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Common FIRB issues for private equity firms

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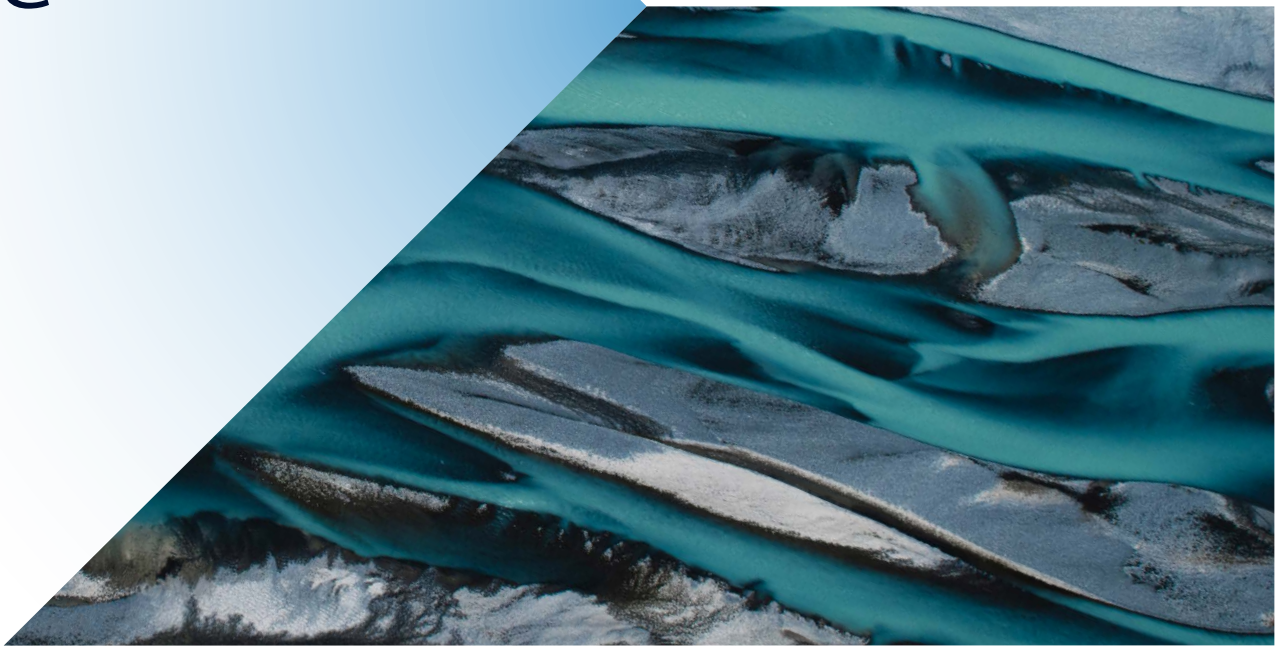

Key takeaways

Australia's foreign investment approval regime is complex. The tests governing whether a transaction requires foreign investment approval—commonly known as Foreign Investment Review Board (***FIRB***) approval—are complex and layered. There are differing ownership percentage thresholds, monetary thresholds and exemptions depending on the nature of the transaction, acquirer and target.

For private equity (***PE***) firms, the need to move quickly on proposed deals means it is essential that any FIRB approval requirement be identified early and that there be an efficient process for seeking such approval. It is also important that PE firms understand the issues that commonly arise in the course of a FIRB assessment. PE firms should also establish a system for attending to post-approval FIRB compliance requirements.

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PE firms commonly encounter FIRB issues due to the following:

PE funds often being classified as 'foreign government investors' and subject to more rigorous screening than other foreign persons, due to their sovereign wealth fund and public pension fund investors.

PE funds commonly seeking to acquire targets above the usual A$330 million FIRB approval threshold.

The need to disclose to FIRB the 5%+ investors in a PE fund in situations where the PE firm is often subject to confidentiality restrictions in the fund documents.

PE firms wanting to seek FIRB approval for a fund to undertake a transaction where such fund has yet to complete fundraising or is an open-ended fund.

Many PE fund portfolio companies becoming foreign government investors and needing to deal with the FIRB regime for the first time, which can impact bolt-on acquisitions and ordinary course land transactions.

