New Zealand manufacturers made those tentative steps through NAFTA to widen their home-base. The nature and pace of future change will very much depend on the amount of confidence
that can be engendered in the business sector from CER in operation.

The paper does not cover what benefits might follow an even closer economic relationship between Australia and New Zealand. But, a better understanding of these would be an essential pre-requisite to moving in that direction.

In exploring some of the broad implications of greater policy harmonisation, Mr Burnett sounds a warning note; at least that is the conclusion I draw from his discussion of the EEC. That experience suggests that despite commitment, structures, and gradualism (or maybe because of structures and gradualism!) the EEC is not functioning as an effective customs union. Even if you resist the analogy, it highlights the distance and the rough passage between a free trade agreement, a customs union and an economic union. The paper thereby gives us a better idea of the long term implications for policy and economic management of coming to grips with the second generation issues arising from CER.

If there is to be a harmonisation game, it follows that the member countries will be starting from different positions; and they will have different views as to who is serving. Do we change or do they? I would like to pursue this question in the context of foreign investment - an issue which now has "one-and-a-half generation" status.

At present, there is definitely an unevenness in the opportunities available to Australian and New Zealand firms respectively to invest across the Tasman. At the same time, there appears to be an increasing presumption, at least in the business community, that trans-Tasman direct investment policies ought to be harmonised.
But this presumption does not seem to be based on a full understanding of the policy options or their implications (trans-Tasman and global).

Let us start with Mr Burnett's perspective on the issue. He points to a growing confidence on the part of Australian enterprises in New Zealand's medium to long term economic prospects, leading to investment; and to New Zealand's capacity (and I would add "desire") to invest offshore. The certainty of the CER trade provisions will itself have an impact on trans-Tasman investment decisions.

The paper also points to the collective freedoms provided in the Treaty of Rome, including free movement of capital and freedom of establishment. Indeed, there is a certain logic in coupling these features with the free movement of goods and labour. This logic rests on the assumption that the over-riding reason for promoting free trade is to encourage competitiveness through specialisation, and hence rationalisation, of production and production facilities. The location of capital, therefore, is an important parameter in the context of efficient resource allocation. But, of course, the issue is more than that. It is also one of ownership.

Mr Burnett mentions the possibility of the free movement of capital between Australia and New Zealand becoming a "right", expressed by amendment to CER. Later in the paper, however, he concludes that such an amendment, covering free movement of capital and freedom of establishment, is really outside the realm of the possible - mainly because of New Zealand fears of a net emigration of capital. But also, there is an Australian anxiety about pursuing a discriminatory foreign investment policy - discriminatory, that is, between different sources of foreign capital.
Australia has cited its Treaty of Friendship and Co-operation with Japan as an important constraint on its ability to change its investment rules with respect to New Zealand. But, to quote an optimist on these matters, "if the spirit is willing the text is weak"!

As well as looking at the trans-Tasman position, it is important to consider the global dimension of the foreign investment issue. If resources are internationally mobile, then it can be assumed that they will be attracted to the highest rate of return (assuming also a wide knowledge of investment opportunities). The question then arises as to whether or not it is to either Australia's or New Zealand's net economic advantage for at least one of those countries to discriminate in favour of foreign investment from the other. Might not firms undertake some investment because it is easier, rather than as a result of comparative economics, thereby foregoing more profitable opportunities in third countries? And, might not a preference for investment from, say, New Zealand, sometimes be at the expense of investment with a comparative advantage from third countries?

The OECD, for one, argues that the desirable direction of change - internationally - is the general freeing up of capital flows. But, accepting Mr Burnett's conclusion that this is unlikely to happen in the trans-Tasman context in the near future, might it not be appropriate to consider possible intermediate positions? A greater airing of the options would seem to be a necessary response to the presumption that trans-Tasman investment policies ought to be harmonised.

