



Australian Government
Australian Taxation Office

Australian Taxation Office Submission

Foreign Investment Obligations in Residential Real Estate –
Inquiry based on Auditor-General's report No.48 (2017-18)

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Introduction

1. The Australian Taxation Office (ATO) appreciates the Australian National Audit Offices' (ANAO) efforts in undertaking Audit Report No. 48 (2017-18), *Managing Compliance with Foreign Investment Obligations for Residential Real Estate* (the report) and the feedback and suggestions contained within the report.
2. The ATO consider the report and its findings to be supportive of the ATO's overall approach to managing the administration of the Foreign Acquisitions and Takeovers Act 1975 (FATA) and consistent with the Government's foreign investment policy.
3. The ANAO have recognised the considerable effort that the ATO has made in a short period of time to establish a new compliance function for the FATA in respect of residential real estate. They have also identified some opportunities for the ATO to further enhance its effectiveness.
4. The ATO agrees with the two recommendations contained in the report and has commenced work on their implementation. The ATO has also considered the observations and suggestions that the ANAO made throughout the report and have taken steps to address them where appropriate.
5. The ATO do, however, have concerns with the analysis the ANAO has undertaken in attempting to draw conclusions on the rate of non-registration by foreign persons on the residential real estate register by comparing the number of registrations on the land register to the number of Foreign Investment Review Board (FIRB) application approvals. This comparison assumes that obtaining FIRB approval should result in registration of an acquisition within a set period of time which is a flawed assumption to make.

Background

6. A Senate committee inquiry report in 2013¹ and a House of Representatives committee report in 2014² made a number of recommendations aimed at strengthening the Australian foreign investment regime.
7. In response to those recommendations, the Government announced a package of reforms to the foreign investment framework. This included introducing legislation to modernise the rules as well as introducing civil penalties and stricter criminal penalties. The ATO was delegated responsibility for managing all residential real estate obligations under the

¹ Rural and Regional Affairs and Transport References Committee, *Foreign Investment and the National Interest*, Jun 2013

² House of Representatives Standing Committee on Economics, *Report on Foreign Investment in Residential Real Estate*, Nov 2014

foreign investment framework, including the collection of fees, screening of foreign investment applications, compliance and enforcement action.

8. This was an extensive new body of work that the ATO implemented in a relatively short period of time. Following the announcement in May 2015, the ATO built the systems, workforce and strategy required to implement this new body of work. Prior to this, the Department of the Treasury (Treasury) had responsibility for all elements of the foreign investment framework, including residential real estate.
9. Since then, the ATO has been further delegated a number of additional responsibilities including; management of the agricultural, land and water (including residential real estate) registers, administration of the annual vacancy fee for foreign owners of residential dwellings, and screening of foreign investment applications and compliance work for non-sensitive commercial acquisitions.
10. Per the Foreign Investment Review Board Annual Report 2016-17, the ATO had 57 full-time equivalent staff employed across the various responsibilities undertaken over the course of the 2016-17 period.

Residential real estate activities undertaken by the ATO

Screening

11. The ATO was delegated responsibility for the screening of applications for foreign investment into residential real estate in December 2015.
12. In the 2016-17 year, the ATO screened over 13,000 applications for foreign investment in residential real estate with total proposed investment worth over \$25 billion.
13. The ANAO did not review the screening functions performed by the ATO as part of this audit.

Compliance

14. The ATO was delegated responsibility for residential real estate compliance work in May 2015.
15. Since then, the ATO has established an effective compliance function which utilises the ATO's existing sophisticated data matching capability combined with other sources of intelligence, including community referrals, to detect and investigate any instances of potential non-compliance with the foreign investment regime.

16. Between May 2015 and January 2018, the ATO completed 3,940 investigations that resulted in 1,158 breaches of the foreign investment regime being detected and 1,067 financial penalties imposed totalling \$5.5 million.
17. 75 forced disposal orders have also been issued to foreign persons where their ownership of residential real estate was not in accordance with the foreign investment policy and considered to be contrary to the national interest. A further 156 properties were disposed of voluntarily by foreign investors during the course of ATO initiated investigations into potential breaches of the foreign investment framework. In total, properties divested were worth a combined \$284.9 million.
18. The ATO has established a litigation program for the application of civil and criminal penalties, working with the Australian Government Solicitor and external counsel to identify suitable cases to progress to court.
19. The ANAO observed in the report that the ATO has undertaken a significant amount of work to develop processes and systems to support the detection and investigation of non-compliance with foreign investment obligations for residential real estate, and that the ATO's investigation processes are largely effective.

ANAO Recommendations

20. The ANAO made two recommendations directed at the ATO, both of which were agreed to:
 - The Australian Taxation Office compiles and implements a residential foreign investment compliance and enforcement strategy, which draws on existing risk assessment and treatment documentation and information about the results of prior compliance activities.
 - The Australian Taxation Office prioritises developing and finalising data matching rules to address key compliance risks to foreign investment in residential real estate.

