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AUSTRALASIA 2017

EXPERT GUIDE

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Introduction

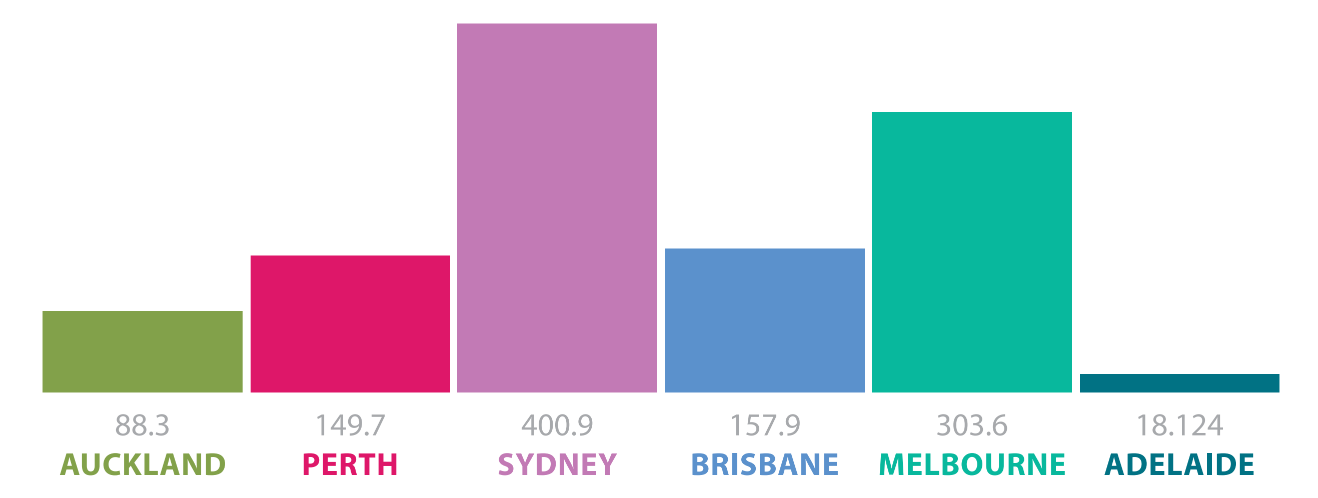
Having survived the 2008 financial crisis relatively unscathed, Australia has been one of the most resilient economies of the 21st Century. The success of the Australian economy was largely built upon the commodities boom which began around 2003 with the soaring prices of iron ore and coal coupled with the increased demand from China and other Asian countries. However, since the commodities crash of 2015, the headlines have made bleak reading for the prospect of Australia's economy. From sensationalist comparisons with Greece[1] to news of Australia's economy posting its worst decline since 2008[2], there has been a common theme prevalent throughout the last 12 months: 'is Australia heading for its first recession in over 25 years?'

The decline of the mining industry has posed various challenges to the Australian economy. In recent years, the mining industry has accounted for more than 50% of Australia's total annual export earnings[3] which is threatened by low prices and falling demand. Recently we have seen the demise of leading names from within the industry with billionaire mining magnate Nathan Tinkler filing for bankruptcy along with the world's biggest coal miner, Peabody Energy, who made a nearly $3 billion loss in its Australian operations during 2015[4]. Indicative of this truly testing time, Australia's corporate and personal insolvency laws are facing a substantial series of changes which are summarised within this expert guide by Ian Walker of MinterEllison.

However, it is not all doom and gloom for Australia. The immediate threat of a recession appears highly unlikely given that more than 90% of Australia's commodity exports are contracted, so net exports will continue to bring in 2% of real GDP[5]. This means that for Australia to have a recession the domestic economy would have to shrink at a higher rate. Furthermore, the domestic economy appears somewhat buoyant with the country in the midst of a real estate boom as well as posting strong opportunities in the infrastructure sector with the privatisation of public assets. This expert guide summarises the current outlook and identifies the most important changes and developments within these sectors. Other highlighted topics include the current landscape for international family law matters as well as an overview of the Auckland Unitary Plan in neighbouring New Zealand.

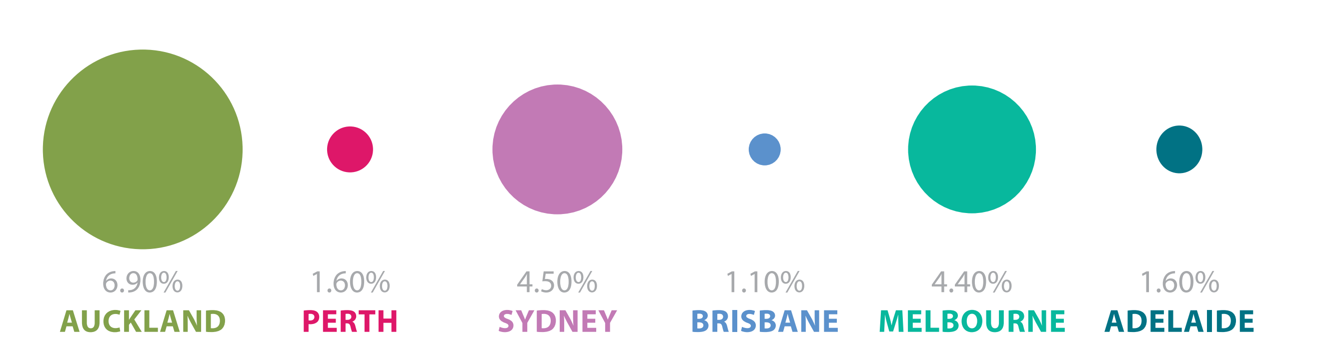
1. Commodities crash could turn Australia into a new Greece (The Telegraph, July 2016) http://www.telegraph.co.uk/finance/news-bysector/industry/mining/11749706/Commodities-crash-could-turn-Australia-into-a-new-Greece.html
2. Australia's Economy Posts Worst Decline Since 2008 (Fortune, December 2016) http://fortune.com/2016/12/07/australia-economy-gdp-turnbull/
3. Mining's contribution to the Australian community: The Whole Story (Minerals Council of Australia, September 2015)
4. Peabody Australia coal company loses nearly $3b in 2015, notes risk from parent's bankruptcy (ABC, June 2016) http://www.abc.net.au/news/2016-06-02/peabody-australia-coal-company-loses-nearly-3-billion/7471748
5. Housing a risk, but Australia won't have a recession for years (The Australian, September 2016) http://www.theaustralian.com.au/business/opinion/alan-kohler/housing-a-risk-but-australia-wont-have-a-recession-for-years/news-story/0b8d20a28bf72bd7b99243fe4e87efec

SNAPSHOT AUSTRALASIA

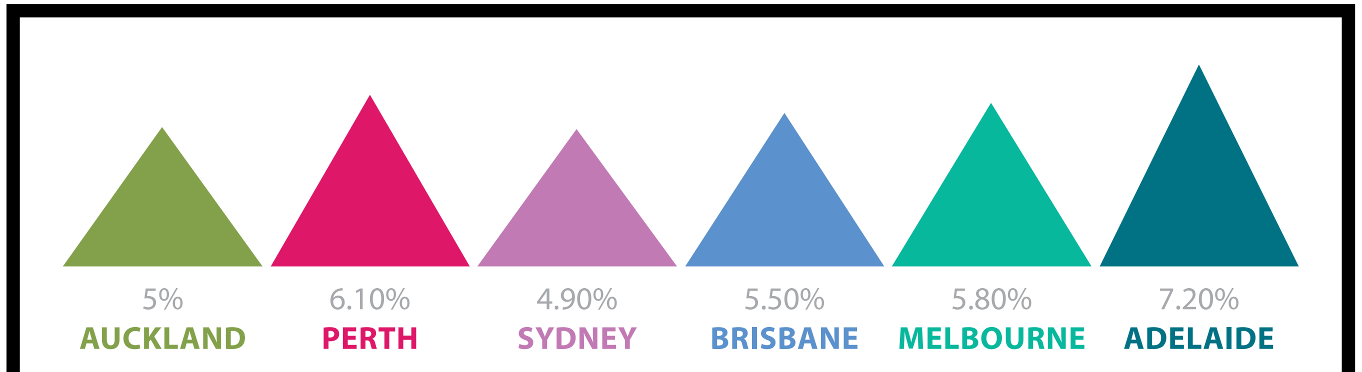


GDP (BILLION)

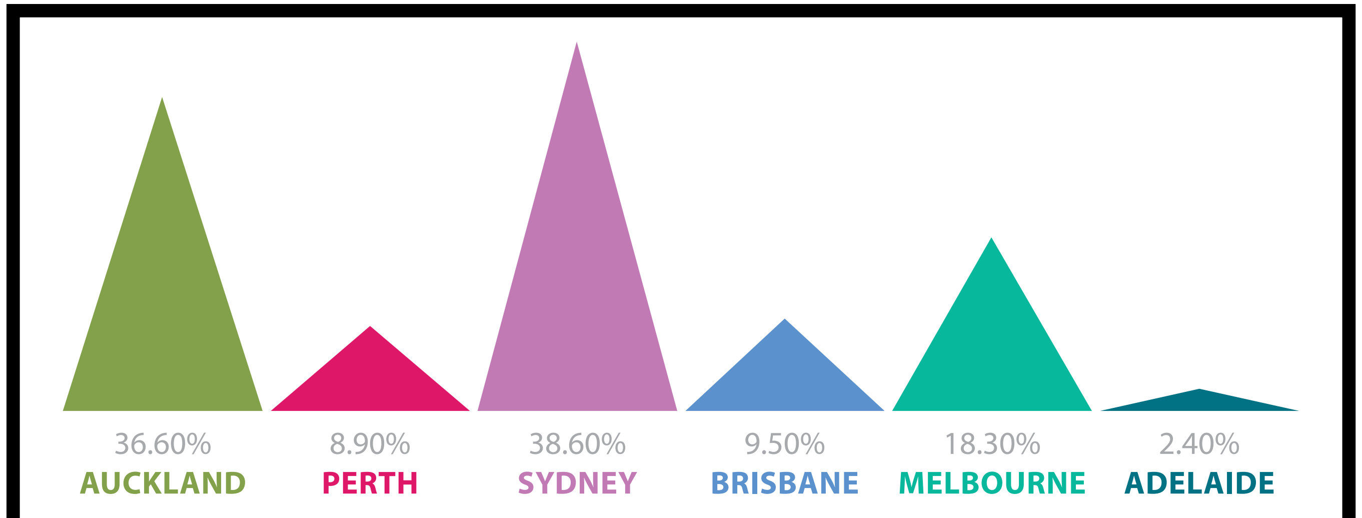
POPULATION (MILLIONS)