Important differences between the Foreign Investment Review Board's (FIRB) and the Overseas Investment Commission's (OIC) policy implementation are, first: takeovers by foreign companies come under FIRB scrutiny if foreign equity is to be 15 per cent or more. In New Zealand, OIC approval
is required if a foreign party wishes to acquire a shareholding of 25 per cent or more.
Secondly: the FIRB gives relatively greater weight to the extent of foreign ownership and control of individual enterprises.
Thirdly: the FIRB makes a practice of imposing conditions on approved investments, often with respect to future allowable equity holdings.
Fourthly: the FIRB sometimes requires a company to advise the media that it has entered into a takeover agreement subject to the Board's approval. This is clearly to alert Australian interests to the proposal so that they also have an opportunity to make an offer. This practice is questionable from a commercial point of view, irrespective of the source of foreign capital.

Possible "intermediate positions" could include the following. First: the FIRB could formally or informally recognize CER as one of the relevant criteria for considering the national benefit derived from foreign investment proposals. This would not, however, serve as a guarantee that CER considerations would over-ride equity considerations.
Secondly: Australia's equity benchmark of 15 per cent could be altered to 25 per cent to be consistent with New Zealand practice. (At least this would allow New Zealand companies to adopt equity accounting, with respect to their interests in Australia, without having to go through the FIRB's formal procedures).

There remains the question as to why New Zealand firms regard significant part-ownership and control of investment in Australia as essential for achieving the rationalisation objective that is inherent in the Agreement, and for deriving national benefit from CER. Will increased ownership of itself facilitate the rationalisation process through a freer flow of information, technical and managerial skills?
I am hoping to research this area more closely in the next few months. It will be interesting to do case-studies of firms which, in the past, have made cross-investment decisions in the name of rationalisation, whether or not in anticipation of CER.

There seems little doubt that Australia's and New Zealand's foreign investment policies will be amongst the set of policies that will influence not only the magnitude of the benefits from CER but also their distribution as between the two member countries. But we need to know more about how different stances on foreign investment are likely to affect the size and distribution of the benefits.

Mr Burnett sees an important link between the distribution of benefits and the relative bargaining strength of the two countries in their future bilateral negotiations. (And he seemed to be giving notice from "big brother" that New Zealand has more to lose if it's naughty).

But there is also the wider question of the extent to which Australia and New Zealand can strengthen their collective bargaining position in respect of their trading and other relationships with the rest of the world. One of the major stepping stones is outwards: CER in the context of ASEAN and the Pacific Rim.
Commentary on:

TRANS TASMAN TAXATION
Paper presented by Dr R.L. Congreve — Page 3, Part II.

by

In his written paper Dr Congreve has, quite properly, addressed himself primarily to the major questions which surround New Zealand enterprises wishing to trade in Australia. In the spirit of C.E.R. my commentary will address not only those questions, but also some of the tax ramifications of Australian entities wishing to trade in New Zealand.

In this regard I expect that a number of you have already had occasion to advise Australian companies and businessmen when they seek to enter the New Zealand market. As a practical point, for the professional advisor, you will no doubt have noticed that, in general, the Australian businessmen of Corporate Executive has had a high degree of exposure to tax planning techniques and the possibly peculiar Australian view of taxation in general. It is an attitude which differs quite markedly from that of his New Zealand counterpart. Any closer relationship between the business communities of the two countries will, I suggest, do more to foster the tax planning industry and environment in New Zealand than vice versa.

There are of course at least two different ways in which to trade between the two countries. The first is relatively straight forward and involves continuing to do business in one's home country, be it New Zealand or Australia but nonetheless to conclude agreements of various sorts with the business community in the other. One presumes that at some time in the future it will be possible for both Australians and New Zealanders to take part in the other way of trade, which is to actually be in business in each other's country. Presumably Messrs Muldoon and Keating, if they be the true protagonists, will resolve their differences in this regard. Turning specifically to Dr Congreve's paper and my task of making commentary upon it I would prefer to start at the end. As an accountant, I find his suggestion of an Australasian Tax Court too horrendous to contemplate and I also find extremely disturbing the suggestion that more effort should be made in unifying tax systems or principles between the two countries. The reason for this, of course, is
that tax advisors in both jurisdictions are only too pleased to play-off the differences between the rules of one jurisdiction and those of the other to the benefit of their clients. This all notwithstanding the Double Tax Convention between the two countries.