Recommendation 1: Compliance and enforcement strategy

21. The ATO has undertaken significant work to identify and assess the risks associated with foreign investment into residential real estate and to develop appropriate treatment plans to address these risks.
22. The approaches taken have been highly effective at identifying potential breaches of the foreign investment rules and taking action to address those breaches, with almost 4,000 cases investigated and breaches detected in approximately 30% of those cases.

23. The ATO has already prepared risk assessment and treatment plans to support its compliance activities. Per the ANAO recommendation, the ATO will now compile those documents and approaches into a single overarching compliance and enforcement strategy document.

Implementation plan and progress

24. The ATO has commenced work on developing an overarching compliance and enforcement strategy in response to the ANAO recommendation.
25. The strategy for the implementation of this recommendation will involve three key deliverables:
- Designing the strategy, by drawing from existing risk assessment and treatment plans and assessing the outcomes of past compliance approaches. The strategy will prioritise and tailor compliance activities based on the type non-compliance behaviour to encourage compliance.
 - Consulting with key stakeholders on the strategy, including Treasury.
 - Implementing the strategy, including communication strategies aimed at educating the foreign investor population and the intermediary community regarding the ATO's approach to managing compliance with foreign investor obligations. Communication activities will be regularly monitored and assessed to evaluate their effectiveness so as to inform future communications strategies.
26. The ATO is currently in the early stages of designing the compliance and enforcement strategy document. It is envisaged that this recommendation will be fully implemented by March 2019.

Recommendation 2: Finalising data matching rules

27. The ATO routinely assesses the potential risks in the foreign investor market that may impact compliance with foreign investment obligations.
28. The ATO develops data matching rules that draw upon extensive data matching capability to generate case pools for potential compliance action that address identified risks.
29. As at July 2018, the ATO has identified 36 suitable data matching rules that address key risks.³ Those data matching rules seek to identify instances of foreign persons failing to seek FIRB approval before acquiring residential real estate, or failing to comply with conditions of their approval (e.g. renting an existing dwelling that was only approved for

³ Per the ANAO report, an additional two data matching rules previously identified have since been declared redundant.

them to occupy as their principal place of residence, or failing to develop vacant land within a specified time period).

30. Of those 36 identified data matching rules, the ATO has already implemented 22 and is in the progress of implementing a further 14.

Implementation plan and progress

31. The ATO is well progressed in developing and implementing outstanding data matching rules which address key compliance risks.
32. The strategy for implementation of this recommendation will involve three key deliverables:
 - Reviewing existing data matching rules (as part of business as usual ongoing review processes) to ensure they address all key compliance risks and/or to determine if new rules are required.
 - Reviewing available data sources to confirm their usability for the proposed data matching rules in addressing an identified behavioural risk.
 - Testing the effectiveness of the data matching rules to further refine the process.
33. Importantly, the ATO continuously assesses behavioural risks that are present; assesses the effectiveness of both existing and proposed data matching rules to treat those risks; and adjusts processes in place accordingly. As such, new data matching rules are often being identified and existing rules retired where appropriate.
34. The ATO is progressing the development and implementation of the outstanding data matching rules. It is envisaged that this recommendation will be fully implemented by March 2019.

Other ANAO suggestions

35. The ATO has continued to make significant progress in its compliance function for residential real estate foreign investment obligations since the ANAO completed their audit.
36. In response to suggestions and observations made by the ANAO, the ATO has implemented a number of changes to processes to further enhance effectiveness.

Civil and criminal penalties

37. The ANAO suggested that the ATO expand guidance to staff with more information on the application of the civil and criminal penalties.
38. As the ANAO observed, the ATO's application of penalties has been limited to infringement notices for non-compliance with the FATA and the ATO has not yet obtained a civil penalty order or criminal penalty.
39. However, as detailed above, since the ATO assumed responsibility for residential real estate, there have been significant consequences for foreign investors who have not complied with Australia's foreign investments rules, with in excess of 1,000 breaches of foreign investment obligations identified and more than \$5 million in penalties raised.
40. Whilst civil and criminal penalties remain an option for the ATO to pursue for serious breaches of the foreign investment rules, they are not appropriate or necessary for use in all instances to effectively manage non-compliance. The ATO has found that working with foreign investors throughout a compliance case to help them understand their legal obligations and the potential consequences of non-compliance available (being forced disposal and potentially civil and criminal penalties) influences behaviour. This is evidenced by the 156 instances of foreign persons voluntarily disposing of their property upon becoming informed of their alleged breach by the ATO.
41. To ensure that appropriate cases are considered for the potential application of civil or criminal penalties, the ATO has recently established a dedicated litigation function to identify instances where the nature of the breach warrants a more significant action.
42. Guidance and training has been developed for compliance staff on the elements necessary to establish whether civil or criminal penalties are applicable and to assist them in understanding the evidentiary requirements to successfully obtain an order for those penalties to apply.
43. As at the start of August, there were a number of cases being considered by the ATO for the potential application of civil penalties with one case referred to the Australian Government Solicitor to commence court proceedings.