Summary of common FIRB issues

Below is a summary of the common FIRB issues which PE firms commonly face. We explore these eight issues in further detail in this document.

1. Determining if the acquirer is a foreign government investor (***FGI***) and, therefore, subject to more extensive FIRB approval triggers than others.

2. Considering the potentially applicable FIRB approval triggers, which depend on various factors including FGI/non-FGI status, onshore transaction/offshore transaction, percentage interest to be acquired, nature of target and, in some cases, transaction value.

3. The need to disclose 5%+ investors in an acquirer entity and upstream funds.

4. How to seek FIRB approval for a fund acquirer where fundraising has yet to complete.

5. PE acquirers becoming subject to more extensive tax conditions requiring upfront notification to the ATO of certain post-transaction events, including capital and debt restructuring.

6. No fixed FIRB assessment periods, and requests for priority or expedited processing must be supported by compelling submissions.

7. Portfolio companies becoming foreign persons (and possibly also FGIs) and, therefore, becoming subject to the FIRB approval regime.

8. Understanding and complying with reporting obligations under the Register of Foreign Ownership of Australian Assets regime.

Assessing if a transaction requires FIRB approval

1. Determining if the acquirer is a foreign government investor (FGI) and therefore subject to more extensive FIRB approval triggers than others

Foreign government investors (***FGIs***) are subject to more extensive FIRB approval triggers than non-FGI foreign persons. As a general rule, an FGI needs FIRB approval to acquire a direct or traced 10%+ interest in an Australian entity irrespective of transaction value (see #4 below). Therefore, a logical first step is to ascertain if the acquirer entity for a proposed transaction is considered an FGI—unless its FGI/non-FGI status is already known.

FGIs include the obvious (such as government agencies, state-owned enterprises and sovereign wealth funds) and the not immediately obvious (such as public sector pension funds, public universities and entities with a particular level of FGI investors). In addition, it is possible, and indeed not uncommon, for a PE fund vehicle to be considered an FGI on account of there being a certain level of FGI investors in the fund vehicle, even if those investors are passive. Generally, an entity (such as a PE fund vehicle that is a limited partnership) will be considered an FGI if either:

- non-Australian Government or government-owned entities or other types of FGIs from the one country have an aggregate 20%+ equity interest or limited partnership interest in the entity; or
- non-Australian Government or government-owned entities or other types of FGIs from any two or more countries have an aggregate 40%+ equity interest or limited partnership in the entity (however this 40% test does not apply if what is known as the passive investor exemption applies—in summary the exemption applies if the entity is a fund where individual investors in the fund are not able to influence any individual investment decisions, or the management of any individual investments, of the fund).

The FGI analysis must be undertaken on a per fund vehicle basis, not aggregated fund basis. For example, if an acquirer entity is owned by three fund vehicles that are limited partnerships and that collectively comprise a single overall fund, the FGI/non-FGI status and percentage interests of the limited partners in each individual fund vehicle needs to be assessed. If any of the fund vehicles is an FGI and has a 20%+ interest in the acquirer entity, that causes the bidding entity to also be an FGI. Even if an FGI fund vehicle has a <20% limited partnership interest in the acquirer entity, that can still result in the acquirer entity being an FGI on the basis that all fund vehicles are associated with each other and, therefore, the FGI fund vehicle is taken to have a 100% FIRB interest in the acquirer entity. If there are further fund vehicles upstream, the FGI analysis must be undertaken in respect of each of those vehicles.

It is therefore recommended that PE firms seek to maintain records of the FGI/non-FGI status of the investors in their funds, so they can quickly identify the FGI/non-FGI status of their managed fund vehicles and have information ready for disclosure as part of a FIRB application (see #3 below).

A PE fund vehicle which is an FGI may be able to apply for a passive FGI exemption certificate (assuming their upstream investors are all passive investors) so that they are subject to the same FIRB approval percentage and monetary thresholds as non-FGI foreign persons. This would place the PE fund vehicle on a 'level-playing field' as other foreign persons.