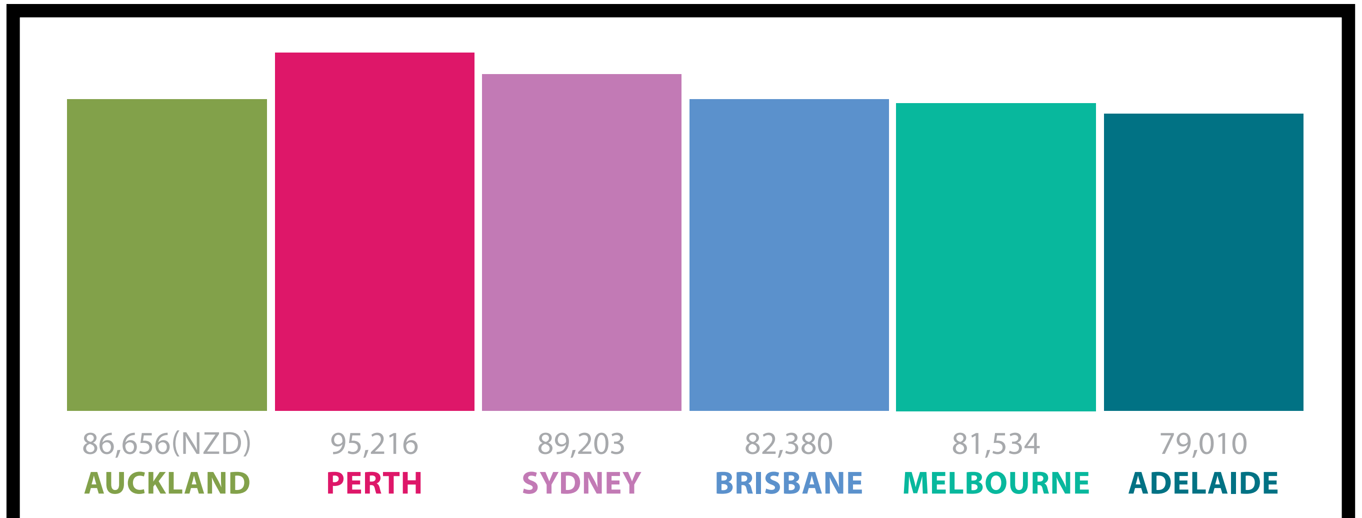
ANNUAL GROWTH



UNEMPLOYMENT RATE



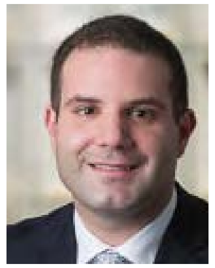
SHARE OF GDP



AVERAGE SALARY (AUD)

Sources: NZ Trade Enterprise, Statistics New Zealand, Ministry of Business, Innovation & Employment, SGS Economics & Planning, Salary Explorer
Regional Population Growth, Australia, 2014-15 (30/03/2016), Source: Australian Government Department of Employment Unemployment Rate Time Series (September 2016)

Australia



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Non-Resident Withholding Tax Regime on Taxable Australian Property

By Davide Costanzo & Varun Kumar

From 1 July 2016, the disposal of certain Australian property (including real estate) by non-resident Vendors will be subject to a non-final 10% withholding tax. The purpose of this is to assist in the early collection of tax from foreign residents and encourage them to meet their tax obligations in Australia. The tax is required to be withheld by the Purchaser and remitted to the Australian Tax Office (ATO) by the Purchaser.

Whilst the new regime is aimed at non-residents, it is affecting all property vendors (including Australian resident taxpayers) irrespective of their residency status. Unless the seller obtains a clearance certificate or declaration from the resident vendor, or the seller obtains a notice of variation from the non-resident vendor, the purchaser is required to withhold 10% at the time of settlement and remit this amount to the ATO.

Some exclusions to the withholding regime are detailed below.

Interaction of 10% withholding and general Capital Gains Tax Law

In general, non- residents are subject to Capital Gains Tax (CGT) on Taxable Australia Property (TAP). Similarly, the 10% withholding is limited to transactions dealing with TAP assets. The following assets are consider TAP:

Taxable Australian real property:

- vacant land, buildings, residential and commercial property
- mining, quarrying or prospecting rights where the material is situated in Australia
- lease premiums paid for the grant of a lease over real property in Australia

Other assets:

- indirect Australian real property interests in Australian entities whose majority of assets consist of the above asset types (e.g. shares in a "land rich" company). As per the Act, an indirect real property interest will exist where:
  (a) a foreign resident has a 10% or more membership interest in an entity (the "non-portfolio test"); and
  (b) more than 50% of the market value of the entity's assets is attributable to Australian real property (the "principal asset" test.
- Options or rights to acquire any of the above asset types.

Exclusions from the withholding regime

- Taxable Australian real property with a market value of less than $2 million.
- an indirect Australian real property interest that provides a company title interest with a market value of less than $2 million
- transactions conducted through an approved stock exchange or a crossing system
- transactions subject to another withholding obligation
- securities lending arrangements as these arrangements do not trigger a CGT liability for the Vendor and therefore no payment obligation is imposed
- transactions where the Vendor is in external administration or transactions arising from the administration of a bankrupt estate, a composition or scheme of arrangement, a debt agreement, a personal insolvency agreement, or same or similar circumstances under a foreign law.

The 10% withholding should not affect the majority of the residential market due to the exclusion for real property valued at less than $2 million.

Australian Resident Vendors – Real Property – For Australian resident Vendors, it is possible to apply for a clearance certificate to the ATO. If this certificate is not provided, the Purchaser is required to remit 10% of the purchase price to the ATO. The clearance certificate is valid for 12 months and can be use by the Australian vendor for multiple transactions.

Australian Resident Vendors – Other Assets – For other assets that are not real property (for example units in a unit trust or shares in a company), a Purchaser can rely on a declaration made by the Vendor stating that the Vendor is not a foreign resident or the interest being sold is not an indirect Australian real property interest. The ATO has not yet issued standard

> "The Purchaser will be required to complete a Foreign Resident Capital Gains Withholding Purchaser Payment Notification form and will be required to disclose the details of the Vendor and the asset. Once the form is processed, a payment reference number will be issued and the payment can be made."

declarations but have confirmed this can be inserted into a sale agreement as a contractual warranty. The declaration is valid for six months from the date of making the declaration.

Foreign Resident Vendors - This has been enacted to encourage foreign residents to lodge tax returns in Australia. The Vendor will be able to claim a refundable tax credit on lodgement of their tax return for the amount withheld. Vendors can apply for variations if they believe the 10% withholding is too high. Reasons for variation include:

- the Vendor will not make a capital gain on the transaction (for example, because they will make a capital loss or a CGT roll-over applies)
- the Vendor will not have an income tax liability (for example, because of carried-forward capital losses or tax losses)
- a creditor of the Vendor has a mortgage or other security interest over the property and the proceeds of sale available at settlement are insufficient to cover both the amount to be withheld and to discharge the debt the property secures
- a creditor acquires legal title to the property (that is, becomes the Purchaser) as a result of an order for foreclosure and its security would be further diminished as a result of having to comply with the withholding obligation.

Purchasers – the liability for failure to withhold rests with the Purchaser. Therefore it is important to note that any penalty and interest charges applicable will be payable by the Purchaser and not the Seller. The withholding applies on a property by property basis (i.e. if the purchaser's share of property is less than $2 million but the property is valued at more than $2 million, it may still be subject to withholding).
The amount payable to the ATO is on settlement date. As per the EM:

Ben is acquiring a residential property for $3 million. Ben knows that the Vendor of the property is a foreign resident and that the acquisition is subject to a withholding obligation. Ben enters into a contract for the purchase of the property on 1 August 2016 and pays a $150,000 deposit. The contract is settled on 1 October 2016 when Ben is required to pay the balance of $2.85 million to the Vendor and receives a transfer of title to the property.

Ben withholds $300,000 from the settlement amount (paying $2.55 million to the Vendor). Ben must pay the $300,000 to the Commissioner on the same day, 1 October 2016.

The Purchaser will be required to complete a Foreign Resident Capital Gains Withholding Purchaser Payment Notification form and will be required to disclose the details of the Vendor and the asset. Once the form is processed, a payment reference number will be issued and the payment can be made.

Practical implications of the withholding tax

- The liability rests with the Purchaser and therefore it is extremely important to for the seller to get their clearance certificates prior to settlement to ensure there are no cash flow issues.
- Where purchasing from multiple Vendors, there may be additional withholding requirements (i.e. to report the 10% withholding for each Vendor separately)
- Where there are multiple Purchasers, the value of the property is taken into account and not the value attributable to each Purchaser in order to use the $2 million exclusion
- When appropriate, the sale and purchase contract can include a Vendor's declaration stating their residency to safeguard the Purchaser's interests.
- Non cash transactions may be caught where two parties may not be dealing at arm's length.
- Scrip for scrip transactions may be an issue where the Vendor is not eligible for CGT rollovers.

__Davide Costanzo__ is a Director in the tax and business advisory division of Moore Stephens in Western Australia. His expertise is in tax consulting and tax compliance for SME business and corporate clients across a wide range of industries including engineering, property development, building and construction, manufacturing and mining and exploration. Davide's work has required a comprehensive knowledge of taxation, accounting and commercial matters.