Whether the investment is from Australia into New Zealand or from New Zealand into Australia, many of the basic tax questions are similar. In the specifics of course, the questions become more difficult and harder to answer but dealing with the relatively ordinary type of proposal with which one is faced, the questions may be summarised as:

1. The Structure - Representative Office, Branch or Subsidiary,
2. Regulatory authority requirements so far as they impinge upon either tax considerations or disclosure problems,
3. Executive remuneration and the taxation regime surrounding that,
4. Funding of the particular operation.

In view of my limited time-frame in this commentary I will make broad comments illustrated by a few specific examples of difficulties. With regard to difficulties which will become apparent with Australian legislation, I can only emphasise that it is not possible in tax to make any assumptions whatsoever about the Australian legislative or judicial reaction to a particular proposal. Local advice is essential and in this regard the Australian tax advisory scene differs somewhat from that of New Zealand.

It is worthwhile mentioning this difference because a number of you will no doubt be seeking Australian advice. In Australia, far more than in New Zealand, and this is particularly true in Sydney and Melbourne, the legal and accounting professions are in direct competition in the area of what I will describe as structural tax planning advice. Without wishing to give an unseemly puff to the Australian accounting profession in this regard, it is fair to say that a number of them are better at tax law than some members of the legal profession. Listen closely to your
Australian client as to where he takes his primary tax advice, establish your own relationships, no doubt mostly within the legal profession in the major cities and make rational use of what you judge at the time to be the best Australian tax advice. It is important also to understand that there are specialists in certain fields as indeed there are in New Zealand but the trend is more exaggerated in Australia.

In his paper Dr Congreve has mentioned the differing effect of Australian tax on a branch or subsidiary; the double tax treaty and the concept of industrial and commercial profits and the equally important concept of permanent establishment. I have here a slide which demonstrates no more than what Dr Congreve has said is the tax effect. The one point that I would note here, that Dr Congreve has not covered, is the somewhat grey area concerning the method in which export incentives are presently calculated based upon the consideration receivable less certain costs. Expressed simply in a sale to an Australian entity the F.O.B. price is taken as the base calculation point for export incentives. In a sale through a branch, of course, the New Zealand exporter is making his sale in Australia to his customer. There are however, all the direct costs related to the transportation and insurance of the goods to deduct from the selling price and the grey area exists over what other costs related to those goods once they have left the shore of New Zealand are in fact to be deducted. The argument is not simple, nor is it one which the New Zealand Revenue have yet come to grips with. Suffice it to say that care must be taken before making any assumptions concerning increasing export incentives by direct sale through a branch. The second slide covers the case of an Australian coming into New Zealand presuming that he will ever be able to do so again, with no account taken of the Australian export market development expenditure grants or allowances.

It is with some sadness that I know turn to Section 23q of the Australian Income Tax Assessment Act. Section 23q is like a troublesome mistress in that it has caused joy and heartache: moments of intense wonder that
something so marvellous could exist and days of deep despondency when the difficulties and problems it creates appear to be insuperable. The despondency is caused only because, it appears from statements of the new government in Australia that Section 23q will die and be replaced by that great leveller: a foreign tax credit system. For those who are not familiar with Section 23q of the Australian Income Tax Assessment Act, it is a magnificent little animal and provides, broadly, that income sourced in a foreign country which is subject to an income tax in that foreign country shall be exempt from income tax in Australia. Let me give you some examples of the vagaries of 23q.