2. Considering the potentially applicable FIRB approval triggers, which depend on various factors including FGI/non-FGI status, onshore transaction/offshore transaction, percentage interest to be acquired, nature of target and, in some cases, transaction value

Having determined if the acquirer entity is an FGI, the next step is to identify the potentially applicable FIRB approval triggers. There are different triggers depending on whether the proposed transaction involves a direct acquisition (an 'onshore transaction') or indirect acquisition (an 'offshore transaction') of interests in an Australian entity, business or land.

Enquiries should be undertaken to ascertain if any FIRB approval trigger applies. If the acquirer has due diligence access, tailored questions should be put to the target.

Internal restructures and continuation fund transactions can also trigger a FIRB approval requirement, even if they do not result in a change of ultimate ownership or change in the upstream PE sponsor.

Onshore transactions

Where an onshore transaction involves the acquisition by a foreign person of interests in an Australian entity, FIRB approval will generally be required in each of the following situations.

Note that each row sets out a separate FIRB approval trigger, so it is possible to need FIRB approval due to multiple triggers.

NATURE OF ACQUIRER ENTITY	% INTEREST TO BE ACQUIRED IN AUSTRALIAN TARGET	NATURE OF TARGET	MONETARY THRESHOLD(S) FOR THE 2024 CALENDAR YEAR
Foreign person who is also an FGI	10%+	Australian company or Australian unit trust.	Nil. FIRB approval required if percentage interest threshold met.
Foreign person (whether or not also an FGI)	10%+	Australian company or Australian unit trust that carries on a 'national security business' in Australia (generally being a business involved in or connected with: a 'critical infrastructure asset' in any one of 11 sectors (communications, financial services and markets, data storage and processing, defence, higher education and research, energy, food and grocery, healthcare and medical, space technology, transport, and water and sewerage), telecommunications, defence or a member of the national intelligence community (of either Australia or a foreign country), or their supply chains).	Nil. FIRB approval required if percentage interest threshold met.
Foreign person (whether or not also an FGI)	10%+	Australian company or Australian unit trust that carries on an Australian media business.	Nil. FIRB approval required if percentage interest threshold met.
Foreign person (whether or not also an FGI)	10%+	Australian company or Australian unit trust that carries on an Australian agribusiness.	Total of acquisition consideration and value of any existing interest in the target is >A$71 million
Foreign person (whether or not also an FGI)	10%+	Australian company or Australian unit trust that is an Australian land entity (ie it has >50% of its assets by value in the form of interests in Australian land).	Acquisition consideration exceeds applicable land monetary threshold, which depends on the type of land held by the target.
Foreign person (whether or not also an FGI)	20%+	Australian company that carries on an Australian business, or Australian unit trust.	Either of the following exceeds the applicable threshold (normally A$330 million): • target's total asset value; or • value of 100% of target's equity securities as implied by acquisition consideration.
Foreign person (whether or not also an FGI)	20%+	Australian company or Australian unit trust that is an Australian land entity (ie it has >50% of its assets by value in the form of interests in Australian land).	Acquisition consideration exceeds applicable land monetary threshold, which depends on the type of land held by the target's subsidiaries.
Foreign person (whether or not also an FGI)	20%+	Australian company or Australian unit trust that has a 20%+ interest in an Australian company or Australian unit trust that carries on a 'national security business' in Australia.	Nil. FIRB approval required if percentage interest threshold met.

Note: there can be situations where the above-mentioned 10%+ threshold instead becomes a >0% threshold, such as where the acquirer is in a position to influence central management or the policy of the target and (in relation to the acquisition of an interest in an unlisted Australian land entity and without limiting the foregoing) where the target invests in established dwellings.

Offshore transactions

Offshore transactions can trigger a FIRB approval requirement even where the target's Australian subsidiaries' assets and/or revenues are not material relative to the target group as a whole.

Where an offshore transaction involves the acquisition by a foreign person of interests in a non-Australian entity with one or more Australian subsidiaries, FIRB approval will generally be required in each of the following situations. Note that each row sets out a separate FIRB approval trigger, so it is possible to need FIRB approval due to multiple triggers.