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__Moore Stephens__ is an audit, accounting, tax and advisory firm that provides astute advice and practical solutions, which consistently deliver solid results. One of our specialties is to provide advice for individuals and companies interested in property development and investment activities in Australia. Having provided assistance to a number of foreign clients, we have built a unique depth and breadth of experience in this sector. Our advisers can assist you with your market entry strategy, implementing a tax efficient structure, handling operational issues and taking advantage of tax concessions available.


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Trends over the past year in the Australian projects and infrastructure sectors

By Nick Adkins, Scott McCoy & Rob Watt

Australia remains among the world's busiest jurisdictions for project financing and infrastructure despite the ongoing energy and resources downturn (sectors that historically drove activity). The Australian infrastructure sector dominated project financing deals in 2016, driven by the privatisation of public assets (particularly in New South Wales) and the sale of private infrastructure assets by private sector participants looking to capitalise on strong domestic and international interest for Australian infrastructure assets.

Privatisations have been actively encouraged by the Australian Federal Government's 'Asset Recycling Initiative', which includes a commitment by the Federal Government to provide a 15% 'asset recycling' payment to state governments that sell publicly owned assets and use the proceeds to fund infrastructure. It has provided an incentive for state governments to proceed with divestments despite some public opposition. This has been most apparent with the privatisation of New South Wales energy transmission and distribution businesses – Transgrid was privatised in November 2015 for AU$10.26 billion, 49.6% of the AusGrid distribution network was privatised in December 2016 for AU$16.189 billion, and the privatisation process for the third and final business Endeavour Energy was launched on 1 December 2016 – Allens has been busy advising the NSW government on these transactions.

Such asset divestments have helped put New South Wales at the centre of the infrastructure boom and the A$9.7 billion sale of the Port of Melbourne during the second half of 2016 should provide a similar boost for future Victorian infrastructure projects. The Asset Recycling Initiative has now ceased, though, so State assets which were not earmarked for divestment by 30 June 2016 will no longer benefit from the scheme.

The perceived success of New South Wales' privatisation program has both raised the bar for other state governments and improved public sentiment towards asset sales – a state election in Western Australia in early 2017 will effectively be a referendum on whether it should forge ahead with its own ambitious divestment program or not, including the sale of its power distribution network.

In the private sector, low commodity prices have frozen investment in traditional greenfield energy and resources projects. However, a change

of prime minister in late 2015 and stabilisation of the Federal Government's renewable energy policy has created a more favourable climate for investment in renewable energy, and we have seen a large increase in renewable development following several years of uncertainty. While a shortage of long-term power purchase agreements from Australia's large retailers continues to hinder the ability for developers to obtain project financing, several of the States and Territories have implemented their own power purchase tenders which supports new renewable developments, and two Commonwealth Agencies – the Australian Renewable Energy Agency and the Clean Energy Finance Corporation – provide grant funding support and debt and other financing for a range of renewable energy projects. The establishment by AGL of a AU$3 billion Powering Australia Renewable Fund for new large scale renewable power development, the general level of interest shown in the private divestment of various renewable assets, and the strong pipeline of projects, provides a good sign for renewables for 2017.

"As in many other countries, the viability of creating a bonds framework to assist greenfield infrastructure projects to access the debt capital markets has been much debated, but remains unsolved to date"

Trends over the past year in terms of project participants

Investment in Australian projects has become increasingly competitive, particularly in the infrastructure sector. Domestic and offshore pension funds, specialist infrastructure funds and sovereign wealth funds have provided a ready supply of equity as have, in more recent times, Chinese state-owned entities.

This increase in overseas equity players bidding for Australian infrastructure assets has led to increased scrutiny by the Foreign Investment Review Board ("FIRB"), which applies foreign investment rules to acquisitions by foreign investors. Public concerns about foreign investment, particularly in residential property and agricultural land, prompted a comprehensive rewrite of the legislation regulating foreign investment, the Foreign Acquisitions and Takeovers Act, which came into effect in December 2015, with toughened oversight of infrastructure acquisitions. This was most apparent during the final stage of the Ausgrid privatisation when FIRB rejected bids by two of the final bidders, State Grid Corporation of China and Cheung Kong Infrastructure. It remains to be seen whether this stance on foreign investment regulation will have a material impact on the willingness or ability of foreign investors to participate in Australian infrastructure projects.

Debt financing in Australia remains well supported by Australia's well-tested and sophisticated project financing market, with strong bank debt liquidity from both domestic and international banks. Banks face competition from non-bank debt providers such as increasingly acquisitive domestic and international pension funds, however, the considerable volume of equity investment opportunities in the infrastructure project pipeline will likely mean that pension funds and superannuation funds will remain selective with their debt participations, and appears limited to providing debt to mature operating projects for now.

As in many other countries, the viability of creating a bonds framework to assist greenfield infrastructure projects to access the debt capital markets has been much debated, but remains unsolved to date (since the retreat of the credit wrappers during the Global Financial Crisis). Nonetheless, most infrastructure financings are structured to permit domestic and international debt capital markets participation post construction or acquisition, and 2016 saw a group of Australian power and infrastructure operating projects access debt capital markets, with a number of issues into the US 144A and US Private Placement market completed in the past year, including by Transurban, Transgrid and a refinancing of the Victorian Comprehensive Cancer Centre PPP.

Opportunities over the next year

The trend of spending on Australian infrastructure projects is set to continue in 2017. Appetite for exposure to returns from Australian projects remains strong and there is a substantial pipeline of infrastructure projects for the coming year, including mega projects such as Victoria's AU$11 billion Metro Rail project, the AU$10 billion Sydney Metro project, the AU$5 billion Western Distributor toll road project in Melbourne and the AU$10 billion Western Sydney Airport at Badgerys Creek, as well as a raft of smaller transport and social infrastructure PPPs.

Government and private sector asset sales will remain the primary focus of the Australian project finance market over the next year. There is a significant pipeline of large scale asset sales, which will entail substantial reinvestment in new infrastructure. For example, the New South Wales poles and wires sales have helped underwrite major new projects like the Sydney Metro and stage 3 of the WestConnex toll road project.

Project financings for PPPs and infrastructure will be supported by Australian governments' willingness to adopt new government funding models to reduce borrowing costs. Upfront capital funding, co-lending and buy-back of debt after construction completion by government has become a common feature of Australian PPPs.

NSW has signaled a change in its PPP procurement from a conventional model incorporating both design & construct and operations & management to a 'services procurement' model which is focused on the provision of services and not the hard infrastructure. The project to test this new model is the first stage of the NSW Government's $1 billion Social and Affordable Housing Fund.

There should also be significant merger and acquisition activity in the energy and resources sectors due to the fall in the Australian dollar and emergence of a recovery in some commodity prices. In the energy sector, Origin Energy and Alinta Energy look set to continue their efforts to sell a number of energy and wind generation assets. Similarly, a number of further coal mining assets seem likely to come to market.

The federal government has committed AU$5 billion to its Northern Australia Infrastructure Facility, under which it will offer concessional loans to encourage and complement private sector investment in economic infrastructure in northern Australia, including resources related infrastructure and water, transport and energy infrastructure.

The renewables sector is set to continue to increase momentum with a strong pipeline of development assets as the market seeks to meet the Australian Renewable Energy Target by 2020. Australian project financing looks set for another very strong year.

Nick Adkins is regarded as one of the leading project finance and infrastructure lawyers in the Australian market. He regularly advises on market-leading transactions in this sector, including currently advising on the financing aspects of the $4 billion Wiggins Island Coal Export Terminal, the $2.8 billion New Royal Adelaide Hospital, the $10 billion Western Sydney Airport development and a bid for the NSW Social and Affordable Housing Fund procurement process. He has also acted on numerous acquisition finance transactions, with a particular focus on acquisition in the energy & resources and infrastructure sectors (including privatisations). Nick regularly presents on project and infrastructure finance, including as a lecturer in Infrastructure Finance for the Sydney University Faculty of Law course 'Advanced Financing Techniques'.

Scott McCoy specialises in project and infrastructure finance, regularly acting for lenders, borrowers and governments on Australia's largest transactions. Recent examples include acting for the NSW Government on the A$10.26 billion privatisation of Transgrid and the A$16 billion privatisation of AusGrid, advising the Commonwealth government on its innovative $2 billion concessional loan for Stage 2 of WestConnex (one of Australia's largest infrastructure projects), and acting for lenders and Sponsors on a range of market-leading PPP transactions, including the North West Rail Link Project (the largest PPP in New South Wales), the Canberra Metro Project (the largest PPP in the ACT), the A$6 billion Melbourne Metro, and the Wiri Men's Prison PPP (New Zealand's first major PPP). Scott has also acted on a range of renewable energy projects and traditional project financings.

Rob Watt advises leading domestic and international financiers, sponsors, contractors and governments on financing transactions. This includes project and structured financings in the infrastructure sector in particular. He has been recognised in Chambers Global Guide and Legal 500 as a leading projects and finance lawyer where he has been commended for his commercial, solution driven approach. Rob has advised on the A$10.26 billion privatisation of Transgrid's transmission network, the A$16 billion privatisation of Ausgrid's distribution network, the financing of the acquisitions of the QCLNG Gas Pipeline, the BassLink Interconnector and Sydney, Perth and Adelaide Airports and the financing of the development of Stage 2 of the WestConnex toll road project, the APLNG and Ichthys LNG projects and the North West Rail Link Project.

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International Family Law Matters In Australia

By Damien Greer & Caitlin Wilson

As a signatory to the Convention on the Civil Aspects of International Child Abduction (the Hague Convention), Australia is both resolute and committed to addressing issues relating to international child abduction and the enforcement of parental rights in foreign jurisdictions.

Provided there are no applicable exceptions, if a parent unilaterally removes a child to Australia from a country that is a signatory to the Hague Convention, the Australian Family Court is obliged to make an Order for the return of that child to their country of residence.

The only grounds for the non-return of a child taken from a Hague Convention country to Australia are as follows:

- That the applicant was not exercising their rights of custody of the child at the time the child was removed;
- That the applicant consented or acquiesced to the removal or retention;
- That there would be a 'grave risk' that the child's return would expose the child to physical or psychological harm, or otherwise place the child in an intolerable situation;
- That the key requirements of the convention have not been met;
- That the child has been in the new country for more than 12 months and is settled there;
- That the child objects to being returned to its home country, and is old enough and mature enough for its views to be considered; or
- That returning the child would breach their fundamental freedoms and human rights.