In the good old days before Australia outlawed cross-border leverage leasing, it was possible for Australian equity partners to achieve capital related deductions on assets utilised in New Zealand amongst other countries. However, problems clearly arise if the income from such lease transactions could be seen to be sourced in New Zealand and taxed in New Zealand. Section 243(2) (p.a.) of the New Zealand Income Tax Act deems, a New Zealand source to income arising from a number of such transactions. There would always be a question about the "real" source as compared to the deemed source particularly if New Zealand chose to tax the transaction. The effect, of course, would be that the income being sheltered from the effects of Australian taxation by virtue of the exemption granted by Section 23q, would cause the capital related deductions to be not available to the Australian partners as the income was not assessable income. I leave it to you to ponder on how and in what circumstances these problems were solved.

Another difficulty relating to Section 23q and New Zealand operations involves a loss-making Australian parent and a profit making New Zealand branch. Due to the operation of Australian loss provisions it is possible for Australian sourced losses to be eaten away and not be available for future use because of New Zealand profits of the same entity. This despite the taxing in New Zealand of those profits. Structural solutions to this particular problem abound. But I have
observed poor pre-planning resulting in such Australian losses being lost forever.

On a lighter note the way to make friends and influence people as a tax advisor, is to ease the Company Directors' own personal tax problems: 23q has been, up to now, a device whereby this can be achieved easily. Any income such as Directors fees paid in New Zealand by a New Zealand entity for services rendered in New Zealand will not achieve treaty protection. The effect, of course, is that they are taxed in New Zealand and achieve Section 23q exemption in Australia for the Australian resident director. As part of an overall employment package it brings smiles to their faces.

If we move back now to a New Zealand enterprise wishing to trade in Australia and consider some of the funding difficulties, I bring to your attention the new Division 13 of the Income Tax Assessment Act. I have included as part of my written paper a New Zealand view of the new Division 13. I have done this because I consider that, at this stage, it is a part of the Australian Act to take very seriously. In brief the new Division 13 was brought into Australian law to counteract and correct the weaknesses exposed in the old Section 136. The old Australian Section 136 sought to give the Commissioner in Australia, in certain circumstances, the power to look toward the profits of an enterprise doing business in Australia and using certain specific criteria to determine a profit which he thought it should have made. Its weaknesses were glaring for years and were finally exposed in the Comalco case. The new Division 13, rather than looking towards an enterprise's profit, looks towards the arm's length nature of individual transactions or series of transactions, where an International transaction, as defined, takes place. Entire seminars have been devoted to Division 13 in Australia; perhaps they should be here, but this is not the place to go into great detail. I will however, give an example of how Division 13 might affect a particular common transaction. The primary purpose of Division 13 is to protect the Australian revenue and certain transactions are affected,
which are not in the purview of the Double Tax Treaty. One of these concerns the loan from New Zealand to Australia of a sum of money from a parent to a subsidiary company.

If that loan is at nil interest or less than market interest, the Second Commissioner of Taxation has suggested that in certain circumstances Division 13 might be invoked. Let us imagine that that loan is made from a New Zealand parent to an Australian subsidiary which acts as a holding company for a number of Australian operational companies. That Australian holding company receives dividend income only from those operational companies. Such income is, under Australian law, fully rebatable. In this circumstance the Second Commissioner has suggested that if he deems interest to be payable to the New Zealand parent he will achieve a 10% tax on that (the limitation being due to the double taxation treaty) and the corresponding deduction which Division 13 makes him give to the deemed payer, will be set-off against the rebatable dividend income. In other words, no effective Australian deduction is available. The Australian revenue will be better off, the New Zealand taxpayer would have suffered 10% tax on interest income which he has not derived and, in my view, will not be eligible for a foreign tax credit in New Zealand as no income is assessable here.

Once again structural solutions are perfectly possible but have to be decided upon in advance. Of course, when contemplating such questions in New Zealand we are still governed in our domestic law by Section 22 which is remarkably similar to Section 136 of the Australian Act as it used to be whether a New Zealand court will be quite as strict in its interpretation of our Section 22 as the Australian court was of its 136 is another matter.