NATURE OF ACQUIRER ENTITY	% INTEREST TO BE ACQUIRED IN NON-AUSTRALIAN TARGET	NATURE OF ANY ONE OR MORE OF TARGET'S AUSTRALIAN SUBSIDIARIES	MONETARY THRESHOLD(S)
Foreign person who is also an FGI	20%+	Australian company or Australian unit trust.	Nil. FIRB approval required if percentage interest threshold met. **However**, FIRB approval **not** required if the FGI de minimis exemption applies (see below).
Foreign person (whether or not also an FGI)	20%+	Australian company or Australian unit trust that carries on a 'national security business' in Australia (generally being a business which is involved in or connected with: a 'critical infrastructure asset' in any one of 11 sectors (communications, financial services and markets, data storage and processing, defence, higher education and research, energy, food and grocery, healthcare and medical, space technology, transport, and water and sewerage), telecommunications, defence or a member of the national intelligence community (of either Australia or a foreign country), or their supply chains).	Nil. FIRB approval required if percentage interest threshold met.
Foreign person (whether or not also an FGI)	20%+	Australian company or Australian unit trust that carries on an Australian media business.	Nil. FIRB approval required if percentage interest threshold met.
Foreign person (whether or not also an FGI)	20%+	Australian company or Australian unit trust that is an Australian land entity (ie it has >50% of its assets by value in the form of interests in Australian land).	Acquisition consideration exceeds applicable land monetary threshold, which depends on the type of land held by the target's subsidiaries.

Note: There can be situations where the above-mentioned 20%+ threshold instead becomes a 10%+ threshold, eg where the non-Australian target itself carries on an Australian national security business, or where the non-Australian target on a consolidated basis is an Australian land entity.

FGI de minimis exemption

The FGI de minimis exemption applies in an offshore transaction where all of the following requirements are met:

- the total value of the target group's Australian assets are < A$71 million (this being the threshold for the 2024 calendar year) and represent <5% of the target group's consolidated total asset value; and
- none of the target group's Australian assets are assets of:
  - a 'sensitive business' (which includes media, telecommunications, transport and encryption and security technologies); or
  - a 'national security business'—note of course that the presence of a national security business will separately trigger a FIRB approval requirement.

Enquiries should be undertaken to ascertain if the exemption applies. It will be important to obtain up-to-date and reliable balance sheets to ascertain asset values. If the acquirer has due diligence access, tailored questions should be put to the target.

Even if the de minimis exemption applies, a foreign-to-foreign transaction can still trigger a FIRB approval requirement on the basis of the Australian land entity rules.

Note that the de minimis exemption is not available for onshore transactions.

FIRB application process: some common issues

3. The need to disclose 5%+ investors in an acquirer entity and upstream funds

It is FIRB's expectation, as reflected in its published application checklist, that each FIRB application contain ownership and control details of the acquirer entity, including identities and country of origin and percentage of ownership of all investors (including the acquirer's parent entity) or shareholders who hold an interest of >5% and details of any beneficial owners.

This includes, for FGIs, details of why they meet the definition of FGI, identities and country of origin of all FGIs where the aggregate interest of FGIs from one country is 5%+ (directly or via a fund), as well as each FGI with an interest of 5%+ (directly or via a fund).

The application checklist does not specify that upstream investors need to be disclosed. Nor does it explain how to determine whether an upstream investor has a disclosable 5%+ interest. In our experience FIRB often requires upstream investor information to be disclosed, based on a 5%+ interest threshold in each upstream entity. For example, if a bidding entity is owned by three fund vehicles which are limited partnerships and which collectively comprise a single overall fund, FIRB often expects to receive details of each person who individually has a 5%+ interest in each fund vehicle—even if that person's look-through interest in the bidding entity is <5%. The FIRB regime does not have a look-through interest concept, and FIRB usually does not consider disclosure requirements by reference to look-through interests.

Often these disclosure requirements need to be complied with in stages. Where a fund's governing document (such as a limited partnership agreement) provides that investor identities must be kept confidential except as required by law or a regulatory authority, a PE firm will be unable to disclose the requisite investor information upfront in a FIRB application. Rather, they can only do so after receiving an express request from FIRB, post-application submission. If the required information is provided promptly after a request from FIRB, there will usually not be any impact on the FIRB assessment period.

Non-disclosure of investor information where required by FIRB will usually cause a submitted application to be put on hold until such time as it is provided. Therefore, where an investor in a fund refuses to be identified to FIRB, it will be necessary to consider possible workarounds, such as reducing an investor's interest to <5%, or moving them into a fund vehicle that will not have any direct or indirect interest in an Australian target entity.