According to the Australian Central Authority (Commonwealth Attorney-General's Department) report on Hague Convention application statistics (September 2016), Australia received between 52 to 75 applications on average per year and made an order for the return of children to their country of residence between 41 and 78 times per year between 2012 and 2016 (note: orders for return may not have been made in the same financial year in which the application was received).

These figures generally evidence Australia's compliance with the Hague Convention and are an indication of the limited ability of the Court to permit the non-return of a child based on the exceptions noted above.

In addition to being compliant with the Hague Convention, Australia has enacted three different sets of provisions that are applicable to the different aspects of international parenting matters within Australia.

These provisions are contained within the *Family Law Act 1975*, the *Family Law (Child Abduction Convention) Regulations 1986* and the *Family Law (Child Protection Convention) Regulations 2003* (the Protection Convention).

These provisions operate to ensure the prompt return to or from Australia of a child unilaterally and wrongfully removed or abducted by one parent to his or her country of residence as well as the registration of overseas parenting orders within Australia.

The Family Law (Child Abduction Convention) Regulations provides for the registration in Australia of a parenting or custody order that has been made in a 'prescribed overseas jurisdiction'. However, the list of 'prescribed overseas jurisdictions' are quite limited, and include only a few countries as well as only a few number of States within the United States of America.

Once registered, the overseas order becomes enforceable as if it were an order made by the Australian Family Court.

Both the Hague Convention and the Family Law (Child Abduction Convention) Regulations prevent parents from 'jurisdiction shopping' – i.e. attempting to have their parenting matter heard in a court where they believe they will have a more favourable decision.

However, the limited capacity to register overseas orders from prescribed jurisdictions only begs the question: how are overseas orders given effect within Australia from countries (or States) that are not 'prescribed overseas jurisdictions'?
Colloquially, these are known as 'mirror orders'. Effectively, mirror orders are new orders that

> "Upon the registration of an overseas maintenance liability, the liability becomes a debt payable to the Commonwealth of Australia and is collected and enforced by Child Support Agency on behalf of the payee."

are made by the Australian Family Court that 'mirror' or reflect the terms of the existing overseas orders.

The majority of the Full Court of the Family Court said in the matter *of Khamis and Khamis* (1978) FLC 90-486 at page 77,515-516) that:

> "*Where the earlier custody order is made by an overseas court of appropriate jurisdiction and that court has recently considered the issues in full and has made a custody order* ***applying the rule that the child's welfare or interests are the paramount consideration****, the Australian Court should be reluctant to act inconsistently with that order unless the exceptions set out in section 68(4) [now s 70J(2)] are met*." [emphasis added]

The Court went on to highlight the overriding principle in determining whether to make a mirror order that it be in the best interests and welfare of the child to do so:

> *"It remains true, however, that a custody order is never final, and an overseas order cannot have higher standing than a local order. Nothing that has been said derogates from the main principle that the welfare of the child is the paramount consideration."*

Provided that the existing orders appropriately take into consideration the best interests and welfare of the child, the option for a mirror order remains.

If mirror orders are intended as an alternative form of protection, steps should be taken before the initial orders are obtained to ensure they are capable of being made and enforced in Australia.

Child Support and Spousal Maintenance Obligation Issues

In addition to the above provisions relating to parenting matters, Australia is also a party to a number of international agreements and conventions in relation to the recognition and enforcement of maintenance obligations (including but not limited to The Hague Convention on the Recognition and Enforcement of Decisions Relating to Maintenance Obligations) which applies to both spousal and child support obligations.

The Convention establishes reciprocal agreements between contracting States to recognise and enforce maintenance decisions made by judicial or administrative authorities in Convention countries.

The Convention also provides for the recognition of administrative assessments (rather than just court orders or court registered agreements).

Relatively speaking, it provides for the easy and prompt enforcement of existing liabilities by both overseas courts and administrative authorities and of both overseas orders and assessments in Australia.

Upon the registration of an overseas maintenance liability, the liability becomes a debt payable to the Commonwealth of Australia and is collected and enforced by Child Support Agency on behalf of the payee.

Importantly, the Child Support Agency can register overseas liabilities for both child support *and* spousal maintenance, provided that they fall within the definition of "registrable overseas maintenance liabilities" in the Registration and Collection Act, which requires that the liability is both:

- A liability to pay a "periodic amount" for the maintenance of a child or spouse; and
- An "overseas maintenance liability", which is defined as a:
    - liability arising under a maintenance order made by a judicial authority of a reciprocating jurisdiction;
    - a maintenance agreement registered by a judicial or administrative authority of a reciprocating jurisdiction; or
    - a maintenance assessment issued by an administrative authority of a reciprocating jurisdiction.

Non-periodic liabilities, which include payments to third parties, such as the payment of school fees and medical expenses, can be entered into the child support register as an "overseas maintenance entry liabilities" rather than a "registrable overseas maintenance liability" and are recoverable in the courts rather than by the Child Support Agency.

Financial Arrangements

Financial arrangements between parties to a personal relationship are determined under the provisions of the Family Law Act, focusing on financial and non-financial contributions, with the exhortation that orders should be made that are least likely to lead to ongoing litigation. That leads to Australian Courts making orders in most instances that are final and unlikely to provide for extended obligations for payment of spouse maintenance (alimony).

> *"Financial Agreements, when properly prepared, are becoming more resistant to attack by disgruntled former parties to a relationship and are capable of protecting parties assets in multiple jurisdictions, a necessity in these days of highly mobile, complex, living and investment arrangements."*

For a number of years parties to a personal relationship have by way of financial agreements, been able to exclude a Court from determining respective financial rights and obligations of parties in the event of a breakdown of a relationship. Financial Agreements, when properly prepared, are becoming more resistant to attack by disgruntled former parties to a relationship and are capable of protecting parties assets in multiple jurisdictions, a necessity in these days of highly mobile, complex, living and investment arrangements.

With over 30 years of practice in Family law, Damien is also an Accredited Family Law Specialist, a Mediator and an Arbitrator. He has a particular interest in complex financial matters and international family law matters.

Damien was invited to become a Fellow of the International Academy of Matrimonial Lawyers in 1996, being one of the longest standing Fellows in Australia.

He has been an appointed expert witness on Australian Family Law before the High Court in the United Kingdom and has provided expert trial evidence on Australian Family Law in the United States. Damien is a regular presenter at legal and other professional seminars, presenting to the International Academy of Matrimonial Lawyers on two occasions.

Since being admitted to practice in 2010, Caitlin has practiced exclusively in Family Law. She has a particular interest in international family law matters, including but not limited to international relocation, international child abduction and other international jurisdictional issues.

Caitlin has assisted clients both within Australia and abroad, including but not limited to countries such as England, Iran, Rwanda, the United States, Italy and Sweden. Caitlin has acted for both Applicants and Respondents in international relocation matters and Hague Convention matters, as well as assisted clients in obtaining mirror orders in Australia (from both prescribed reciprocating jurisdictions and non-reciprocating jurisdictions).

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THE UNIVERSITY of ADELAIDE

Private Property and the Climate Future of Negligence

By Paul Babie

Introduction

Private property consists of a bundle of rights comprising three primary powers of choice: use, exclusivity, and disposition. These three rights allow their holder to choose how to use, who to exclude, and how to dispose of whatever good or resource, tangible or intangible (from land, to shares, to trademarks and patents, to money, to reputation), is said to comprise the subject-matter of property.[1]

All common law systems provide two avenues for preventing the unfettered exercise of choice pursuant to property in ways suiting only personal preferences: (i) the law of tort, particularly nuisance, trespass and negligence;[2] (ii) environmental legislation providing remedies for those harmed by the actions of those exercising choice pursuant to private property.[3] In either case, the issue of damage is paramount to success, and actions are typically founded upon harm retrospectively caused.

Climate change, though, may force us to reconsider whether an action may lie only for harm already suffered, or it can be brought in respect of harm that may occur at some future time. The decision of the United States District Court of Eugene, Oregon, in *Kelsey Cascade Rose Juliana et al v The United States of America*,[4] denying a motion to dismiss a suit brought on the basis of future harms, suggests that both common law and legislation could develop so as to allow claims on the basis of future climate harms.

Kelsey Cascade Rose Juliana et al v The United States of America

Kelsey involves a class action brought in 2015 by a group of young individual activists (aged between 8-19) and James Hansen[5] as guardian for plaintiff 'future generations', who contend that the United States government, through the alienation of public trust land, has allowed fossil fuel exploitation resulting in carbon pollution of the atmosphere, climate destabilisation and ocean acidification which had resulted in concrete harm to the plaintiffs as the beneficiaries of the federal public trust in public land. The plaintiffs assert a novel theory exhibiting characteristics of both a civil rights action and one based upon National Environmental Policy Act/Clean Air Act/Clean Water Act. The plaintiffs seek to force the government to take action to reduce harmful pollution now and, in a novel outcome, in respect of future generations. In short, the basis of the claim depends upon demonstrating harm to future generations. This is relevant to the future of negligence and to the interpretation of environmental legislation which prohibits such harm.

In rejecting the motion to dismiss, Magistrate Judge Coffin of the United States District Court in Eugene, Oregon, found that because climate change is already damaging human and natural resources it is sufficiently concrete and imminent and traceable to the challenged conduct that the plaintiffs consequently possess standing to bring an action against the defendants. While personal harms are a consequence of broader harms, that does not discount concrete harms already suffered by individual plaintiffs or likely to be suffered by plaintiffs in particular in the future.