At this stage I think some mention should be made of source and source rules. A number of problems have arisen both in Australia and New Zealand, but particularly in Australia, concerning "source" and foreign tax credits. The essential element of both jurisdictions giving a credit
for foreign taxes paid and indeed that contained in the Double Tax Treaty is that the income concerned should have a source in the country whose taxpayer seeks to have the foreign tax credited against his domestic tax liability. Care must be taken in both jurisdictions in looking at statutorily imposed "source", that is deemed source; where such a source may not exist in general law for the particular income. The problem is self evident. The New Zealand Commissioner, may by virtue of statutory provisions, deem income of a particular character to have a source in New Zealand and to be taxable accordingly in the hands of a non-resident. But the Australian Commissioner could deem that same income by virtue of different statutory rules or by virtue of the operation of general law only to have a source in Australia. The Australian Commissioner may decide in such circumstances not to give the relevant tax credit. And while we are talking about foreign tax credits it is also worthwhile noting that both jurisdictions will give a foreign tax credit only so far as the domestic tax would have run against the particular income concerned. Problems have in the past occurred and may do so again where a question arises to the priority of incentive tax credits as compared to foreign tax credits.

Although New Zealand has fairly recently amended it's statutory provisions relating to priority of tax credits (Section 293(2A)) to allow for a foreign tax credit to be granted against New Zealand tax payable prior to the application of certain export incentive oriented provisions, it is nonetheless a limited correction of a problem. The reason being that section 156F in relation to export market development expenditure, apparently takes priority over the foreign tax credits resulting in certain circumstances in a loss of the foreign tax credit against New Zealand income tax, for all time.

No commentary on Australasian taxation within C.E.R. would be complete without a mention of sales tax. Sales tax is a much more important animal in Australia than it is in New Zealand. This applies both to professional advisors and to sales tax payers or more accurately sales
tax collectors. The rates, while not being necessarily as high as those applicable in New Zealand, are rising and the range of goods upon which the sales tax is levied is getting wider - subject to Senate approval of course - and the entire subject matter is one that should be taken seriously by a New Zealander wishing to trade in Australia. Naturally, no rationalisation of approach or even rates has been made between the two countries. Perhaps the greatest danger facing the New Zealand enterprise wishing to trade in Australia is one of simply leaving the problem too long before enquiries are made. If the goods in question are not taxable in New Zealand, then it is understandable that the question is not raised in time. Sales tax in Australia is levied more or less on the same basis as it is levied in New Zealand. That basis is that it operates as a wholesale tax usually levied on the last wholesale sale of goods, but this situation varies in a number of circumstances, the actual method of trading and structure for income tax purposes may not be totally appropriate for sales tax purposes. It is important that the relevant advice is taken before matters have progressed too far for remedial action.

Having said this, however, and having made my other comments regarding the care to be taken by both Australians and New Zealanders I have tried to find a simple idea to correspond with Robin's suggestion of an Australasian Tax Court. My own expression is borrowed from the most bloody minded member of the EEC. "Vive la difference"
1. History

The originating enactment of Division 13 ("Div.13") was section 31 of the Income (No.2) Act 1915 (U.K.) which became in turn, section 23 of the Income tax Assessment Act 1915 - 1921, section 28 of the Income Tax Assessment Act 1922, and then the former section 136 of the Income Tax Assessment Act 1936 ("the ITAA"). The new Div.13 (section 136AA to section 136AG of the ITAA) was substituted for the former section 136 by the 1982 Amendment Act. The provisions of the new Div.13 apply to income derived and expenditure incurred after 27 May 1981. The former section 136 applies to income and deductions incurred prior to that date provided that the Commissioner is of the opinion that they are appropriately related to that period.