4. How to seek FIRB approval for a fund acquirer where fundraising has yet to complete

FIRB decisions are made on the basis of a specific acquisition structure that has been disclosed to FIRB, including details of 5% or greater investors (see #3 above). It can therefore be challenging for a PE firm to seek FIRB approval for a fund acquirer that has yet to complete fundraising or where the fund acquirer is an open-ended fund. This is because, at the time of submitting a FIRB application, the PE firm may not know who the ultimate investors in the fund will be. They may have an idea of the types of investors and their likely percentage interests, but are unable to provide definitive disclosure upfront.

In practice, it is possible for a fund acquirer to submit a FIRB application before completing fundraising, subject to adherence to the following general guidelines.

- Before a decision is made on the FIRB application, the applicant informs FIRB of details of the actual or expected 5% or greater investors (see #3 above). This information should be provided as soon as the applicant is aware of the information, to minimise any delay in receiving a decision.
- During the period between receipt of a FIRB approval and closing of the relevant transaction, seek to ensure there are no changes in the fund's investor composition that could necessitate supplementary disclosure to FIRB.
- After closing of the relevant transaction, be aware that the proposed introduction of new investors in the fund acquirer (or an upstream fund) or the acquisition of increased interests by existing investors in the fund acquirer (or an upstream fund) can trigger a FIRB approval requirement for those investors. It will depend on various factors, such as the nature of the investors, the size of their post-transaction interests and whether the fund is an Australian land entity.

As regards the final point above, it is important to note that FGIs from the same country are deemed to be associates. For example, say a fund vehicle owns 50% of the acquirer entity and that fund vehicle is an FGI on account of having 30% ownership by US FGIs. The acquisition by any new US FGI of an interest in that fund vehicle will result in that US FGI having an aggregate FIRB interest of 30% plus its own interest in the fund vehicle. This will result in the US FGI acquiring a traced interest in the Australian entity or entities that the acquirer entity has acquired, and trigger a FIRB approval requirement for that US FGI unless the de minimis exemption applies. There are certain ways of seeking to address this issue, which our FIRB team can advise on.

5. PE acquirers becoming subject to more extensive tax conditions requiring upfront notification to ATO of certain post-transaction events, including capital and debt restructuring

It has been reported that the Australian Treasurer has directed FIRB to more strongly scrutinise the tax arrangements of foreign PE funds buying and selling Australian assets.[1] Since 2023, this has been reflected in new and additional tax conditions in FIRB approvals for PE acquirers.

Previously, PE acquirers usually received these types of tax conditions:

- 'Standard' tax conditions—essentially requiring compliance with Australian tax laws.
- Requirement to notify and engage with the Australian Taxation Office (***ATO***) in advance of any future disposal of the target.
- In some cases, requirement to provide the ATO with details of the acquirer's and target's immediate post-completion capital structure.

Increasingly, PE acquirers are receiving an additional set of tax conditions. These may include (in general terms) a requirement to notify the ATO, in advance, of any of certain related party, capital and debt restructuring and intra-group transactions that occur within a specified period post-transaction.

At the same time, PE acquirers must give the ATO all tax advice relating to these transactions (subject to the ability to make a claim for legal professional privilege or accountant's concession), as well as all step plans, diagrams, agreements, financial models and documents explaining the commercial rationale of these transactions.

1. Kehoe. J. (3 January 2024), 'Private equity tax plans in Chalmers' sights', Australian Financial Review. https://www.afr.com/policy/tax-and-super/private-equity-tax-plans-in-chalmers-sights-20231123-p5emak

6. No fixed FIRB assessment periods, and requests for priority or expedited processing must be supported by compelling submissions

There is no fixed period within which a decision on a FIRB application must be made. The FIRB legislation provides that once an application is submitted and FIRB has confirmed receipt of the applicable filing fee, the Australian Treasurer (or delegate) has a 30-calendar-day period during which to make a decision. However, this period can be (and is often) extended, sometimes multiple times.

There is no 'fast-track' FIRB assessment process. On the other hand, PE firms as an investor category are not subject to longer assessment periods than other foreign investors, and frequent filers can expect a more efficient process than otherwise.