Judge Coffin relied upon the test of harm found in *Federal Election Commission v Akins*: 'often the fact that an interest is abstract and the fact that it is widely shared go hand in hand. But their association is not invariable, and where harm is concrete, though widely shared, the Court has found 'injury in fact.''[6] However, Judge Coffin found that 'the Constitutional limits on standing eliminate claims in which a plaintiff has failed to make out a case or controversy between himself and the defendant'. Rather, the plaintiff must show that he has personally suffered some actual or threatened injury as a result of the putatively illegal conduct of the defendant. As such, 'while the FAC identified numerous climatic, meteorologic, and political harms that the earth and its inhabitants will suffer as a result of the government's action and failure to act with respect to CO_2 emissions, the

plaintiffs differentiate the impacts by alleging greater harm to youth and future generations.' Thus, 'plaintiffs give this debate justiciability by asserting harms that befall or will befall them personally and to a greater extent the older segments of society.'

In addition to specifying the harm, though, a plaintiff must also make out a causal connection between the injury and the conduct of which plaintiffs complained. The defendants' assertion in *Kelsey* was, of course, that the association between the complained of conduct (namely, subsidising the fossil fuel industry, favourable revenue code provisions, allowing transport of fossil fuels and authorising fossil fuel combustion) was too tenuous and filled by intervening actions to amount to a sufficient causal connection to the harm sustained. On the facts, however, Judge Coffin found that 'there [was] an alleged strong link between all the supposedly independent and numerous third party decisions given the government's regulation of CO_2 emissions.'

Conclusion

Will the approach taken by Judge Coffin to the future harms of climate change mean that corporations or others are liable for future harm in the case of climate change choices? The *Kelsey* litigation is far from over. But it ought to give both individuals and corporations pause for thought concerning the nature of their activities that may contribute to GHG emissions. Only time will tell if liability might attach to individual and corporate defendants for tort or statutory claims for future climate harms. In the case of climate change, though, time seems an increasingly scarce commodity.

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Thanks to Emily Carr (LLB, 2016) for providing outstanding research assistance.

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3. See eg, in the United States the National Environmental Policy Act, 42 USC § 4321; Clean Air Act, 77 Stat 392; Clean Water Act, 86 Stat. 816. In Australia, see, Environment Protection and Biodiversity Conservation Act 1999 (Cth).
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5. Author of the critically acclaimed James Hansen, Storms of My Grandchildren: The Truth About the Coming Climate Catastrophe and Our Last Chance to Save Humanity (Bloomsbury, 2009).
6. Federal Election Commission v Akins, 524 US 11 (1998).

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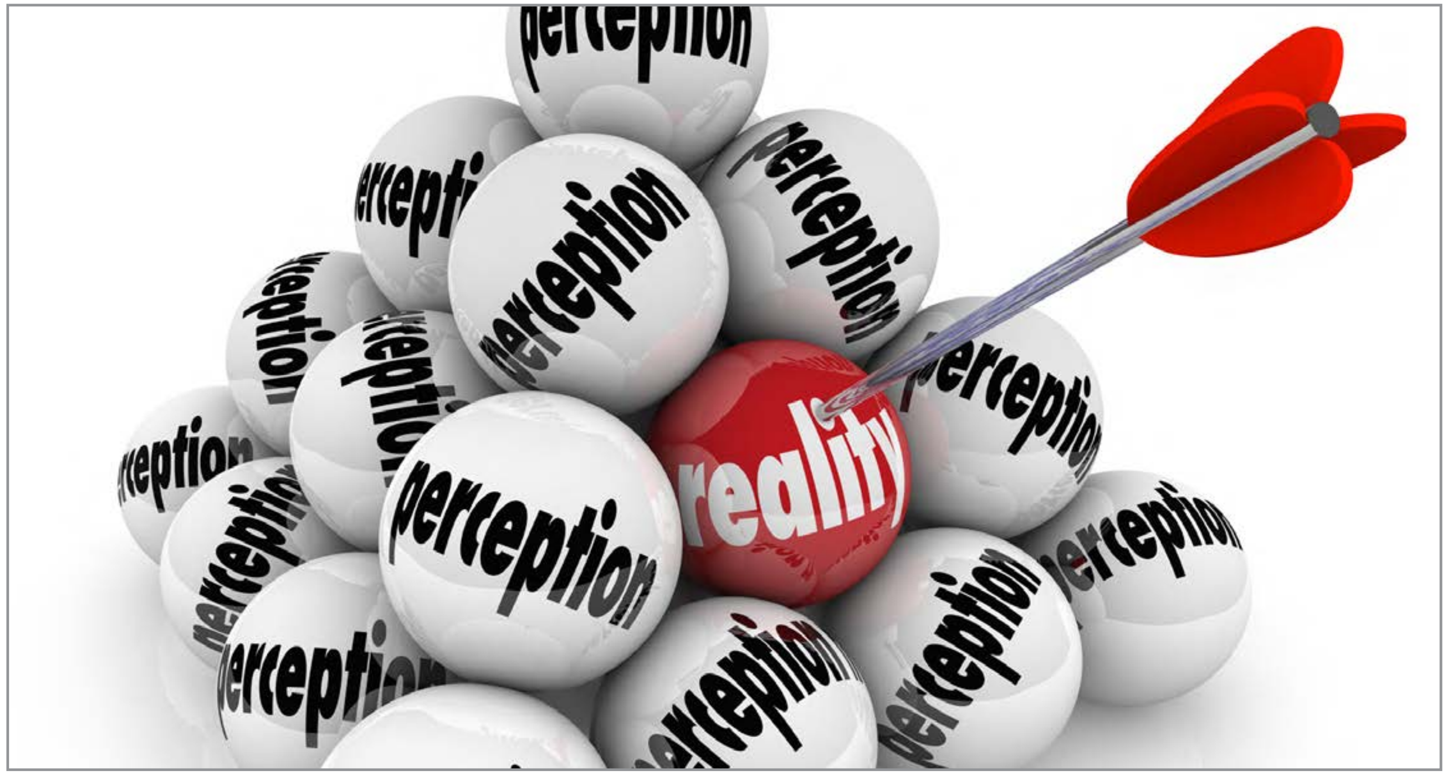

Smart contracts: bridging the gap between expectation and reality

By Cheng Lim, TJ Saw & Calum Sargeant

There has been an explosion of interest in "smart contracts" and blockchain technology over the past two years, with software developers, financial institutions, regulators and law firms rushing in to explore smart contract design and blockchain development. The hype over smart contracts has resulted in headlines such as "Blockchain 'smart contracts' to disrupt lawyers"[1] and speculation that blockchain smart contract technology "threatens thousands of legal jobs and lawyers' role in intermediating commercial negotiations and disputes"[2].

Advocates of the technology are excited by the potential for smart contracts to encode and perform complex agreements automatically. The dream is to build a contract from a code library which will be stored on a blockchain, signed digitally and which will set in motion an irrevocable set of instructions that will be automatically executed, subject to clearly predefined exceptions. To commercial parties, the appeal of smart contracts lie in (i) the digitisation of trust through certainty of execution, and (ii) the creation of efficiency through the removal of intermediaries and the costs they bring to transactions.

There is little doubt that smart contracts will find compelling use cases and achieve those objectives in many instances. But equally, it is important to realise the limitations of smart contracts and understand that there are many elements of contractual relations that are not suitable for performance through deterministic computer logic embodied in a smart contract. If there are unrealistic expectations for what the technology can achieve, early adopters may find that they frustrate, rather than simplify, their dealings with others.

We set out in this article to define an appropriate role for smart contracts (whether on a public or consortium blockchain) and provide a model for designing smart contracts which can operate effectively and safely in a world which is full of uncertainty, ambiguity and is not deterministic.

A smart contract is not everything

The term "smart contract" is a misnomer. A smart contract shares theoretical similarities with a legal contract, in the sense that they are both frameworks for regulating the interaction between different entities, but it is important to note where those similarities start and end.

A smart contact is, at its heart, a computer programme – encoded logic that receives certain inputs and executes a set of instructions to reach one of many pre-defined outcomes. It is not relevant to the encoded logic whether or not promises or consideration exist between the parties, or whether or not representations have been made in relation to the subject matter of the instructions. It is not relevant whether its instructions were intended or legal. At its heart, a smart contract simply guarantees execution of a particular code base.

A normal, non-smart, or "dumb" contract, on the other hand, is an agreement between two or more parties characterised by mutual promises or obligations, and is enforceable by law. A dumb contract can be thought of as serving multiple and possibly interlocking goals:

Database of obligations – a contract serves as a catalogue of the mutual obligations and promises between two or more parties. It is a collection of negotiated points relating to a particular agreement between the parties, stated in language that parties can refer to and at least in theory understand. Even so, there are many situations in which courts have to determine what the parties agreed, or intended to agree, in their contract, which has led to rules of law such as the parol evidence rule, and the implication of terms into contracts which are "so obvious, that they go without saying".

Regulating the relationship between contracting parties – a contract is given legal effect by the surrounding framework of laws in which the contract sits, thus ensuring that parties are held to their obligations. The legal framework elevates an agreement from a moral obligation to an obligation that is recognised and enforced by society at large. The law of the relevant jurisdiction may compel performance of the obligation (as in the case of an order for specific performance or injunction) and may incentivise performance by penalising breach. Alternative-

> *While a smart contract may contain some part of the "database of obligations" between the parties in its instructions, it is unlikely to be a comprehensive catalogue of all those obligations*

ly, the external legal framework may allow for a modification of the obligations in the contract if, for example, there is a need to imply an additional term into the contract. And of course, the legal framework may allow the contract to be completely voided if, for example, if there is illegality or a total failure of consideration.

Part of the execution mechanism – a contract may also contain elements of a mechanism by which contractual obligations can be executed. Wrapping an obligation in the cloak of contract creates an expectation of performance supported by the external legal framework, giving rise to an "execution norm". The prospect of legal enforcement that attaches to a contract, as opposed to a moral obligation, increases confidence that the obligation will be performed.

How does a smart contract compare to a dumb contract?