Div.13 aims to eliminate the removal of profits from the Australian tax regime, whether by transfer pricing or other means of international tax avoidance, where there are either separate entities involved or one entity who conducts business in another country through a branch or permanent establishment.

2. The Former Section 136
The former section 136 gave the Commissioner a discretion to adopt, as taxable income of the taxpayer, such an amount of the total receipts of the business as he determined, once it appeared to him that there was an income deficiency when compared to the taxable income that may have been expected to arise from that business.

Three conditions had to be satisfied before an assessment under the former section 136 could be made:

(a) the business had to be carried on in Australia;

(b) there had to be non-resident control as provided by the section; and,

(c) it had to appear to the Commissioner that the business produced either no taxable income, or less than the amount of taxable income which may have been expected to arise from the business.

Problems with this provision, as outlined in the Explanatory Memorandum to the legislation which abolished it, were:

"(a) the section, in general, applied to non-residents who engage in international profit shifting and does not set
out to deal with Australian residents engaging in such activities;

(b) the limitation to business income may preclude application of the section to rents, interest, or other transactions not clearly linked to a business;

(c) the section may only apply to companies and not to other entities such as individuals and trusts;

(d) the section is inadequate to impute the derivation of income in a transaction which would produce income if it were one between independent parties, such as an interest-free loan to an off-shore associate;

(e) the section's link with total receipts could be unduly restrictive - it could mean that even where total receipts have been reduced by a tax avoidance arrangement, the Commissioner would be unable to look beyond the reduced amount in determining taxable income."

The operation of the section could also be avoided by either interposing another resident company between the company carrying on the Australian business and the non-resident, or arranging for residents to hold preference shares which constituted a majority of the shares, while the controlling
shares were held by non-residents.

The requirement that the business which was carried on in Australia had to be "controlled principally by non-residents" was held by the Courts to look to de facto or actual control and not to the capacity to control. That is, if the Directors of a resident company controlled that company's business from within Australia and if there was no evidence of interference with the management of the business by the non-residential shareholders, the company would not be held to be controlled principally by non-residents. This also limited the application of Div.13.

3. The Present Division 13

The new Div.13 allows the Commissioner to reallocate income arising from an "international agreement" where no, or insufficient, consideration passes under the agreement, where he is satisfied that the parties were not dealing at arm's length and that the consideration given was not an arm's length consideration. The Commissioner can impute or create income where necessary to give effect to the arm's length principle.

The provisions are limited to international transactions and will not affect purely domestic transactions with no international element. The provisions also do not affect
transactions concerning a business carried on by non-residents in Australia at or through a permanent establishment unless either non-resident without a permanent establishment, or a resident with a foreign permanent establishment, is also involved. Transactions between residents would only be caught where at least one resident carries on business outside Australia and the transaction concerns the non-resident business. Thus the threshold test of non-resident control of a business has been removed so that specific 'control' situations are not required.

The question asked by the Commissioner prior to invoking Div.13 is no longer whether the taxable income of the business is insufficient, but whether there are arm's length dealings in relation to a particular supply or acquisition of goods or services and then whether the consideration paid or received is less than an arm's length consideration.

In summary, the transactions which are aimed at reducing the liability to Australian income tax must have the following before the Commissioner may exercise his discretion to invoke Div.13:

(a) an international agreement;
(b) non-arm's length dealing;
(c) non-arm's length consideration.
Once he has invoked Div.13 and prior to the issue of an assessment, he must determine the sources of the income, reallocate the income and make consequential adjustments if he considers the adjustments necessary.

4. International Agreement

An "international agreement" is a necessary requirement for Div.13 to operate. An agreement is an international agreement if:

(a) a non-resident supplied or acquired property under the agreement otherwise than in connection with a business carried on in Australia by the non-resident at or through a permanent establishment of the non-resident in Australia; or,

(b) a resident carrying on a business outside Australia supplied or acquired property under the agreement, being property supplied or acquired in connection with that business.