An applicant can request that their application be given priority, but note that proposals that directly protect and support Australian businesses and Australian jobs will take priority over foreign-to-foreign transactions. In any event, for an applicant to have any prospect of obtaining priority or expedited processing they need to demonstrate that failure to obtain FIRB approval by a particular date will result in significant (and, if possible, quantifiable) financial detriment for the acquirer or target (eg if FIRB approval is not received by a specified date, the transaction counterparty is entitled to terminate the transaction agreement, and this would result in the applicant suffering loss of opportunity). It is not sufficient to merely state that the transaction parties have a commercial desire to complete by a particular date.

In any case FIRB cannot provide any guarantee that a decision can be provided by a particular date. This is because timing of a decision is dependent on various factors, including the number of other applications in the system, the time required to complete intra-government consultations and the availability of the decision-maker (being either the Treasurer or their delegate).

In light of the above, PE firms should aim to submit FIRB applications as early as possible in the transaction process. However, they should weigh this against the costs of doing so, including the low likelihood of receiving a refund of the FIRB application fee if a transaction does not eventuate.

After receiving FIRB approval: some common issues

7. Portfolio companies becoming foreign persons (and possibly also FGIs) and therefore becoming subject to the FIRB approval regime

The acquisition by a foreign PE fund of an Australian portfolio company will cause that company to become a foreign person (and also FGI if the acquirer is an FGI)—unless the company was already a foreign person (and possibly also an FGI) under its previous ownership.

This will result in the portfolio company becoming subject to the FIRB regime and needing to consider if FIRB approval is required for each future acquisition of interests in Australian entities, businesses and land. This can affect bolt-on acquisitions and ordinary course acquisitions of interests in land such as leases. The portfolio company also needs to ensure it complies with reporting obligations under the Register of Foreign Ownership of Australian Assets regime (see #8 below).

The FIRB regulatory burden is particularly onerous for portfolio companies that have become FGIs and discover they need FIRB approval to acquire a 10%+ interest in any Australian entity, any freehold interest in Australian land and any greater than five-year lease over Australian land, in each case irrespective of transaction value.

Where a portfolio company is an FGI they may be able to apply for a passive FGI exemption certificate (assuming their upstream investors are all passive investors) so that they are subject to the same FIRB approval percentage and monetary thresholds as non-FGI foreign persons. This would place the portfolio company on a 'level-playing field' with other foreign persons.

An alternative (which is also available to non-FGI foreign persons) is to apply for a combined businesses, entities and land exemption certificate which allows the recipient to undertake multiple acquisitions of interests in Australian entities, businesses and land without having to obtain individual FIRB approval for each transaction. Such certificates have specified terms, financial limits, scope limitations and conditions.

As to which type of exemption certificate is suitable for a particular portfolio company will depend on their individual circumstances, including the nature, size and frequency of expected future acquisitions.

8. Understanding and complying with reporting obligations under the Register of Foreign Ownership of Australian Assets regime

Since 1 July 2023, the FIRB legislation has required foreign persons who:

- acquire certain types of interests in Australian land, exploration tenements and water interests (in each case irrespective of whether FIRB approval is required for such acquisitions); or
- acquire interests in Australian entities and businesses where FIRB approval is required for such acquisitions,

to notify the Registrar (being the ATO) of the Register of Foreign Ownership of Australian Assets (the ***Register***) of such acquisitions, within 30 calendar days of each such acquisition.

In addition, a person who becomes a foreign person (such as an Australian portfolio company that is acquired by a foreign PE fund) is required to notify the Registrar of certain types of existing interests in Australian land, exploration tenements and water interests, as though the person acquired those interests on the day it became a foreign person. Also, a person who becomes a foreign person is required to notify the Registrar of existing interests in an entity or business where that person would have needed FIRB approval to acquire that interest if they had acquired the interest on the day they became a foreign person. This can be an extremely burdensome exercise, particularly for target entities with numerous subsidiaries and businesses, and it all needs to be done within 30 calendar days after the target becomes a foreign person.

There are ongoing obligations for foreign persons to make Register notifications of certain subsequent events, such as disposals of interests that were previously notified to the Register.

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