While a smart contract may contain some part of the "database of obligations" between the parties in its instructions, it is unlikely to be a comprehensive catalogue of all those obligations, particularly where the contractual obligations are complex. This is because:

parties may negotiate terms that are not capable of being assessed deterministically by a computer program (that is, not capable of Boolean expression and an algorithmic determination, but instead requiring human judgement);

in order to be sufficiently expressive, obligations may import indeterminate concepts of reasonableness or appropriateness that again are not suited to algorithmic determination;

the expression of an obligation in code may not accurately reflect the agreement between the parties (for example because of error or omission); and

the contract may itself contain a further agreement to agree, or a mechanism for amending the contract which is not in itself algorithmically deterministic.

Of course, a smart contract is clearly part of the execution mechanism. In fact, it is possible for the smart contract to be the entire execution mechanism and not just an element of it. The execution norm established by a dumb contract could be replaced by the execution norm of irrevocable instructions of a smart contract that guarantees performance. This "guaranteed execution" of encoded obligations is the key feature of a blockchain smart contract.

Smart contracts operate without reference to any external legal framework, in that execution or performance of the obligations in the smart contract happens independently of the surrounding legal framework. However, this does not prevent that legal framework from applying to and affecting the broader contractual relationship between the parties. It is possible that the law may mandate an outcome which is different to that which is programmed into the smart contract, for example in order to correct a misrepresentation which is embodied in the code of the smart contract.

In other words, smart contracts do not exist in a vacuum. Leaving aside the inability of smart contracts to document obligations which are not algorithmically deterministic, those who wish to use or establish smart contracts will have to deal with issues which have existed for many years in the "dumb" world. These are issues such as:

What if the code base does not reflect what the parties understood to be their agreement (eg a common mistake of law or fact)?
What if the effect of the code base was represented by a party to be different to what it actually was (eg a misrepresentation)?
What if one party did not have the legal capacity to enter into the smart contract (eg being under age)?

Particular challenges with public blockchain smart contracts

One particular new issue is the design of smart contracts which sit on a public blockchain and which interact with different and possibly hostile actors with misaligned incentives. These smart contracts need not only to deal with the challenges referred to above, but to also incorporate principles of defensive programming as well as analysis of the underlying game theoretic design.

In particular, it is imperative for a public smart contract to:

have its scripting language compile properly into its machine language, in the way it was intended;

be structured in a ways which is computationally efficient (making use of the fewest state changes to achieve the desired outcome) as it is expensive to devote computational resources over the blockchain to run a program; and

be robust in its design so that malicious actors may not exploit weaknesses in the code to "stalk" or "spam" the contract and its prevent legitimate intended uses from being executed.

This is more than a theoretical possibility, as illustrated by the recent events surrounding the smart contracting public blockchain network Ethereum and the Distributed Autonomous

Organisation (DAO) smart contract that sat on it. The DAO was a smart contract intended to pool investment funds (which and at one point totalled $150M worth of the cryptocurrency, Ether) which could be allocated by members of the DAO to different projects. A hacker spotted a mistake in the programming of the smart contract, and utilised it to drain the Ether from the DAO into child DAOs controlled by the hacker. Importantly, the underlying Ethereum blockchain and smart contract both functioned in the pre-determined way it was designed, but the failure of proper smart contract design created a functional vulnerability which ultimately undermined the intent of the DAO.

A model for designing smart contracts

We start from the proposition that a contract is not a set of irrevocable instructions but rather a collection of mutual obligations subject to the overlay of law. A smart contract is a set of instructions that may give effect to the obligations of the parties, but it must also be amenable to rectification where it no longer satisfies the requirements of law or fails to reflect the obligations agreed by the contracting parties. Where a smart contract is designed in a way that cannot achieve this, it may result in misalignment between rights recognised by law and rights recognised by the public.

Looked at in this light, a smart contract is really best suited as an execution mechanism for a set of deterministic obligations, rather than as a contract in itself. In some ways it is similar to an "escrow" mechanism which is common in M&A transactions, where money is paid to a trusted third party stakeholder, and which can be released to one or the other party in certain specific, determined circumstances. The smart contract is part of the contractual matrix between the parties and is the mechanism by which execution of certain obligations is guaranteed.

We consider the following to be an appropriate model for designing and implementing "smart contracts":

there would be a dumb contract between the parties, in the form of a "legal wrapper" which sets out terms of the contract which are not deterministic and not suitable for execution through the smart contract. An example of this would be a right to terminate a contract or take a particular action because of the occurrence of a "material adverse event";

the smart contract code must be designed to execute elements of the contract suited to algorithmic determination, for example an obligation to pay an amount of money at a fixed time, or a process for determining an interest rate by reference to a margin and a particular published reference rate such as LIBOR;

the legal wrapper would incorporate the smart contract code by reference into the contract, but would take priority over the code if there was some conflict between the two;

there should be a "fail-safe" in the smart contract code, that allows the code to be terminated in certain agreed scenarios by any party to the contract (e.g., by trusted authorities with multi-signatory keys). Consequences of the use of the fail-safe (whether appropriate or not) would be resolved by the parties in accordance with the legal wrapper and within the framework of the law. The "fail-safe" could also allow parties to amend the smart contract code when there is a contract variation, or where a party chooses to waive certain rights under the contract.

We posit that smart contracts are unlikely to make lawyers extinct. In fact society is likely to require more lawyers than ever before, to make sure that smart contracts, like dumb contracts, reflect the intention of the parties and allow for execution of agreed outcomes!

Cheng is an M&A partner in our Melbourne office who specialises in helping clients navigate complex legal, commercial and regulatory landscapes in telecommunications, technology and infrastructure.

He has been a key telecoms advisor to Telstra for over 2 decades. In the last 5 years, he has led the the KWM team advising Telstra on the 3 major iterations of its landmark Definitive Agreements with nbn, under which Telstra agreed to disconnect and sell its copper and HFC assets to nbn to support the rollout of the nbn broadband network using an optimised multi-technology model.

Cheng has extensive experience in privacy, data breaches and data security, having advised Telstra and other clients on these matters for more than a decade. He is the global leader of the KWM cyber security initiative.

He guides clients through major IT, sourcing and procurement projects, particularly in regulated industries such as electricity, financial services and telecommunications. In addition, he brings his extensive experience in technology to assist both buy-side and sell-side clients in M&A transactions.

Cheng has particular expertise in the operation and maintenance of rail infrastructure and rail franchising in Australia. He has acted for successful bidders in many major transport infrastructure and defence projects in Australia.

Cheng has been consistently recognised by surveys as one of the leading technology lawyers in his field over many years. In 2015, he was ranked by Best Lawyers as its Melbourne Telecommunications Lawyer of the Year. He is also ranked in Band 1 in TMTChambers Global Guide 2015 and as a Leading Individual in TMT by the Legal 500.

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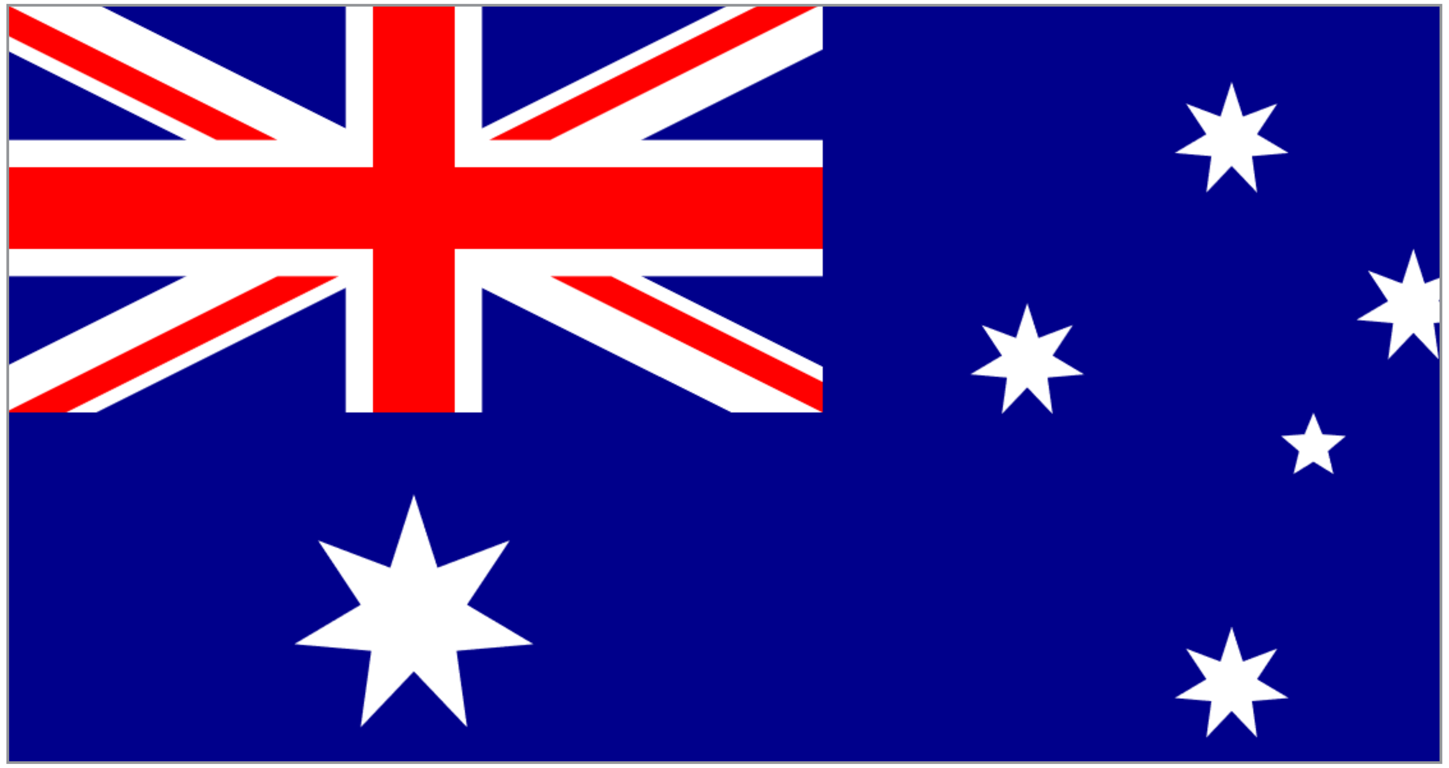
Australia's Insolvency Law Is Changing

By Ian Walker



Australia's corporate and personal insolvency laws are facing a substantial series of changes to be made by the *Insolvency Law Reform Bill 2015* (ILRB 2015). The ILRB 2015 was introduced into Parliament on 3 December 2015, but does not relate to restructuring. But there are more changes likely to occur, particularly in relation to turnarounds and the restructure of financially stressed companies.