As stated previously, transactions concerning a business carried on in Australia by a non-resident at or through a permanent
establishment are excluded, unless the transaction involves either another non-resident with no permanent establishment or a resident with a foreign permanent establishment.

"Agreement" is defined to include all types of formal and informal arrangements and understandings. "Property", "services", "supply" and "acquire" are also widely defined. "Permanent establishment" includes a place where any property of the taxpayer is manufactured or processed, either by the taxpayer or by another person.

5. **Arm's Length Transaction**

Before the Commissioner can reallocate the taxpayer's assessable income, he must be satisfied that two or more parties to the international agreement were not dealing at arm's length with each other.

To reach his conclusion, he must have regard to "any connection between any two or more of the parties to the relevant agreement or any other relevant circumstance".

This gives him an extremely wide discretion but generally parties will not be arm's length if either one party controls the other, or both are under common control. However, it would
appear that "any connection" would include independent parties who have certain understandings with each other in relation to their dealings.

If, for example, a company in Australia bought a raw material from an independent supplier overseas, paying an inflated price because it sold the finished product at a correspondingly inflated price to an Australian affiliate of the overseas supplier, non-arm's length dealings would exist. The purchase by the interposed company would therefore be open to attack under Div.13.

6. Arm's Length Consideration

The price received or paid for the supply and requisition of property or services under the matrimonial agreement must be equal to an "arm's length consideration" which is defined to mean the consideration which might reasonably be expected to have been received and given had the dealings occurred between independent parties dealing at arm's length.

The arm's length principle is internationally accepted with regard to transfer pricing. It is also the method adopted by the O.E.C.D. in its Model Double Tax Convention.

The four methods of ascertaining arm's length prices (viz.
comparable uncontrolled price, resale price, cost price, any other method) could each give a different value, any one of which could be represented to be an arm's length price. However, once account is taken of the particular circumstances of the industry in question and the company's circumstances, the variety of methods and range of prices would narrow down to one appropriate method giving the most appropriate price. The fourth method would be implemented where it was not practicable or possible because of any reason (including insufficient information) for the Commissioner to determine what might be termed an "objective arm's length consideration".

7. Commissioner's Determination to Apply Provision

Once the Commissioner is satisfied that:

(a) there is an international agreement;
(b) the dealings are not at arm's length; and,
(c) the consideration passing is not an arm's length amount,

he must determine whether or not to invoke the provisions of Div.13. Once he decides to invoke Div.13, the arm's length consideration is substituted for the consideration which was decided on by the parties and is treated as the actual consideration for all purposes of the ITAA.
If, for example, an overseas company lent interest-free to its Australian subsidiary, the overseas lender would not derive the interest, subject to withholding tax of 10%. If such interest was imputed to the lender, the consequential adjustment provisions would probably require that a deduction be allowed to the borrower, saving the Australian subsidiary tax at the rate of 46%. As the non-payment of interest would also mean that there would ultimately be a flow of dividends subject to dividend withholding tax, invoking the Division would not benefit the Australian Revenue. Thus the provisions would not be invoked by the Commissioner.

8. Territorial Source of Income

Once Div.13 is invoked, questions may arise as to the source of the income. The Commissioner must have regard to the nature and extent of any relevant business carried on by the taxpayer, the place or places at which it is carried on and the degree to which it operates in different countries.

Where a non-resident carries on business in Australia through a branch or other permanent establishment, the profit shifting is achieved by means of book transactions within the one legal entity and not between two or more parties.
Where the transactions involve the one legal entity, before the Commissioner can invoke Div.13, it must be shown that:

(1) a resident taxpayer carries on business through a P.E. in another country or a non-resident carries on business through a P.E. in Australia;

(2) the ordinary reallocation provisions cannot apply because two or more parties are not involved;

(3) a question has arisen as to the source of income or deductions;

(4) the question if determined according to the contents of the tax return would produce a "tax result" more favourable than if the Commissioner exercised his power of reallocation; and,

(5) finally, the Commissioner must hold the opinion that the derivation of income or incurring of deductions is wholly or partly attributable to the activities of the taxpayer at the P.E.