Review of compliance decisions

44. The ANAO suggested that the ATO review a sample of compliance decisions to ensure decision making is consistent and timely.
45. In response to this suggestion, the ATO has developed and implemented an internal quality assurance process which assesses a sample of cases on a monthly basis to measure quality against five key metrics:
 - Technical accuracy
 - Appropriateness of decision to circumstances
 - Timeliness
 - Administratively and legally sound
 - Case management and recording of outcomes
46. This process will allow the ATO to identify instances of inconsistent treatment or delays in compliance decisions. It will also allow for the identification of capability gaps that can be addressed by staff training.

Communication activities

47. The ANAO observed that the ATO had reduced communications activities (including the use of social media and published guidance to ATO webpages) to educate foreign investors and advisors of their obligations.
48. The ATO has since published extensive guidance on the new vacancy fee for foreign investors of residential real estate on the ATO website. This has been supported by social media posts on LinkedIn and live webinars targeting key intermediaries.
49. The ATO has also undertaken an extensive education campaign involving face-to-face visits with the largest intermediaries representing foreign investors in residential real estate across the country, as well as phone meetings with smaller intermediaries, to update them on recent developments and initiatives and to obtain feedback from them regarding the current FIRB process.
50. To assist in the population of the residential land register, and to ensure that foreign investors are aware of their vacancy fee obligations, the ATO is in the process of conducting a large prompter campaign with emails being sent to foreign persons that have obtained FIRB approval in recent years to remind them of their obligations.
51. The ATO has also commenced an evaluation of past communications activities to assess their effectiveness and inform future strategies.

Residential land register

Background

52. In 2015 the Government announced the ATO would establish a foreign ownership register for residential land. The register is intended to provide increased transparency on the level of foreign ownership of residential land in Australia.
53. Importantly, the register will track actual purchases of real estate by foreign persons, not FIRB application approvals (which may not always result in an actual purchase).
54. Whilst the intention is for this register to be populated automatically by the ATO through the use of data matching against land title transfer data provided by the States and Territories, the inherent difficulty in doing so is the way in which each jurisdiction collected data on 'foreign persons'.
55. To address these challenges, the Australian Government announced measures to facilitate the States and Territories capturing foreign identifier information for property transactions in a consistent format, enabling automatic population of the register.
56. To support the new reporting requirements, the States and Territories each had to introduce legislative amendments and system updates. However, in light of delays that occurred by the States and Territories in passing necessary legislation, the ATO has undertaken an extensive manual data matching exercise to populate the register. This has involved comparing all ATO issued FIRB approvals against State and Territory property transaction data to identify property sales that should be registered. This process has been supported by introducing a self-registration requirement for foreign investors upon settlement as a condition of their foreign investment approval.
57. This manual process, combined with self-registration, has been effective at populating the register to date and is providing a high degree of integrity to the data. The collection of foreign identifier information by the States and Territories will allow for significant automation of the process in the future.

ANAO commentary and analysis

58. The ANAO undertook analysis of self-registration on the residential land register in attempt to assess the rate of non-registration.
59. In doing so, they compared the number of registrations to the number of FIRB approvals issued over a set period which indicated that only 7.1% of approved applicants went on to register.

60. The ATO is concerned that this analysis implies significant under-registration (in the realm of 92.9%). However, this assumes that obtaining FIRB approval should result in registration (over a set period of time) which is a flawed assumption for a number of reasons:
- Applicants who receive FIRB approval may never end up settling on a property and therefore will never register.
 - Settlement (particularly for 'off the plan' purchases) can often occur 2-4 years after FIRB approval has been received and those purchases would not be registered until that time (creating a significant time lag which makes meaningful comparison between the two data sets challenging).
 - The ANAO compared approval data from 1 July 2015 to 8 December 2017 (a 30 month period) with self-registration data from 1 July 2016 to 17 December 2017 (a much shorter 18 month period). As such, a significant variance would always be expected when comparing these two data sets.
61. The ANAO relied on this analysis to conclude that there may be significant non-registration by foreign investors in residential real estate however, as explained above, it is not possible to determine the rate of non-registration by comparing these two data sets.
62. Furthermore, as detailed above, the ATO has undertaken an extensive manual data matching exercise to populate the land register pending automation of the process via receipt of foreign identifier information contained in State and Territory property transaction data, mitigating the risk that under self-registration poses to the integrity and accuracy of the register.

Conclusion

63. Overall, the ATO believes that the ANAO report is a positive reflection of the significant work the ATO has undertaken in the past three years to implement and administer a residential real estate compliance function.
64. The ATO is on track to have both formal recommendations in the report fully implemented by Q1 2019 and has already made significant progress in addressing other suggestions and comments made by the ANAO.
65. Whilst delays in passing necessary State and Territory legislation to collect and provide foreign identifier information to the ATO has impacted the ability to automatically populate the residential land register, the ATO is confident that the mitigation strategies being implemented (manual data matching combined with a self-registration requirement), supported by extensive communication activities, are ensuring that the register will capture relevant property transactions.