On 7 December 2015 after the ILRB 2015 was introduced comments were made by Prime Minister Malcolm Turnbull as part of the Federal Government's Innovation Package, to the effect that there should be other reforms to Australia's insolvency law in order to encourage entrepreneurship and innovation.

Insolvency Law Reform Bill 2015

This Bill has been passed by the Parliament by both the House of Representatives and the Senate. As it is passed by the Parliament once it receives Royal Assent from the Governor-General, the majority of the legislation will commence 12 months later. It is currently likely to commence some time in either February or March 2017.

The ILRB 2015 contains a series of amendments to both the *Bankruptcy Act*, that covers personal insolvency, and the *Corporations Act* that covers corporate insolvency. It introduces into each Act, a schedule, called either the Insolvency Practice Schedule (Bankruptcy), or the Insolvency Practice Schedule (Corporations). It also makes further amendments consequential on the introduction of the Schedules to specific provisions of both the *Bankruptcy Act* and *Corporations* Act and a number of other pieces of legislation.

The aim of the ILRB 2015 is to create common rules in both personal and corporate insolvency. The new rules are intended to remove unnecessary costs and increase efficiency in insolvency administrations, to align registration and disciplinary frameworks, but also align a range of specific rules regarding the handling of personal bankruptcies and corporate external administrations. The new rules are also intended to enhance communication and transparency between stakeholders, such as creditors, liquidators or administrators and to promote market competition based on price and quality. There is also a major increase in the powers available to the corporate regulator ASIC to regulate practitioners in the corporate insolvency market

The reforms by the Bill are also intended to result in a net regulatory savings for insolvency practitioners as a result of compliance cost savings by reducing mandatory information provisions and requirement for meetings. The forecast is that there will be a $50.1 million annual reduction in regulatory compliance costs.

Regulator and creditor control over insolvency practitioners

There is to be a new registration and disciplinary regime for liquidators. Registration for corporate insolvency practitioners will initially be controlled by a committee organised by ASIC and conditions may be imposed on the registration of a practitioner. There will be an application fee expected to be $2,200. There will be a requirement for renewal of a registration every three years, subject to payment of a fee expected to be $1,700. ASIC will also be empowered to take direct action against practitioners who breach their duties, or do not observe any conditions that apply to their registration. ASIC will be able to suspend or deregister offending insolvency practitioners.

Creditors will be given at their cost, the right to appoint a registered liquidator to carry out a review, of the insolvency practitioner's remuneration, or a cost or expense incurred by the insolvency practitioner in the administration. ASIC will also be given the power to appoint a registered liquidator to conduct a review of matters in relation to the external administration conducted by the insolvency practitioner.

Insolvency practitioners are intended to be more responsive to creditors and improve overall confidence in the professionalism and competence of insolvency practitioners. Creditors whether by resolution, or individually, are entitled to ask the insolvency practitioner for information, to provide a report, or to produce a document. These requests must be complied with, unless what is requested is not relevant to the external administration, or would cause the insolvency practitioner to breach his or her

> "The safe harbour defence will require the directors of the company to appoint an adviser who is to provide restructuring advice designed to ensure the company's continued solvency and the ongoing viability of its business."

duties in relation to the external administration. ASIC is also given power to review why an insolvency practitioner has refused to provide material, a report, or a document, in response to a request from a creditor. Creditors are also given the ability to resolve at a meeting for the removal of the insolvency practitioner and appoint a replacement.

Changes to reduce costs in insolvency

There are a number of regulatory changes that provide cost savings for corporate insolvency practitioners. These changes are not contained in the Insolvency Practice Schedule (Corporations) introduced by the Bill, but are the subject of direct amendments to the *Corporations Act* introduced by the Bill. For example, currently s508 *Corporations Act* requires the liquidator in a members' voluntary or creditors' voluntary winding up that continues for more than one year, to convene a general meeting of the members or creditors within three months of the end of each year. There is also a requirement in s508 for a report to be provided on the liquidator's acts and dealings and the conduct of the winding up. The ILRB 2015 will repeal s508 as well as s509 that requires a final meeting in a creditors' voluntary winding up. Accordingly there will be no need for those meetings to be convened by liquidators, or annual reports which will save substantial costs in many insolvent administrations.

Recommendations for further changes to Australia's insolvency and restructuring laws

There are a number of recommendations, endorsed by the Prime Minister, made by the Productivity Commission, that if implemented would see a change to personal bankruptcy law and provide changes to Australia's restructuring law. The recommended changes are contained in the Productivity Commission's report, '*Business Set-up, Transfer and Closure*', a report publicly released on 7 December 2015.

In the context of personal bankruptcy, the main change is to reduce the formal period of personal bankruptcy from three years to one year in order to reduce the stigma attached to bankruptcy. The shorter period of bankruptcy is intended to encourage capable entrepreneurs to start new businesses where their initial ventures were unsuccessful on honest and legitimate grounds.

Legal restructuring elements in the Australian corporate insolvency market will be enhanced by at least two of the Productivity Commission's recommendations.

First, there will be a '*safe harbour*' recommended by the Productivity Commission that would be used as a defence for company directors to liability for insolvent trading. Insolvent trading can cause directors to have personal liability for losses suffered by creditors, due to liquidation, where the debt was incurred by the company when the company was insolvent. The *safe harbour* defence zone can only be entered if the company is solvent, even though it is proximate to a specific circumstance of financial difficulty and needs to be restructured. The *safe harbour* defence will require the directors of the company to appoint an adviser who is to provide restructuring advice designed to ensure the company's continued solvency and the ongoing viability of its business. In terms of the defence for the directors who appoint the adviser, it will also be necessary for them to take the steps to complete the restructuring and then the defence will apply for the period from the adviser's engagement until the implementation of the restructuring advice is complete. Also the company must stay solvent during the restructuring period.

The second major change relates to *ipso facto* clauses which allow contracts to be terminated on the basis of an insolvency event. The termination of the contract can often bring the company's business to an end. *Ipso facto* clauses will be made unenforceable while a company is in insolvent administration or undertaking a restructure through a scheme of arrangement.

These recommendations are still to be prepared into a legislative form for consideration by the Parliament and the market and is likely to come out later this year if it is produced on behalf of the Commonwealth Government.

Ian Walker is one of Australia's leading insolvency and restructuring specialists. He has been a partner of MinterEllison for 27 years. MinterEllison is one of Asia Pacific's leading law firms and operates in Australia, Hong Kong, mainland China, Mongolia, New Zealand and the United Kingdom through a network of integrated and associated offices.

Ian has more than 30 years' experience in security enforcement for all types of creditors, banking litigation, and insolvency, restructuring and work out issues. Ian advises insolvency appointees including liquidators, receivers, administrators and deed administrators on creditors' rights, their powers and duties He also advises third parties affected by insolvency such as creditors and directors. This includes advising company directors on the governance issues that face them when insolvency is imminent

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An Own Goal In The Making? The Implementation Of BEPS In New Zealand

By Neil Russ

New Zealand is a country with a significant land mass and a small population, located in the South Pacific. Although its ethnic origins were Māori and European, today New Zealand is a truly Asian country with strong links to China, Japan, Singapore, the Middle East and elsewhere, in addition to our traditional trading and investment partners in Australia, Canada, the European Union, and the USA. New Zealand's economy has a heavy emphasis on primary production (particularly dairy). It is said that New Zealand is as far as one can get from everywhere else in the world, and still buy a decent coffee. It is a remote, open, economy, and a net capital importer with a sophisticated broad-based low rate tax system. The fiscal pressures and economic inter-relationships faced by New Zealand in terms of trade and investment are quite different to many other countries. How can the OECD's politically-driven base erosion and profit shifting (BEPS) initiatives be expected to impact on New Zealand corporates operating overseas and multi-nationals with operations in, or sales to, New Zealand?

New Zealand's Tax Environment

New Zealand has long-established and sophisticated income tax and indirect tax (GST) regimes. It is characterised by having a broad base, reasonably low marginal rates of taxation for individuals and by its (relatively speaking) lack of exceptions and exemptions. The tax policy process conducted by the Inland Revenue Department (primarily) and the New Zealand Treasury is well-resourced and sophisticated. Policy changes are typically made after meaningful engagement with taxpayers and industry groups, as part of the "generic tax policy process". New Zealand's unicameral legislature means that law changes often occur more quickly, and with less Parliamentary scrutiny, than in other jurisdictions. In general, New Zealand is as advanced as any OECD country in identifying and countering unacceptable tax practices. The income tax and GST regimes represent a principled yet pragmatic balancing act, suitable for a small, capital-importing nation.

BEPS in New Zealand

BEPS has been described by the OECD as a "global problem which requires global solutions". The OECD considers that there are gaps and mismatches in the tax rules which enable multi-national enterprises (MNEs) artificially to shift profits to low or no-tax locations

where there is little or no economic activity. The reality is that the "gaps" and "mismatches" in the tax rules are, arguably, the outcome of a long process of countries acting in their own self-interest, and of regional (and global) tax competition. New Zealand's response to BEPS has been to focus on four Action Points in particular:

1. Hybrids
2. Tax treaty abuse
3. Transfer pricing, and
4. GST and the cross-border supply of services, intangibles and goods.