Before the taxable income of the permanent establishment or branch is reduced by the operation of Div.13, consideration must
be given to what might have reasonably been expected to occur if the permanent establishment was a distinct and separate entity dealing at arm's length.

9. **Compensating Adjustments**

Once the Commissioner has exercised his power to reallocate income to one party, there may be a need to consequentially adjust the assessable income of the other party. For example, if a non-resident lends to a resident at an excessive interest rate, there would be a reduction in the resident borrower's interest deduction so that only the arm's length interest rate would be deductible for the purposes. The interest income of the non-resident should be reduced by a similar amount, and consequently the Australian interest withholding tax which would have been imposed on the original amount.

Before the Commissioner can make a compensating adjustment, he must be of the opinion that:

1. (a) income is included in assessable income of a taxpayer which could not have been included if the parties were independent and dealing at arm's length; and

(b) that a deduction would be allowable if the parties
were dealing independently at arms length; and

(2) it is fair and reasonable that the income should not be included or the deduction should be allowed.

Once he is satisfied of the above, he would be obligated to make the adjustment only if, in his opinion, it was fair and reasonable to do so.

10. **Double Tax Treaties**

Where Australia has a Double Tax Treaty with the non-resident party's country, the provisions of the relevant Treaty will take precedence over the operation of Div.13. As there are provisions in the Treaties which provide for the reconstruction of accounts where necessary, on an arm's length basis, both Division 13 and the Double Tax Treaties would have a similar effect in relation to the area of international tax avoidance.

In some instances, where the treaties themselves give precedence to the domestic law, Division 13 will always operate if the taxpayer is an Australian resident (see Arts 1(3) and 9(3) of the U.S./Australian Treaty).

11. **Penalties**
The former section 136 and the Double Tax Treaties carry no penalty consequences.

The new Div.13 provides for a statutory penalty which also applies to the application of the corresponding tax treaty provisions. It is calculated at the rate of 10% on the difference between the taxable income as returned and the taxable income as adjusted pursuant to Div.13, from the due date of the lodgment of the taxpayer's return to the date when an assessment is made under Div.13 or a related treaty provision.

The penalty provisions were enacted to dissuade companies from using transfer pricing practices and/or lodging their returns calculated on the basis of non-arm's length pricing.

II. EFFECT OF DIVISION 13 ON TRANSFER PRICING

Transfer Pricing is the practice whereby a resident company sells to an affiliate in a "lower tax country" goods at a low price so as to reduce the resident company's profit from the sale. The affiliate company would then sell the goods to the eventual purchaser at a higher price. The affiliate company in the lower tax situation thus
makes the greater profit from the transaction. The technique can also be used for transactions involving royalty payments, loans with or without interest, provision of services and the leasing of equipment or other property. The overall effect is that taxable profits are diverted into a lower tax country thus lessening tax revenue received in the resident's country. The former section 136 would have asked, "Is the taxable income of the resident company insufficient?" The new section 136 looks to the presence or absence of an international agreement, non-arm's length dealing in relation to a particular supply or acquisition of goods or services and non-arm's length consideration leading to a detrimental effect on the Australian Revenue.

Once the Commissioner invokes Div.13, the price paid or received by the Australian resident would be amended to become an arm's length consideration and tax on the resulting profits would be levied accordingly. The Australian resident would also have to pay the 10% penalty on that additional tax.

The reallocation of income could thus, in effect, produce a form of double taxation where the tax authorities in one country will tax the amount they have reallocated, but the compensating adjustment by the tax authority in the other country (resulting in a lesser tax burden) may not be made.

There could also be uncertainty in business transactions where the
transfer pricing is carried out for non-tax considerations, as to
whether or not the transaction will be subject to examination by the
tax authorities and assessments altered accordingly.