New Zealand's international tax policy settings are considered generally robust, though there are numerous reforms being proposed with effect on non-resident investors and the cost of capital for New Zealand borrowers in particular. These include:

"New Zealand has joined with the G20 and the automatic exchange of information initiative, and has made a political commitment to begin exchanging information on a voluntary basis from 2018 and on a mandatory basis in 2019, adopting a timeline consistent with Australia"

- Neutralising the effect of hybrid mismatch arrangements (Action 2).
- Limiting base erosion via interest deductions (Action 4). Worryingly, the proposed solution in terms of thin capitalisation changes is that worldwide interest payments will be calculated for multinational enterprises, and allowable tax deductions would be allocated on a country-by-country basis relative to the revenue generated in that country. Plainly, for a country with a small population base and high interest rates such as New Zealand such a proposal has the potential to affect New Zealand in a disproportionately harsh manner.
- A large number of non-resident withholding tax rules (and associated approved issuer levy rules) are also proposed to be changed which, as currently proposed, would have the net effect of increasing the tax charge on a number of borrowing arrangements (including joint ventures with off-shore firms) from the current 2% to 10%.

New Zealand is also looking at reviewing the taxation of foreign trusts (although this is strongly resisted by the foreign trust advisory sector) and by improving the quality and usefulness of tax information via administrative measures (enhanced compliance measures) to:

- Require large corporates to file income tax returns earlier so that information can be analysed and shares identified sooner
- Require large corporates to disclose additional information that is readily available to them in a standard format so that it can be quickly analysed
- Introduce a voluntary code of practice for large corporates which would likely include having good tax governance, a transparent relationship with Inland Revenue and avoiding aggressive tax planning.

Automatic exchange of information

New Zealand has joined with the G20 and the automatic exchange of information initiative, and has made a political commitment to begin exchanging information on a voluntary basis from 2018 and on a mandatory basis in 2019, adopting a timeline consistent with Australia. That information exchange, which will be based on the United States Foreign Account Tax Compliance Act (FATCA) requirements, will require financial institutions to undertake enhanced due diligence procedures on account holders and then to report ownership and further account information to Inland Revenue, to be automatically exchanged with applicable treaty partners.

Tax treaty upgrades

New Zealand's current network of international tax treaties will also be upgraded and in 2015 new double tax agreements or protocols are to be agreed with Korea, Australia, Norway, Slovak Republic, China, Portugal and Samoa. In addition, New Zealand is supporting The Multilateral Convention on Mutual Administrative Assistance in Tax Matters as its primary exchange of information mechanism. Officials have stated that New Zealand does not anticipate entering into additional tax information exchange agreements (TIEAs) beyond the existing programme of San Marino, Antigua and Barbuda, Aruba, Grenada, Macau and Monaco.

Increased transfer pricing audit activity

At a domestic level, transfer pricing scrutiny has increased dramatically in New Zealand with Inland Revenue undertaking comprehensive fact gathering, including:

- Interviewing staff in New Zealand and overseas to verify the functional analysis that has been presented in transfer pricing documentation
- Detailed questioning and request for information from other tax authorities to understand the entire supply chain across all relevant countries
- Request for the provision of all business emails for particular staff over a specified period of time
- Requests for information allowing the analysis of profit margins derived at each step of the supply chain offshore
- Review of other available information to confirm activities undertaken by staff.

The route being undertaken in terms of Action 4 (transfer pricing to limit base erosion by interest deductions) is also anticipated to include the introduction of country-by-country reporting for New Zealand subsidiaries of foreign-based multinationals of significant size. The Australian threshold for country-by-country reporting is A$1billion, but the New Zealand threshold has not yet been determined. A threshold of the NZ$ equivalent of the Australian threshold would exclude all but a handful of New Zealand businesses.

Conclusion

In this writer's view, the BEPS initiatives are welcome at a political level, but the details of the changes being made in certain key areas (and the speed with which changes could be implemented), when combined with the specific actions being taken in other jurisdictions, could result in unwelcome and harmful effects for New Zealand as a nation. New Zealand has had prior experience of this when it implemented its now-repealed controlled foreign company regime in 1986. As a net capital importing

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nation, heavily reliant on trade and ready access to markets, anything which drives up the cost of capital (such as increases in non-resident withholding taxes on interest, from 2% to 10%), or forcing symmetrical tax treatment of hybrid instruments (for example, aircraft lease payment arrangements), or denying interest deductions to a greater extent under revised thin capitalisation rules, will all operate as a net additional cost to doing business in New Zealand. MNEs and other large investors (such as pension funds investing in forestry and infrastructure assets) might simply go elsewhere, and not invest at all. The actual cash cost of New Zealand being seen as a good global citizen at a political level, could ultimately fall on the New Zealand taxpayer increasing the cost of doing business and reducing competitiveness. If that occurred, the implementation of BEPS would indeed be an "own goal", for this country.

Neil leads Buddle Findlay's tax practice. He specialises in corporate and international tax issues, as well as structured transactions. In addition to his tax expertise Neil has a multi-jurisdictional background in banking and capital markets transactions.

Neil is currently advising a number of New Zealand and offshore clients on the tax aspects of investment transactions and asset disposals. He advises a number of the firm's clients with the development of new business structures and products, and regularly assists clients with tax investigations, binding and non-binding ruling applications and tax risk reviews. Neil is convenor of the New Zealand Law Society's Tax Committee and is involved in the formulation of tax policy, and is frequently dealing with Inland Revenue and Treasury officials on proposed law changes.

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The Auckland Unitary Plan – Development Potential

By Chris Moore & Francelle Lupis

The Auckland Unitary Plan (AUP) was notified as Operative (in part) on 15 November 2016. (Some provisions are yet to be made operative, pending the resolution of a number of appeals to the Environment and High Courts.) The AUP is the rulebook for Auckland's future development, determining what we can build and where we can build it. Auckland's population is expected to increase by up to 1 million additional residents over the next 30 years and providing for that demand was a central issue during development of the AUP, with the debate between Auckland Council and submitters focussed on whether Auckland's growth should be accommodated in taller buildings or if Auckland's urban limits should be allowed to "sprawl".

Ultimately, Auckland will need to grow both up and out to meet projected demand. Under the AUP, there are four primary residential zones across Auckland. The higher density zones will serve as the focus for future intensification, while the single house zone has been used to identify areas where lower density residential neighbourhoods (often with character or heritage value) are to be preserved:

1. **Single house**: The purpose of the Residential – Single House Zone is to maintain the amenity values of established residential neighbourhoods. The particular amenity values of a neighbourhood may be based on special character informed by heritage features, large sites with significant trees, a coastal setting or other factors such as a specific neighbourhood character. This zone is generally characterised by one or two storey buildings consistent with a suburban built character.

2. **Mixed housing suburban**: The Residential – Mixed Housing Suburban Zone is the most widespread residential zone covering many established suburbs and some greenfields areas. The zone enables intensification, while retaining a suburban built character. Development within the zone is generally intended to be two-storey detached and attached housing in a variety of types and sizes to provide housing choice.

3. **Mixed housing urban**: The Residential – Mixed Housing Urban Zone is a reasonably high-intensity zone enabling a greater intensity of development than that provided previously. Over time, the appearance of neighbourhoods within this zone is intended to change, with development typically up to three storeys in a variety of sizes and forms, including detached dwellings, terrace housing and low-rise apartments. Up to two dwellings are permitted as of right subject to compliance with the standards.

4. **Terrace housing and apartment buildings**: The Residential – Terrace Housing and Apartment Buildings Zone is predominantly located around metropolitan, town and local centres and the public transport network to support the greatest density, height and scale of development of all the residential zones. Buildings are enabled up to five, six or seven storeys in identified Height Variation Control areas, depending on the scale of the adjoining centre, to achieve a transition in height from the centre to lower scale residential zones. This form of development will, over time, result in a change from a suburban to urban built character with a high degree of visual change.

Whilst there is speculation that the Auckland housing market may be cooling, shrewd investors and developers are pouring over the AUP to identify land with favourable zoning. A premium will inevitably be placed on land nearby town centres and transport corridors that are likely to thrive with the benefit of improved public transport networks.

The key to maximising opportunities presented by the AUP will be identifying land that is well located but also of a sufficient size to enable a feasible development to take place. Some commentators are predicting that approximately only 15% of the new zones will be utilised to their potential. This is understandable given that some well-established residential suburbs have been zoned for terraced housing and apartment buildings, but will require the amalgamation of several individually held titles before any development of real scale can be progressed. In other locations, while land has been up-zoned, new infrastructure or upgrades to provide additional capacity are required before further intensification can occur.

Investors and developers will also find more choices available as a result of the new residential zoning. House-hunters previously faced two primary options: detached dwellings or small apartments. The AUP's flexibility will allow other types of homes (duplexes and townhouses) and greater variety in terms of size. In particular, the relaxation of density rules creates many more opportunities to subdivide small sections both vertically (e.g. terraced housing) and horizontally (e.g. multi-storey flats).

The new opportunities for small-scale development could not have come at a more important time. Financing large projects has become more difficult. The apartment squeeze in Australia (particularly in Sydney, where off-the-plan purchasers are reportedly walking away from deposits) has put the pressure on New Zealand subsidiaries of Australian banks to tidy up their loan books and steer away from property. At the same time, New Zealand is in the midst of a construction boom. Our construction industry, made up of many small to medium sized businesses, is struggling to up-scale to meet the demands of new major projects. Small-scale developments can help to avoid both these issues: the capital costs are significantly lower (smaller-scale builds avoid the large land requirements and expensive mechanical services associated with apartment complexes) and they are a more natural fit for our construction industry. As it becomes increasingly difficult to obtain funding for apartments, Auckland will rely on a more modest section-by-section approach to increasing density and alleviating the housing shortage.

As with any property development or investment, due diligence will be paramount when assessing the AUP and the impact it may have. Our team at Greenwood Roche comprises experienced advisers and would be happy to help with any queries.

Chris Moore is one of New Zealand's leading property lawyers and is the immediate Past President of the New Zealand Law Society, following from his role as the chair of the Property Law Section of the Law Society from 2004-2013. He has over 35 years' experience in commercial leasing and commercial property issues acting for a range of public and private sector clients.

Francelle Lupis offers specialist advice on law reform and district and regional plan formulation. Over the last four years she has been closely involved in the Proposed Auckland Unitary Plan process, including early involvement in the draft Plan, feedback and formal submissions, convening and leading submitter working groups to reach collaborative outcomes, and participation in mediations/hearings for a large number of clients and industry groups.

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